5 Reasons your pension scheme would be better off in a DB master trust

Citrus

Increasing running costs and stricter expectations from The Pensions Regulator are just some of the challenges facing employers and trustees of DB pension schemes. Many schemes would be better off in a DB master trust to overcome these challenges. From accessing better investment returns, to cost sharing benefits and economies of scale, we explore the 5 key reasons why you should consider transferring your scheme into a master trust like Citrus.

What is a DB master trust?

DB master trusts are an efficient, affordable way for employers to ensure their DB scheme is taken care of in a quality pension plan managed by experts.

Employers transfer their scheme's assets and liabilities into their own 'section' of a larger DB trust, and then close down their old scheme.

This consolidates the running of the scheme into the DB master trust alongside other schemes and employers. There is no cross-subsidy of risk between different employers. The DB master trust will have its own advisers and may also provide a new trustee board to support all of the sections.

5 reasons your scheme would be better off in a DB master trust

#1

A resilient investment strategy for the long-term

#2

Reach your long-term objective with more certainty

#3

Improve governance standards and meet TPR's expectations

#4

Save on your annual running costs

#5

Benefit from the knowledge and experience of a professionally run scheme

A resilient investment strategy for the long-term

Schemes need to think longer-term and embrace a resilient funding and investment strategy to ensure a smoother ride through turbulent times. One of the key challenges facing many DB pension funds is the lack of access to the same range of investment opportunities as their larger equivalents. While larger schemes benefit from accessing best-in-class managers and funds, many schemes struggle to meet minimum investment requirements, or the higher costs associated with the latest innovations and asset classes.

By pooling assets together into a bigger, more substantial master trust fund, these schemes can generate much better outcomes – in some cases up to a 25% increase in returns. There are three main reasons for this:

1. Access to a wider range of investment opportunities

Having a larger pool of assets means master trusts can access a wider range of asset classes that deliver the prospect of higher returns. This includes assets such as private debt and infrastructure which smaller schemes are typically unable to afford or access on a standalone basis. This means the portfolios are less dependent on equity markets in order to generate returns.

2. Ability to implement a more sophisticated, capital efficient strategy

Making use of the latest funds and innovations can enhance capital efficiency - essentially making the scheme's assets work harder and providing better value for money. This can generate significant and regular income which reduces transaction costs and helps to manage cashflow-related risks.

For example, using leveraged LDI and synthetic equities, Citrus' investment strategy frees up c.45% of the assets in the portfolio, which can be reallocated elsewhere. Depending on the needs of each section within the master trust, the capital is used to reduce risk and/or seek higher returns. In Citrus' case, this results in a c.25% improvement in expected return for each unit of investment risk taken – a very material improvement.

3. Cost sharing with other sections

Finally, grouping schemes together achieves economies of scale, allowing schemes to benefit from lower management charges and reducing transaction costs. By pooling assets across schemes, and sharing services such as scheme administration, running costs and fees are significantly reduced.

By moving into a master trust like Citrus, schemes can get the best of both worlds: access to the same opportunities as larger funds, while maintaining the ability to tailor the strategy to meet their section's specific needs and objectives and evolving that over time as circumstances and market conditions change.

Reach your long-term objective with more certainty

Setting and reaching your scheme's long-term objective (LTO) is the ultimate consideration for all DB pension schemes, and The Pensions Regulator's new DB funding code will require a single long-term objective for all schemes, regardless of scheme size and covenant. Trustees and sponsors will need to consider their ultimate goal and set a clear plan for getting there within a realistic timescale.

What are the options for your LTO?

The DWP provided four examples of suitable long-term objectives in its 2018 white paper:

1. **Running-on** with employer support (for schemes still open to accrual)
2. Reaching for **self-sufficiency** with low-risk investment strategy and minimal call on the sponsoring employer
3. **Buying-out** with an insurer
4. Entering a **consolidation vehicle** within an agreed timeframe

The majority of trustees are now targeting buy-out, whereby an insurer takes on the responsibility of paying out pensions to members.[1] The insurer carries the associated investment and inflation risks, as well as the risk of members living longer than expected.

This is a particularly attractive option, so demand from pension schemes to complete a buy-out is increasing. So much so that demand now outweighs insurers' capacities to write business at their best prices. Insurers therefore have more choice around which pension schemes they wish to offer their best terms to. Appetite to secure benefits for smaller schemes is particularly limited.

The small scheme journey to buy-out

This is where a master trust can help. Moving to a master trust is a great way for smaller schemes to access the same insurance opportunities as larger schemes, at an attractive price.

Grouping multiple schemes, or sections, into one trust at a point at which they're all ready to transact provides insurers with a more attractive proposition and leads to lower buy-out costs. Subsequent wind-up costs are also reduced by sharing fixed costs amongst the employers in the master trust.

Staying on track

But what if buy-out is still a long way off? This is the case for most schemes. There are still some steps you can, and should be, taking now to keep your scheme on track and reach your goal with certainty.

Best practice is to adopt an integrated risk management (IRM) approach which:

- aligns suitably strong technical provisions with your long-term goal;
- quantifies investment risk, ensuring the covenant can support it; and
- reduces investment risk through use of a capital efficient strategy.

As mentioned in reason #1, master trusts give access to better investment opportunities and more sophisticated strategies than typically available to many schemes. This extends to IRM. Citrus' tried and tested IRM approach puts member schemes in a better position to meet their LTO. By considering funding and investment strategy together, we can identify the most appropriate combination of contributions and investment risk for each section in the scheme.

To keep on track, member schemes have access to sophisticated funding monitoring tools such as 'The Brain', developed by Hymans Robertson, to help assess progress against long-term targets. This can be used to monitor changes in the funding level for MI purposes and to identify opportunities to de-risk the investment strategy where, for example, the funding level moves ahead of expectations.

All these solutions are typically inaccessible or unaffordable for smaller standalone schemes. Moving to a master trust can overcome these hurdles and lead to more certainty in reaching your long-term objective.

[1] Hymans Robertson's Trustee Barometer research 2020

Improve governance standards and meet TPR's expectations

Running a pension scheme takes a lot of time and commitment from your Trustee board to make the best decisions and help your scheme meet its long-term objective (LTO). With increasing complexities in the system, and much higher expectations from The Pensions Regulator, fulfilling the role of a trustee is tougher now than ever before.

Trustee knowledge & understanding

By taking on your trustee responsibilities, master trusts not only reduce the burden of running your pension scheme, you can rest assured it is being governed to the highest of standards.

Having an experienced Trustee board, supported by a team of experienced advisers, means the Citrus Trustees have a wide breadth of knowledge and experience of scheme issues, and are kept up-to-date on the latest industry and regulatory developments. Having a professional Trustee on the board also brings an independent perspective and they can incorporate best practice methods for trusteeship and governance of the scheme.

You can leave all the decision-making to the master trust board, or otherwise it is possible to nominate a Trustee for your own section.

Meeting TPR's toughening expectations

TPR's recent consultation on the future of trusteeship and governance focused on two key themes - trustee knowledge and understanding, as well as scheme governance and effective decision-making. The consultation aims to raise standards for small and medium schemes not currently being run effectively, ultimately ensuring all pension schemes deliver good value for their members. If the scheme is not being run to a good standard, it recommends consolidation into a larger scheme which has higher governance standards.

In addition to this, a consultation on the new Code of Practice on scheme funding closed in September 2020. The new code will implement stricter measures to 'optimise' scheme funding, along with stronger powers for The Pensions Regulator. Those who do not comply are at risk of regulatory intervention, which can be an expensive and time-consuming process.

Both consultations steer towards a much tougher regulatory environment. All schemes, particularly smaller inefficiently run schemes, will need to up their game. The growing requirements mean additional time and effort from employers and trustees to ensure they're met.

Moving into a master trust like Citrus reduces the additional work required from the employer. By taking on trustee responsibilities and running your scheme to the highest standard, employers have more time to focus on running their business and can rest assured their scheme is in safe hands.

Save on your annual running costs

The costs of running DB pension schemes have soared in recent years. According to Hymans Robertson research, the c.5,500 DB schemes in the UK spend around £6.5bn-£8.5bn in running costs every year. And despite UK companies committing £billions in deficit contributions, many have seen deficits rise.

Employers face additional pressures, with an increasing governance burden and tighter regulatory scrutiny diverting attention away from running their businesses.

Sharing the costs

Through accessing the benefits of scale and sharing costs with other employers, joining a DB master trust can significantly reduce the burden of running a DB pension scheme.

Cost savings can be realised in two key areas:

1. **Administration costs** are shared among the employers in the scheme, reducing the individual cost to each employer. This includes charges associated with producing annual reports and accounts, actuarial valuations, auditor fees and Trustee meetings.
2. **Through economies of scale** investment charges are also reduced, with an estimated c.0.25% reduction in investment manager fees per year

How much could you save?

Calculations from our advisers Hymans Robertson have shown that running costs can be reduced by over 30% by moving to Citrus. This could make a significant difference to your bottom line.

Cost savings are greatest particularly for schemes paying above average investment, advisory and administration fees. You can benchmark the running costs of your own DB pension scheme through TPR's comparison tool:
https://www.thepensionsregulator.gov.uk/en/trustees/managing-db-benefits/db-scheme-costs-comparison-tool.

Find out how much your specific scheme could save by using our quick Citrus calculator https://citruspensions.hymans.co.uk

Benefit from the knowledge and experience of a professionally run scheme

The last, but certainly not least, benefit of moving to a DB master trust is the knowledge and experience of having a professionally led Trustee board. Professionalisation has been shown to help improve governance standards and strengthen the Trustee board, helping your scheme to meet TPR's toughening expectations.

Hitting the higher bar

With the increasing complexity of the pensions system, and regulatory requirements continuing to toughen, the role of a trustee is more challenging than ever before. It's time consuming and expensive to not only provide adequate training to trustees, but also to recruit trustees into a role with greater responsibility and requirements.

For smaller schemes, this is often too big a challenge to meet. As a result, TPR has found that smaller schemes tend to display poorer governance standards.[2]

With a professional trustee board managing the scheme to the highest of standards, master trusts provide a way for smaller schemes to adopt best practice governance standards, while removing the burdens of training and recruitment.

Benefit from a team of professionals

In addition to a professional trustee board, master trusts like Citrus also benefit from a team of best-in-class advisers, which smaller schemes traditionally can't afford.

Actuarial and legal support is inclusive of being a member of a master trust, helping with any technical guidance and section-specific issues, as well as end-game planning and advice on the covenant, including an annual employer review.

The advisers and Chair of Trustees at Citrus have extensive experience of working with a variety of different pension schemes, both large and small, and have dealt with a wide range of scheme issues along the way, therefore they are likely to have experience of the issues that your scheme is currently facing. They can also incorporate best practice methods established through working across different sizes and types of scheme to yours.

As covered in Reason #1, having advisers running the investment strategy means less time required by your team, and likely greater value for money due to more sophisticated and resilient strategies implemented.

See below for the full range of services offered in a master trust:

Covenant
Annual employer review
Professional advice

Investment
Strategy and implementation
Range of investment assets

Actuarial
Online analytics – daily funding updates
End-game planning
Integration of strategy

Trustee and scheme secretarial
Active governance
Regulatory compliance
Focus on long-term objectives

Legal
Technical guidance
Section specific issues
Practical support

Administration
Dedicated member support
Online member experience

[2]Source: https://www.thepensionsregulator.gov.uk/en/media-hub/press-releases/most-db-savers-in-well-run-schemes-but-tpr-acts-to-address-issues-in-small-schemes

If you'd like to discuss any of the reasons in more detail or would like further information about Citrus, please contact Lindsay Davies:

Lindsay Davies
Pensions Manager
T: 0207 082 6371
enquiries@citruspensions.co.uk