

Title: Master Trust Authorisation IA No: RPC Reference No: Lead department or agency: Department for Work and Pensions Other departments or agencies: The Pensions Regulator	Impact Assessment
	Date: March 2018
	Stage: Final
	Source of intervention: Domestic
	Type of measure: Final Stage
	Contact for enquiries: CRAIG.MITCHELL1@DWP.GSI.GOV.UK
Summary: Intervention and Options	

Cost of Preferred (or more likely) Option (option 2)				
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2014 prices)	One-In, Three-Out?	Business Impact Target Status
-24.7	-24.7	2.7	N/A	N/A

What is the problem under consideration? Why is government intervention necessary?

Master Trusts are a form of multi-employer occupational pension scheme. Employers can select a Master Trust to provide a pension for their workers rather than setting up their own pension scheme or choosing other arrangements such as a Group Personal Pension (GPP) which is a form of contract-based pension scheme. In recent years there has been significant growth in the development and use of Master Trust structures as a vehicle to provide occupational pension schemes. There were 9.9m members and over £16bn assets in 81 Master Trusts in the UK in January 2018.¹ This grew from 0.2 million members in 2010 as a result of the introduction of an obligation on employers to automatically enrol their eligible workers into a qualifying workplace pension scheme. Further growth in membership is forecast. Master Trust schemes are important for the success of this pension reform - they can offer good value for members due to scale and the benefit of trustee oversight (and the associated fiduciary duties).

In the Pension Schemes Act 2017 (the 2017 Act) the Government established a framework for an authorisation and supervisory regime for Master Trusts providing money purchase benefits. Regulations have been developed to commence the regime and provide the necessary detail on aspects of the regime for it to operate effectively. This intervention is intended to address gaps and weaknesses in the current regulatory environment for Master Trusts that may otherwise result in scheme members' benefits having a lower level or missing elements of protection compared to other types of pension scheme arrangement. It is essential to protect members' benefits (savings) if confidence in pension saving is to be maintained and to achieve the aim of the Automatic Enrolment programme to increase security in later life by getting millions of individuals saving more for retirement.

What are the policy objectives and the intended effects?

- 1) To protect Master Trust members' pension savings (and confidence in savings), in particular addressing gaps in the regulatory regimes which have arisen because of the way in which Master Trusts have evolved.
- 2) To ensure the Pensions Regulator (the Regulator) has the necessary powers to regulate and enforce new minimum standards for such schemes.

¹ The Pensions Regulator: 'DC Schemes Returns 2017/18', Summary, Table 2.
<http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2018.aspx>.

What policy options have been considered, including any alternatives to regulation?

As the Bill Stage Impact Assessment did not monetise the impacts of any provisions made in the 2017 Act, we are treating Option 0 as the counterfactual where Primary legislation was not enacted. Option 1 is where we assess the impacts if only the 2017 Act remained in place, and no provisions of the secondary legislation were commenced. Option 2 discusses the preferred option, the commencement of the Master Trust Authorisation Regime.

Option 0 – Do Nothing: As if no provisions of the 2017 Act had been enacted

This option will retain the existing voluntary process for Master Trust Assurance Framework (MTAF) accreditation. To date, 23 Master Trusts have successfully completed this process and are on the Regulator's published list.² Typically, schemes with large numbers of members have gained assurance, so that in total over 80% of the total membership of Master Trust schemes are in Master Trusts that are signed up to the MTAF. However, the current framework is voluntary and does not address all the issues covered by the 2017 Act. In addition, a significant majority of schemes have not signed up, as of January 2018 an estimated 1.6 million members were in schemes that had not gained assurance. Therefore, this option does not address the key risks identified, or meet the policy objectives.

The Regulator would incur extra cost by having to support any failing Master Trusts, as has already happened with two smaller schemes. The Regulator is funded by a levy on pension schemes so ultimately all other pension schemes would be responsible for funding any remedial action.

Under the current voluntary assurance arrangement there are a large number of Master Trusts (59 out of 81) that do not participate, which manage around £5.7bn of assets.

Option 1 - Retain the existing provisions for minimal protections of Master Trust members' savings within the Pension Schemes Act 2017 and voluntary process for assurance by independent audit (Master Trust Assurance Framework (MTAF)).

The 2017 Act provides some minimal protection for members of Master Trusts which are in place from 20 October 2016. In summary:

- A Master Trust that experiences a triggering event (an occurrence that could affect the future of the scheme) has to report it to the Regulator.
- Once the scheme had a triggering event it can't raise its charges on members above certain levels until that event has been resolved.
- If members of the scheme are transferred to another scheme, the receiving scheme cannot raise its charges above certain levels to cover the cost of the transfer.
- Before the ban on increasing charge levels can be lifted, the scheme must inform the Regulator when the triggering event has been resolved and the Regulator must agree that all relevant triggering events have been resolved.
- The scheme funder is liable for the costs incurred by the scheme during the triggering event period where liability for those does not lie elsewhere.

This option will not meet the concerns above because:

- the minimal protections in the 2017 Act do not address the problem identified that there are currently insufficient barriers to entry to establishing a Master Trust and taking on new members. While they partially address gaps in the regulatory regime around protection for members in the event of scheme failure the full requirements of the 2017 Act are intended to provide more rounded protection – in particular implementing preventive measures i.e. requiring schemes to meet minimum standards through authorisation and supervision, through which the likelihood of uncontrolled scheme failure is significantly reduced.

Option 2 - Master Trust Authorisation Regime: Introduce a new compulsory authorisation regime within the framework set out in the 2017 Act. This has additional requirements compared to the MTAF.

This would introduce a comprehensive authorisation process that protects members and strikes an appropriate balance on all of the key risks. The Department for Work and Pensions discussed options with key stakeholders in a series of Ministerial Roundtables in May 2016, and further stakeholder events in July 2016. It concluded that options 0 and 1 would not meet the policy objectives outlined above. Option 2 is therefore the preferred option. In summary, the 2017 Act has made provision for option 2 through the introduction of the overarching requirement for Master Trusts which are already existing or established after the date the regime comes into force (intended to be 1 October 2018) to apply to become authorised whether that is to continue operating or to take on new members and contributions for the first time. It outlines the broad framework for the authorisation

criteria and provides enhanced powers and responsibility to, and for, the Regulator in performing its regulatory functions. The 2017 Act also includes a prohibition on trustees of Master Trusts from increasing charge levels or imposing new charges on members or charging members for leaving the scheme once certain events have happened (which indicate the Master Trust is at risk). There is a corresponding prohibition on a Master Trust which receives a bulk transfer of members from a failing Master Trust from passing on costs to its own members from that failing Master Trust.

There are several policy options for each component of the 2017 Act; these will be explained further in the relevant sections within the evidence base. Where possible, a range has been given to qualify the impact of different parts of the policy.

At this stage there is still considerable uncertainty over the full impacts of the proposal. Some impacts will depend on specific features of the Master Trusts applying for authorisation, of which there are a wide variety, which creates some uncertainty about the costs outlined below. Many of the regulations specify clear minimum standards that must be met by Master Trusts in order to gain authorisation, but are not prescriptive on how the Master Trust should meet them. This adds to the uncertainty around any estimates of the costs of this policy. Some detail about how schemes can demonstrate that they meet these requirements will be set out in the Pension Regulator's Code of Practice, which has been published in draft for consultation.

Departmental signoff (SCS): Fiona Walker

Date: 20 March 2018

Economist signoff (*senior analyst*): Andrea J. Lee

Date: 19 April 2018

Better Regulation Unit signoff: Prabhavati Mistry

Date: 22 March 2018

Summary: Analysis & Evidence

Policy Option 0

Description: Do nothing (retain existing voluntary accreditation process)

FULL ECONOMIC ASSESSMENT

Price Base Year 2017	PV Base Year 2016	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: N/A	High: N/A	Best Estimate: N/A

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	1		
High			
Best Estimate		N/A	N/A

Description and scale of key monetised costs by 'main affected groups'

N/A

Other key non-monetised costs by 'main affected groups'

As this option retains a voluntary assurance process, which a significant majority of Master Trust schemes have not signed up to, members would not be adequately protected from scheme failure. The Regulator would incur extra cost by having to support any failing Master Trusts, as has already happened with two smaller schemes. The Regulator is funded by a levy on pension schemes so ultimately all other pension schemes would be responsible for funding any remedial action. If the Regulator is not given adequate powers to engage with failing schemes there is the potential for members' to lose some of their savings.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	1		
High			
Best Estimate		N/A	N/A

Description and scale of key monetised benefits by 'main affected groups'

N/A

Other key non-monetised benefits by 'main affected groups'

N/A

Key assumptions/sensitivities/risks	Discount rate	3.5
N/A		

BUSINESS ASSESSMENT (Option 0)

Direct impact on business (Equivalent Annual)			Score for Business Impact Target (qualifying provisions only) £m:
Costs: N/A	Benefits: N/A	Net: N/A	N/A

Summary: Analysis & Evidence

Policy Option 1

Description: Retain the existing provisions for minimal protections of Master Trust members' savings within the Pension Schemes Act 2017 and voluntary process for assurance by independent audit (Master Trust Assurance Framework (MTAF)).

FULL ECONOMIC ASSESSMENT

Price Base Year 2017	PV Base Year 2016	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: N/A	High: N/A	Best Estimate: N/A

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	1		
High			
Best Estimate		N/A	N/A

Description and scale of key monetised costs by 'main affected groups'

Master Trust schemes will have to notify the Regulator of any triggering events as specified in the 2017 Act, and will incur associated costs. As this was not costed in the Bill stage Impact Assessment it has been monetised in this assessment. As is currently the case, the voluntary accreditation process will have costs for those that choose to take part in it, but no scheme is forced to incur costs by this policy option.

The equalised annual direct cost to business (EANDCB) as a result of this policy option would be 0.

Other key non-monetised costs by 'main affected groups'

The 2017 Act introduced a prohibition on trustees from increasing charge levels or imposing new charges on members or charging members for a transfer when a Master Trust leaves the market. There is also a prohibition on the trustees of a Master Trust which receives a bulk transfer of members from a failing Master Trust from passing on to members the costs from the failing Master Trust. These have not been costed as the impact of this measure is dependent on whether the scheme would have chosen to increase members' charges and any associated cost would depend heavily on the size of the Master Trust that had experienced the triggering event. Without the Master Trust authorisation and supervisory regime, members would not be afforded adequate protection against uncontrolled scheme failures. The Regulator would not be in a position to ensure that Master Trust schemes meet the standards required to effectively operate a Master Trust scheme.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant	Total Benefit (Present Value)
Low	1		
High			
Best Estimate		N/A	N/A

Description and scale of key monetised benefits by 'main affected groups'

N/A

Other key non-monetised benefits by 'main affected groups'

Master Trust schemes will be required to notify the Regulator of any triggering events, which may improve the speed at which triggering events can be responded to or resolved with the Regulator's help. There will be a benefit to members of the Regulator receiving notice of a triggering event, which could lead to improved engagement with the Master Trust to resolve the triggering event or help them leave the market.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
<p>Though there have been cases where Master Trusts have failed or decided to exit the market, these have, so far been relatively small schemes and it has been possible for the Regulator to voluntarily agree with them a controlled wind up. We do not have information about the likelihood of an uncontrolled Master Trust failure, the extent to which member benefits would be at risk in the event of failure, or about the scale of the impact that any failure would have on confidence in the sector. We do have some evidence from the Regulator that a small number of existing schemes, including some large ones, could present real risks of failure.</p>		

BUSINESS ASSESSMENT (Option 0)

Direct impact on business (Equivalent Annual)	Score for Business Impact Target (qualifying provisions only) £m:		
Costs: N/A	Benefits: N/A	Net: N/A	N/A

Description: Introduce a new compulsory Master Trust Authorisation Process

FULL ECONOMIC ASSESSMENT

Price Base Year 2017	PV Base Year 2016	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: N/A	High: N/A	Best Estimate: -24.7

COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low		1		
High				
Best Estimate	0.0		3.1	25.9

Description and scale of key monetised costs by ‘main affected groups’

Whilst the high level framework for the authorisation regime is set out in the Pension Schemes Act 2017, the detailed standards that schemes will be required to meet (and how they are met) are set out in regulations that have been subject to consultation with the industry. The regulations will be supported by a statutory Code of Practice issued by the Pensions Regulator and this has been published in draft for consultation.

The key cost will be for all existing and future Master Trust schemes that will need to make changes to be authorised by the Regulator. These costs will include those associated with meeting scheme requirements, the cost of applying for authorisation, and familiarisation costs.

There is an additional cost to business to fund the Regulator to conduct the new authorisation and supervision processes, and on-going levy charges for supervision made on all Master Trusts. Schemes will have new administrative costs that arise from the need to prepare documents and other evidence to submit with an application for authorisation, to liaise with the Regulator as they consider the application and once authorised of providing updated business plans etc. and to notify the Regulator of specified events.

The authorisation regime may lead to some Master Trusts pre-emptively leaving the market, as they no longer believe it commercially viable to remain in the market under the increased burden that the authorisation process will place on schemes. The costs incurred here are those associated with winding up the scheme and transferring all members to another scheme. There will also be a cost to any Master Trusts that are not authorised by the Regulator, who will no longer be able to operate and will have to transfer all members out of the scheme and close the scheme.

Other key non-monetised costs by ‘main affected groups’

The 2017 Act also introduced a prohibition to protect members from increased costs as a result of a failure of a Master Trust. The prohibition covers increasing charges, introducing new charges on members or charging a member for transfer during a specific period following a triggering event. The regulations will also grant the Regulator the power to issue a pause order, which will; stop any new members being taken on by the scheme, stop further contributions or payments towards the scheme by or on behalf of any employers or members, or any specified employers or members, stop any payments out of the scheme to members and stop transfers or transfer payments out of the scheme. The cost of this has not been monetised here as the scale of the cost is highly dependent on the scheme which is issued a pause order. And we assume that there will be less than 10 pause orders during the appraisal period.

BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low		N/A		
High				
Best Estimate	N/A		0.1	1.2

Description and scale of key monetised benefits by ‘main affected groups’

The group that will benefit the most as a result of this policy will be the members who are saving into Master Trust pension schemes. While it is not possible to estimate the value of members’ assets that would have been at risk under the baseline throughout the duration of the appraisal period, information provided by the Regulator shows that £5.7bn of assets under management are currently managed by Master Trust schemes that do not have Master Trust Assurance and are not backed by an insurer.

Other key non-monetised benefits by ‘main affected groups’

All members in Master Trusts will benefit from improved protection, reduced likelihood of Master Trust failure and associated potential loss of savings (and consequently future retirement income), and protection from costs incurred in closing down the scheme. There are currently 9.9m members in Master Trust schemes. We have not monetised these benefits as we do not have a baseline projection of how many schemes would have failed with and without a compulsory authorisation process.

We have not monetised any wider benefits associated with greater confidence in the sector as a result of compulsory authorisation and reduced likelihood of Master Trust failure, as the scale of this would be dependent on the amount of member detriment experienced under the counterfactual. There may also be savings for the Regulator in future years by avoiding problems arising and safeguarding member benefits.

Master Trusts were managing assets to the value of over £16 billion in 2017/18,³ and these are forecast to grow as automatic enrolment roll-out continues. All of these assets will benefit from the protections introduced under this measure, although it is not possible to quantify the value of the assets that were specifically ‘at risk’ in the counterfactual scenario. The scale of the cost to members of scheme failure under the ‘Do Nothing’ approach has not been estimated here, from which we would estimate any benefits to members.

Some of these benefits only arise after the regime has commenced. The protection in relation to costs to the member if the scheme fails took effect early, as a simplified version of this measure, a more detailed version of the measure is in the regulations, applied retrospectively from the date of introduction of the Act.

There may be a benefit to well-run schemes, as they may not be undercut by badly run competitors, increased trust in the Master Trust market could also benefit schemes through increased membership in the long term. Similarly, if a Master Trust had failed in the ‘Do Nothing’ scenario, this could cause a decrease in membership of Master Trusts due to a loss of confidence in them. We have assumed that any lost revenue to a Master Trust will be gained by another Master Trust, thus constituting a transfer; this is because a Master Trust has to transfer all members, in most cases to an authorised Master Trust, before it can wind up.

The assets of all Master Trusts that leave the market will be transferred to another authorised Master Trust, as specified by the Regulations, and could lead to better outcomes for members if they benefit financially through economies of scale, both in administration and investment.

Members’ savings that may have been lost due to disorderly exit under the counterfactual will be protected by the authorisation regime, as in broad terms, schemes are prohibited from raising charges in a period where the scheme is at risk, and schemes will be required to hold assets to cover the running on and wind up of the scheme.

Key assumptions/sensitivities/risks

Discount rate

3.5

³ The Pensions Regulator: ‘DC trust: presentation of scheme return data 2017 – 2018’ January 2018.
<http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2018.aspx>.

This Impact Assessment relies heavily on intelligence from the Pensions Regulator, which is based on the Regulator's ongoing contact with all Master Trusts since March 2016. As Master Trusts are a very specific type of pension scheme, there are limited ways in which we can reliably collect data on these schemes. The Regulator is, therefore, best placed to collect such information. Some of the information used, however, is commercially sensitive and aggregate figures are used where appropriate.

Given the scope of authorisation is intended to go wider than accreditation, it is reasonable to assume that the associated costs (and member benefits) will be higher. However, it is expected that any authorisation process will incur costs for each Master Trust scheme.

There is considerable uncertainty in the likelihood of Master Trust failure (and the level of member benefits at risk) in the counterfactual. Under this option it is not possible to reliably estimate the benefits to members associated with reduced risk of failure.

The costs to business will depend on the number of Master Trusts that choose to remain in or enter the market. Across the 87 Master Trusts known to the Regulator in 2017, it believes that there will be some consolidation in the counterfactual scenario and this may reduce the number of Master Trusts to around 70. However, the impact of authorisation on the number of Master Trusts is not known with certainty. It is anticipated that some schemes will not seek authorisation and some will fail to meet the criteria and exit the market. This is assumed to reduce the number of Master Trusts further to around 56, although this will be heavily dependent on individual schemes reaction to the authorisation regime.

The impact of the intended prohibition is also at present uncertain. There is no reliable data on the schemes expected to exit the market following the introduction of the 2017 Act, the level of member benefits managed by those schemes who wind up, or the extent to which schemes winding up would have used member benefits to pay for the costs of winding up.

The potential for the authorisation regime to increase barriers to entry to the market has to be carefully balanced with the need for increased member protection. The regime will ensure that any new Master Trusts must meet certain standards that would have been recognised as the minimum that they would have been expected meet in the counterfactual.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs: 2.8	Benefits: 0.1	Net: -2.7	N/A

Evidence Base (for summary sheets)

Background

What is a Master Trust?

1. Master Trust is a phrase commonly used to describe a multi-employer occupational pension scheme. A Master Trust is usually established by a founder who sets the trust deed, rules and appoints a board of trustees. Employers are then able to select the Master Trust for their workers rather than needing to set up their own pension scheme.
2. The Pension Schemes Act 2017 (the 2017 Act) defines a Master Trust as an occupational pension scheme, that is not a public service pension scheme:
 - a. that provides money purchase benefits
 - b. used (or intended to be used) by two or more employers
 - c. is not used (or intended to be used) only by employers who are connected employers

Occupational pensions

3. Private pensions can be either occupational (usually trust-based) or personal pensions, including group personal pensions (which are usually contract-based). The category into which they fall affects which regulations they must comply with and which body is responsible for regulating them. In general, Master Trusts are occupational trust-based schemes, regulated by the Pensions Regulator (the Regulator).

Money purchase benefits

4. A pension scheme that provides money purchase benefits is also known as a defined contribution (DC) scheme. The member builds up a pension pot, based on how much the member pays in contributions, employer contributions (if applicable) plus investment returns and tax relief, less any charges. The income they will receive is dependent on what they can obtain, based on the value of the pot at the point that they become a pensioner.
5. Any scheme that offers a promise of a specific income (whether in full or part) or some form of guaranteed return is not a money purchase pension. These schemes are also usually known as defined benefit (DB) schemes.

Multi-employer

6. Traditionally, the majority of trust-based occupational pension schemes have been developed for a single employer or corporate group (connected employers). However, Master Trusts are multi-employer occupational schemes for un-connected employers where instead of the employer setting up their own pension scheme, the scheme will be provided by an external organisation which runs a pension scheme for numerous employers. A Master Trust will generally have one board of trustees who are responsible for the interests of all members across all employers.

Characteristics of Master Trusts

7. As an occupational pension scheme, Master Trusts are subject to laws that have traditionally been designed for and applied to the single-employer model (as this is how such schemes had tended to be set up), and they are regulated by the Regulator. However, as multi-employer schemes for unconnected employers there are many ways in which Master Trusts share more in common with group personal pension schemes (a type of contract-based scheme which is regulated by the Financial Conduct Authority (FCA)).
8. In broad terms, contract law works in a different way to trust law and occupational pension law. The FCA regulate firms that offer personal pensions, including conducting fit and proper person tests for key individuals delivering regulated activities. Also, the solvency risk of insurance providers of personal pension schemes is regulated by the Prudential Regulation Authority (PRA). Personal pensions, along with other financial products and services, are covered by the Financial Services Compensation Scheme.

Composition of a Master Trust

9. The 2017 Act describes two roles within a Master Trust that have not previously been defined; these are the scheme funder and the scheme strategist. These roles sit alongside the scheme's trustees and play crucial roles in the dynamics of a Master Trust. The 2017 Act places certain duties on these persons which are included in the cost benefit analysis.

Scheme funder

10. In summary, the scheme funder is a person who is responsible for paying the costs of the scheme (if they are not covered by charges on members) and for taking any profit. For example, many schemes will not yet have achieved the scale at which income covers costs; as they will incur set up costs to establish their systems and processes and for marketing. Where schemes are set up for profit, the scheme funder will be the person who can take money out of scheme (i.e. rather than reinvesting it). While we expect that most Master Trusts will be able to identify a scheme funder, not all schemes will have one (for example where a scheme is run by a not-for profit organisation).
11. The regulations will help the Regulator assess schemes that cannot readily identify a scheme funder and do not have other sources of income apart from the administration charges or from the employers who are required to meet the costs of the scheme. To facilitate the Regulator's financial assessment, regulations will require schemes to disclose their strategy for meeting their costs in the absence of a scheme funder.
12. The scheme funder can be more than one person and can be the same person as the corporate trustees or scheme strategist.

Scheme strategist

13. The scheme strategist is the person who makes business decisions relating to the commercial activities of the scheme. Commercial activities should be considered in its widest sense – for example, a decision that the scheme operates within a limited market and will not seek to make a profit. Such decisions will have an impact on the business strategy, the likely size of the scheme, its charging model and financing arrangements. The 2017 Act requires that the scheme strategist prepares a business plan, a key document which must accompany the application for the authorisation. Whoever prepares the plan would be a scheme strategist.
14. The scheme strategist can be more than one person and can be the same person as the trustees or scheme funder.

Trustees

15. Trustees fulfil a well-established role in occupational pension schemes. They have duties to act in the interests of the scheme's members within the

remit of the scheme's deeds and rules. The trustees may also be the scheme funder and/or the scheme strategist.

Master Trusts and Automatic Enrolment

16. Automatic enrolment (AE) was introduced in 2012 to reverse the long-term decline in the number of people saving into workplace pensions. AE was rolled out between 2012 and 2018, and all UK employers now have to enrol workers into a qualifying workplace pension scheme if they are working in the UK, earn more than £10,000 per year, are over 22 years old and are under state pension age. Employers have to pay minimum contributions to workplace pensions, currently set at 1% of a band of qualifying earnings, due to rise to 3% by April 2019. By the end of February 2018, over 1,110,000 employers had automatically enrolled more than 9.4m eligible workers.⁴ Once fully implemented, automatic enrolment is expected to increase the number of individuals newly saving or saving more in a workplace pension by around 10 million,⁵ and increase the amount that is being saved in workplace pensions by around £19.7bn a year.⁶
17. Where employers do not have existing qualifying workplace provision they will be required to choose a scheme in which to automatically enrol eligible workers. To support the aims of AE, the Government set up the National Employment Savings Trust (NEST), to ensure that all employers had the option of joining a trust-based scheme without having to set a scheme up themselves (which would likely be a large burden, especially for small, medium and micro employers).
18. Since the roll-out of AE began in 2012, there has been significant growth in the number of Master Trust schemes in the DC marketplace. It is estimated that there could be as many as 7.8 million active members in Master Trust schemes by 2035.⁷ In addition to active members there will be growing

⁴The Pensions Regulator: 'Automatic Enrolment declaration of compliance monthly report', March 2018. <http://tpr.gov.uk/docs/automatic-enrolment-declaration-of-compliance-monthly-report.pdf>.

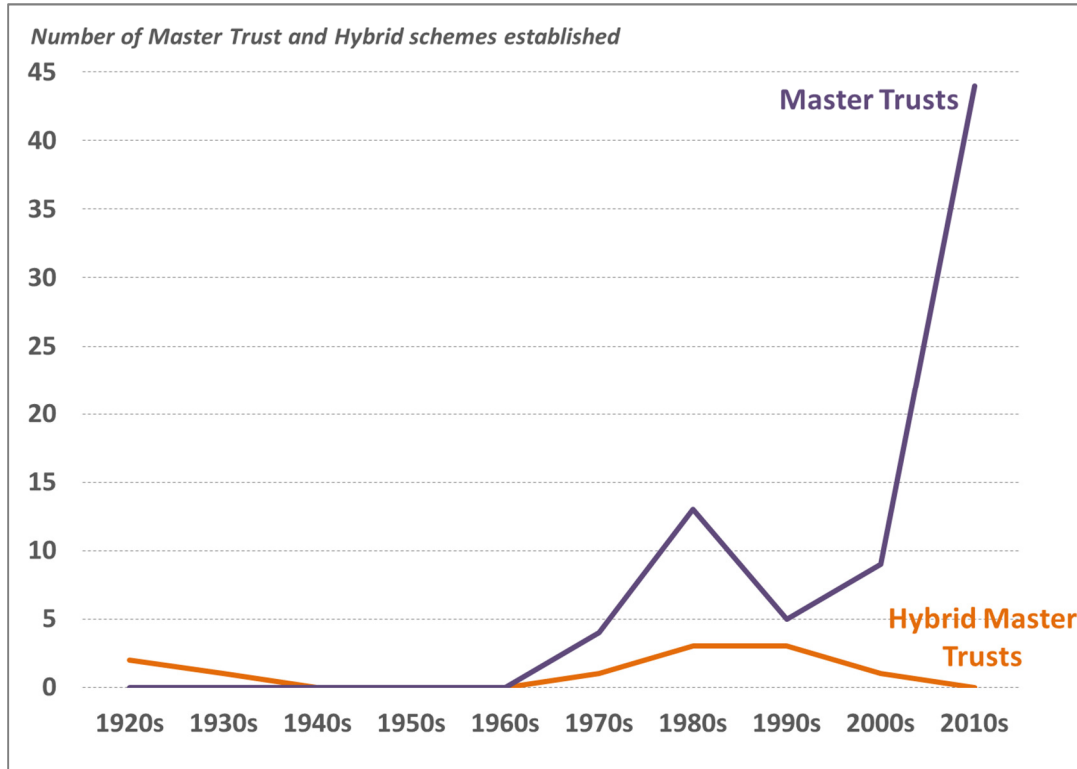
⁵ Department for Work and Pensions: 'Workplace pensions: Update of analysis on Automatic Enrolment 2016', October 2016. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/560356/workplace-pensions-update-analysis-auto-enrolment-2016.pdf

⁶Department for Work and Pensions: 'Automatic Enrolment 2017 review' December 2017. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/668657/automatic-enrolment-review-2017-analytical-report.pdf.

⁷ The Pensions Policy Institute: 'The Future Book: unravelling workplace pensions 2017 edition', October 2017. <http://www.pensionspolicyinstitute.org.uk/publications/reports/the-future-book->

numbers of deferred members. NEST had a total of 4.5 million members at 31st March 2017, 2.7 million active and 1.8 million deferred.⁸

Figure 1: Number of new hybrid (DB & Money Purchase multi-employer schemes) and Master Trust schemes set up per decade.⁹



unravelling-workplace-pensions,-2017-edition-. Active members are those currently contributing to a pension.

⁸ National Employment Savings Trust: 'Annual report and Accounts 2016/17', July 2017. https://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/NEST-Corp-ARA_2016_2017.PDF.pdf.

⁹ Information provided by the Pensions Regulator.

19. In 2010 there were around 0.2 million members in Master Trust schemes. By January 2018, this had increased to around 9.9 million, including active and deferred members. Master Trust memberships now make up around 85% of memberships of DC trust-based schemes, and in 2018 Master Trusts being used for AE were reported to be managing assets to the value of around £16.3 billion.¹⁰ This is expected to grow significantly as AE rollout completes, minimum contributions rise to 8%, and members' assets grow.
20. Evidence from the Regulator suggests that 86% of members that are automatically enrolled into a DC trust-based scheme are enrolled into a Master Trust.¹¹ A 2015 DWP survey found that those employers that had already implemented AE, 37% were using Master Trust schemes (23% NEST; 14% other Master Trusts). Of those employers who were yet to 'stage' (implement AE), although the majority (60 per cent) either already offered pension provision or had not yet decided which type of scheme to use, 21 per cent planned to use a Master Trust (including NEST).¹²

Existing regulation and voluntary assurance schemes for Master Trusts

21. The sharp increase and expected continued growth in membership of Master Trusts means it is increasingly important that they are adequately regulated to ensure millions of members' savings are protected.
22. Existing pension legislation applying to DC occupational pension schemes largely applies to Master Trusts. For example, they must comply with governance and administration requirements, which are the subject of the

¹⁰ The Pensions Regulator: 'DC Scheme Returns 2017/18', Summary, Table 2, January 2018. <http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2018.aspx>.

¹¹ The Pensions Regulator: 'DC Scheme Returns 2017/18', File 4 AE, Table 4.6, January 2018. <http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2018.aspx>.

¹² Department for Work and Pensions: 'Employers' Pension Provision survey 2015', March 2016. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/504346/rr919-employers-pension-provision-2015.pdf

Pension Regulator's DC Code of Practice.¹³ AE schemes must meet the qualifying criteria for such schemes, which include a limit on the charges that members pay and ban on certain types of members' charges. The Pensions Regulator has existing powers, for example to ask for information (e.g. in the annual scheme return) and to take action if there is evidence that a scheme is not being well run or trustees are inadequately fulfilling their duties. The authorisation regime provided for in the 2017 Act will complement these requirements. The existing legislation was largely designed to address risks in single-employer schemes, and is aimed at ensuring participating employers and trustees fulfil their roles. Therefore, it does not fully address the risks from which the authorisation regime seeks to protect Master Trust scheme members

23. In 2014 the Institute of Chartered Accountants in England and Wales (ICAEW), in partnership with the Regulator, developed the Master Trust Assurance Framework (MTAF) as a way of helping Master Trusts demonstrate that they have standards of governance that meet the Regulator's Defined Contribution (DC) code and DC regulatory guidance. The framework provides an independent review against a defined set of governance objectives agreed by the Regulator. This is generally seen as an indicator of a well-run scheme. Successful Master Trusts receive a report confirming that they have been independently assessed as meeting the MTAF standards and can be included on the list of schemes on the Regulator's website.¹⁴ This voluntary process assesses whether a scheme can be considered well-run during a certain period, but it does not seek to address gaps in the regulatory framework.
24. There are currently 23 Master Trusts that have gone through the MTAF process and are on the Regulator's list, out of a total of 81 schemes. This means that a significant number of Master Trusts have not yet signed up to this voluntary framework.
25. Master Trust schemes may also have taken up other third party assurance, accreditation or quality standards such as ISOs (International Organisation for Standardisation), accreditation with PASA (Pensions Administration Standards Association) or the Pension Quality Mark. Again these all address various aspects of how well a scheme is run, but are not

¹³ The Pensions Regulator: 'Governance and administration of occupational trust-based schemes providing money purchase benefits', July 2016. <http://www.thepensionsregulator.gov.uk/docs/code-13.pdf>.

¹⁴ <http://www.thepensionsregulator.gov.uk/trustees/master-trust-assurance.aspx>

compulsory and none fully covers the aspects that the Pension Schemes Act 2017 seeks to address.

Problem under consideration

26. There are several specific areas of risk arising in relation to Master Trusts compared to other types of occupational pensions and also compared to group personal pension schemes:

- Master Trusts have developed new types of business structures which create a **significant alteration of the relationships** (and behavioural incentives) between key players (member, employers, trustees, provider) which are integral to the current basis for existing law and regulation;

- Many Master Trusts can be run on a profit basis. **Introducing the profit motive**¹⁵ into the realm of trust-based occupational pensions introduces a significant new dynamic (and changes incentive structures) which existing occupational pension regulation does not take into consideration – to date this has been the domain of the FCA and regulation of group personal pensions and other financial products.

- Master Trusts operate at a **scale** which is unprecedented in occupational pensions. The collapse of a large scheme would create a greater shock to the confidence of savers generally than that of a single employer DC pension. The number of members and size of assets are heavily concentrated in a relatively small number of very large Master Trusts.

- Master Trusts have multiple employers to serve – the **complexity** involved in serving the customer base and the distance of removal from the end user poses a challenge to costs, and complicates the existing system of educating and enabling trustees to carry out their functions in a competent manner. This also leads to another example of the principal-agent problem –the employer chooses a workplace scheme for their workers but the trustees operate the scheme for members from multiple employers.

- Master Trusts are **not subject to the regulation that applies to other financial products**, such as contract based workplace pensions. This makes the scheme cheaper to set up and deliver for the provider; savings which could be passed onto members. But in taking this route, Master Trusts avoid key requirements that exist within the FCA regulatory remit, such as tests for financial stability and key personnel competence; yet the essential nature and

¹⁵ Although the board of trustees need to have regard to their fiduciary duties; the corporate entity that sets the trust deed and rules is not covered by this requirement.

relationships within a Master Trust appear to be more like a financial product such as a group personal pension.

- Some Master Trusts were previously DB schemes, which have opened money purchase sections to control costs. This creates **different governance challenges** for trustees.

27. A Work and Pensions Select Committee report¹⁶ into automatic enrolment concluded that:

“Gaps in pension law and regulation have allowed potentially unstable Master Trusts onto the market. Should one of these trusts collapse, there is a very real danger that ordinary scheme members could lose retirement savings. There is also a risk that faith in auto-enrolment as a whole will be undermined. We support the Minister’s call for a Pensions Bill to introduce stronger regulation of Master Trusts.”

28. Some of the fundamental dynamics and influences that are assumed to be in place in occupational pensions do not apply to Master Trusts. An individual employer does not have an on-going interest in the running of the scheme and the future of the scheme. Instead schemes have a largely transactional relationship with the employers. Although, in some of the long established schemes that provide both money purchase and non-money benefits for historical reasons, employers may have vested interests in continuing viability of the money purchase part of scheme which is in effect the Master Trust. Many Master Trusts, unlike other occupational pension schemes are set up to create profit or to be self-sustaining. Finally, the potential volume of savers involved in the schemes means that a failure of one could impact on confidence in pension savings more widely. These factors give rise to new risks which in turn presents the need for a different type of regulation to ensure member benefits are protected.

Rationale for intervention

29. The rationale for Government intervention is:

- To **protect scheme members** from suffering financial detriment as a result of new and increased risks presented by Master Trusts which are not adequately covered by the existing regulatory framework. Also, to level the playing field in what types of risk members are protected from both within the Master Trust market and between types of DC scheme.

¹⁶http://www.publications.parliament.uk/pa/cm201516/cmselect/cmworpen/579/57906.htm#_idTextAnchor010

- To **promote quality** based on a level playing field in the Master Trust sector by ensuring that reputable Master Trust arrangements are not undercut by less reputable arrangements seeking to gain a competitive advantage by weakening member protections or by exploiting loopholes.
- To **protect confidence in pensions saving** in the UK by reducing the risk of high profile failure or fraud in the Master Trust sector. Given the growing prevalence of Master Trusts in providing benefits it will also help protect the good reputation of the AE programme, which is a key pillar of the Government's approach to ensuring people make adequate provision for their financial needs in later life.
- The Office of Fair Trading (OFT) 2013 market study identified that the DC market had a **very weak demand-side** and that competition alone could not be relied upon to drive good outcomes for consumers.¹⁷ This is primarily the result of a **principal-agent problem**.
- The **complexity of the market and products** further complicates the ability of employers to make decisions in the best interest of workers. The OFT made recommendations for actions for different parties to take in response to its findings. One of the recommendations was for Government and regulators to ensure an equivalent level of protection between Master Trusts and contract-based, off the shelf products.
- It is incumbent on Government to ensure that regulation is adequate in Master Trusts. A large proportion of members have been automatically enrolled rather than actively choosing to participate in workplace pension saving. Latest estimates suggest that an additional 10 million individuals will be newly saving or saving more as a result of AE.¹⁸

Policy objectives

30. The key policy objectives are:

- To close a key loophole in the regulatory remits in order to achieve **equivalent protection** across the DC landscape for members of Master Trusts in so far as providing protection from similar types of risk, and protection from new risks arising in Master Trusts.
- To ensure the **market evolves in a balanced way** – the objective is to achieve an appropriate balance between member protection and the cost of regulation across the industry. Master Trusts can offer good deals to

¹⁷http://webarchive.nationalarchives.gov.uk/20131101164215/http://www.offt.gov.uk/shared_offt/market-studies/oft1505.

¹⁸ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/560356/workplace-pensions-update-analysis-auto-enrolment-2016.pdf.

members due to efficiencies of scale, and can offer a good route for employers who do not want to set up an individual scheme just to meet their AE duties. However, this must not be at the cost of protecting the member against key risks which Government has sought to provide to members of other sorts of pension schemes under existing regulation.

- To provide an on-going supervisory role to prevent costly adjustments later down the line which may impact the Master Trust founder's business plans, and also to **reduce the likelihood of member detriment** in the future.
- In the case of a Master Trust scheme being established after the introduction of the authorisation regime, to put the Regulator into a position where it can proactively ensure **schemes are authorised before members join**.
- To **reduce** the likelihood of a Master Trust being set up for **fraudulent purposes**.

Description of options considered

31. As the Bill Stage Impact Assessment did not monetise the impacts of any provisions made in the 2017 Act, we are treating Option 0 as the counterfactual where Primary legislation was not enacted. Option 1 is where we assess the impacts if only the 2017 Act remained in place, and no provisions of the secondary legislation were commenced. Option 2 is the preferred option, where the full authorisation and supervisory regime is commenced.

Option 0 - Do Nothing: No provisions of the 2017 Act would remain in place.

32. This option would retain the existing voluntary process for MTAF accreditation. To date, 23 Master Trusts have successfully completed this process and are on the Regulator's published list¹⁹. Typically, schemes with large numbers of members have gained assurance, so that in total over 90% of the total membership of Master Trust schemes are in Master Trusts that are signed up to the MTAF²⁰. However, the current framework is voluntary and does not address all the issues covered by the 2017 Act. In

¹⁹ The Pensions Regulator: 'Master Trust assurance'.

<http://www.thepensionsregulator.gov.uk/trustees/master-trust-assurance.aspx#s19297>.

²⁰ The Pensions Regulator, Parliamentary Question 34203.

addition, a significant majority of schemes have not signed up, as of January 2018 an estimated 1.6m members and around £5.7 bn of assets were in schemes that had not gained assurance.²¹ Therefore, this option does not address the key risks identified, or meet the policy objectives.

33. The Regulator would incur extra cost by having to support any failing Master Trusts, as has already happened with two smaller schemes. The Regulator is funded by a levy on pension schemes so ultimately all other pension schemes would be responsible for funding any remedial action.

Option 1 - Retain the existing provisions for minimal protections of Master Trust members' savings within the Pension Schemes Act 2017 and voluntary process for assurance by independent audit (Master Trust Assurance Framework (MTAF)).

34. This option would involve not commencing the authorisation regime as set out in the 2017 Act. This would leave the minimal protections in place that were introduced by the Act that were only ever intended to be interim measures.
35. The 2017 Act provides some minimal protection for members of Master Trusts which has effect in relation to triggering events which happened on or after 20 October 2016. In summary:
 - a. A Master Trust that experiences a triggering event (an occurrence that could affect the future of the scheme) has to report it to the Regulator.
 - b. Once the scheme had a triggering event it could not raise its charges on members until that event has been resolved.
 - c. If members of the scheme are transferred to another scheme, the receiving scheme cannot raise its charges to cover the cost of the transfer.
 - d. Before the ban can be lifted, the scheme must inform the Regulator when the triggering event has been resolved and the Regulator must agree that all relevant triggering events have been resolved.
 - e. The scheme funder is liable for the costs incurred by the scheme during the triggering event period where liability for those does not lie elsewhere.

²¹ The Pensions Regulator: 'DC Schemes Returns 2017/18', Summary, Table 2, January 2018. <http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2018.aspx>.

36. This option will not meet the policy objectives because:
- a. under the current voluntary assurance arrangement there are a large number of Master Trusts (64 out of 81) that do not participate.
 - b. the minimal protections in the 2017 Act do not address the problem identified that there are currently low barriers to entry to establishing a Master Trust and taking on new members. While they partially address gaps in the regulatory regime around protection for members in the event of scheme failure the full requirements of the 2017 Act are intended to provide more rounded protection – in particular implementing preventive measures i.e. requiring schemes to meet minimum standard through authorisation and supervision, by which the likelihood of uncontrolled scheme failure is significantly reduced .
37. We have monetised the impact of these transitional provisions remaining in place below.

Option 2 - Master Trust Authorisation Regime: Introduce a new compulsory authorisation regime within the framework set out in the 2017 Act. This has additional requirements compared to the MTAF.

38. The 2017 Act set up the framework for authorisation and supervision of Master Trusts, which includes:
- a. a requirement on Master Trust schemes to be authorised to operate – i.e. to take money from members or employers, or to enter into an agreement with an employer to provide pension savings for its employees or workers.
 - b. a system for Master Trust schemes to apply, be assessed for and be granted authorisation by the Regulator, and for the withdrawal of authorisation if the Regulator decides a scheme is no longer meeting the required criteria.
 - c. provision for appeals if the Master Trust is not content with the Regulator's decisions.
 - d. the five criteria that schemes must meet in order for the Regulator to be satisfied that they can be and remain authorised:
 - i. Fit and proper persons to act in relation to key roles in the scheme.
 - ii. Financial sustainability, that the scheme has:
 - 1. a sound business strategy, and
 - 2. sufficient funds to meet costs set out in the Act.
 - iii. That the scheme funder meets certain requirements.

- iv. That the systems and processes used in running the scheme are sufficient to ensure that it is run effectively.
 - v. That the scheme has an adequate continuity strategy addressing how the interests of the members are to be protected if the scheme experiences a triggering event.
- e. that a list of authorised Master Trusts will be published by the Regulator.
 - f. for information to be provided to the Regulator that will enable it to carry out ongoing supervision of the Master Trusts' compliance with the above criteria. This includes a requirement to notify certain significant events that will be listed in regulations. For penalties to be applied to people who do not provide the above information.
 - g. a list of key events that could put the future of the scheme at risk – known as triggering events.
 - h. requirements that triggering events are notified and that the scheme either follows an option to resolve the matter that led to the triggering event or proceed to wind up the scheme.
 - i. in either case, that the scheme has an implementation strategy approved by the Regulator, based on its continuity strategy, that sets out how the members' interests are to be protected in the particular circumstances of the triggering event that has occurred.
 - j. that the scheme follows that implementation strategy and provides periodic reports to the Regulator.
 - k. Prohibitions, following a triggering event until it is resolved or the scheme is wound up, on:
 - l. an increase in charges or introduction of new charges on members, or charging members for leaving the scheme.
 - m. the scheme taking on new employers.
 - n. a requirement that if the scheme is to be wound up that members' rights and benefits are transferred to another authorised Master Trust first, with regulations providing a relatively streamlined process for such a transfer.
 - o. powers for the Regulator to apply a pause order, should it be needed to help the Trustees carry out the implementation strategy and it is necessary to protect members' interests. The pause order allows the Pensions Regulator to prevent money flowing in or out of the scheme and of members being taken on or being transferred out.
39. The criteria have been created in response to specific key risks identified in Master Trusts, and where parallels with FCA type requirements would be appropriate. These risks were identified and tested with stakeholders at the roundtable events, and via officials' engagement with stakeholders. Those

events demonstrated that although there is a range of views on ‘how’ to measure adequate mitigation against those risks, there is broad agreement that regulation of minimum standards in relation to these risks is appropriate.

40. The 2017 Act has introduced a new compulsory authorisation framework, enhanced powers for the Regulator to regulate and enforce a set of authorisation criteria, and a specific prohibition on trustees increasing charges, imposing new charges or charging members for leaving when a Master Trust intends to exit the market. There will also be a corresponding prohibition on Master Trusts, which receive bulk transfers of members from failing Master Trusts, from passing on costs to their own members from the failing Master Trust.

Authorisation Criteria

41. The 2017 Act did not specify the detailed standards that will apply to each criterion. Setting out the details in secondary legislation is more appropriate and can provide the flexibility needed and lead to the implementation of a proportionate regime - for example, enabling the criteria to be met through a variety of ways rather than a simple prescription or one size fits all. This also provides a route to respond to a changing market in the future.
42. The 2017 Act gained Royal Assent on the 27th April 2017, and this Impact Assessment is to accompany the regulations being made under the powers provided for in the Act.

Other options considered

43. Other alternatives would involve repealing the 2017 Act and adopting options such as adjusting the FCA’s remit to take regulatory responsibility for Master Trusts. This would mean that the current FCA rules in relation to financial products would apply to Master Trusts. Taking this action could cause confusion in the pensions industry. The Regulator is responsible for occupational pension schemes and Master Trusts are occupational pension schemes. The FCA is responsible for personal and stakeholder pensions.

Key evidence and assumptions

The Pensions Regulator’s engagement with Master Trusts

44. Due to the very specific nature of businesses that operate Master Trusts, there is little publicly available data specifically on these schemes.
45. This Impact Assessment is heavily reliant on information and estimations provided by the Regulator, who has conducted visits to approximately 40 Master Trusts over the past year as a result of a proactive engagement exercise. The Regulator has also visited 60 Master Trusts since the end of 2016 in another set of visits. The Regulator is, therefore, best placed to provide estimates due to its in depth and specialist knowledge of individual Master Trusts and this final impact assessment is based on its knowledge.
46. Where possible, similar existing requirements and processes will be used for comparing parts of the 2017 Act, in order to show comparative costs.
47. The following section provides an estimation of the likely costs and benefits under each option. Industry consultation has been used to gather further evidence to support the development of secondary legislation.

Key Assumptions

48. The key impact on business will fall on Master Trust schemes,²² and scheme funders that are sponsoring the Master Trusts. These costs will relate to:
 - the cost of meeting any prescribed standards/requirements (one-off and on-going);
 - the cost of assessing these standards and demonstrating compliance to the Regulator;
 - familiarisation costs.
49. The key assumptions required to assess these costs relate to:
 - a. the Regulator estimates there were 87 Master Trusts at January 2017.²³ In order to assess the impact we will need to estimate how many Master Trusts would stay in, enter, or exit the market under each option. On the basis of intelligence gathered through proactive engagement and investigations with a sample of Master Trusts, the

²² It is possible that schemes may pass on any increase in costs to employers (or members) through increased fees or charges, but this would be indirect, and a transfer that would not affect net cost to business.

²³ This figure is subject to some uncertainty as there is currently no requirement for a Master Trust to identify itself as a Master Trust when it registers with the Regulator upon its establishment and it is a changing market.

Regulator assumes that there will be some natural consolidation of the Master Trust market and some Master Trusts will seek to exit. Currently the Regulator estimates that this consolidation could reduce the market to around 70 Master Trusts without intervention (option 0).

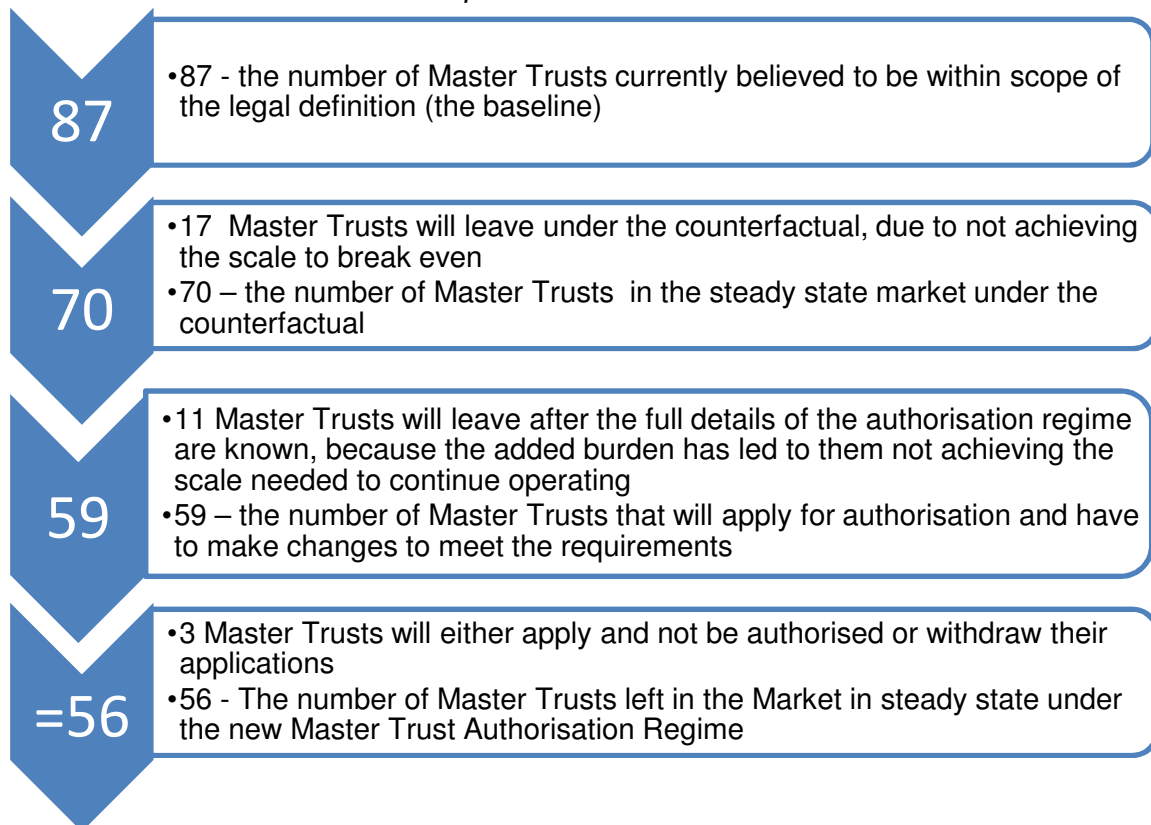
- b. the Regulator has also estimated that under the introduction of an Authorisation regime (option 2) there may be further exits from the market of Master Trusts that do not seek, or fail to achieve, authorisation.²⁴ This could reduce the number of Master Trusts to around 56. This assumption is based on the Regulator's proactive engagement with Master Trusts, and there are two main reasons why a Master Trust might leave in this period; because the extra burden caused by authorisation will mean that the scheme is no longer sustainable, or if the scheme is not authorised by the Regulator. There is considerable uncertainty in these estimates; it is possible that once the final requirements are known, more Master Trusts will exit than we have estimated here. It is, however, impossible to know this until after the legislation comes into force and the regime is in place. The Pensions Regulator will continue to monitor the size of the market on an ongoing basis. The regulations will be supported by the Regulator's Code of Practice.
- c. the number of Master Trust schemes that will need to make changes to meet the requirements of the authorisation regime, and the estimated time (and associated costs) for assessing and meeting standards, as well as familiarisation with the new process and supervisory regime. Costs are likely to vary considerably between Master Trusts, given that existing standards will vary, and the costs for a relatively small Master Trust may differ from very large schemes. For the purpose of this Impact Assessment, we have assumed that 59 Master Trusts will apply for authorisation, and 56 of these schemes will be authorised. In many cases for lower cost parts of the policy, we have calculated a best estimate. These estimates are based on a high level analysis using the information available from the Regulator.²⁵
- d. The three Master Trusts that apply for authorisation and are not authorised will incur the same costs of application as all other Master Trusts in the third year of the policy. As they will then transfer all members out and wind up their schemes, they will not incur any costs

²⁴Information provided by individual Master Trusts and modelling have informed this estimate, made by the Regulator.

²⁵ Neither DWP nor the Regulator is setting a target nor is this suitable to be used as a market forecast.

from year 4 of the appraisal period onwards, the cost of winding up the scheme has been calculated below.

Figure 2: Assumptions about the number of Master Trusts remaining in the Market under the baseline and option 2²⁶



- e. All Master Trust schemes within scope will incur costs as a result of the new regime, though the costs will not be uniform across all schemes. Through the Regulator’s proactive engagement with Master Trust schemes, we have attempted to segment Master Trust schemes in terms of the likely scale of additional costs of meeting the authorisation criteria compared to the counterfactual scenario. We have used this segmentation for areas where more information about that criterion is not known. We estimate that of the 59 Master Trusts that will apply, 49 will experience lower burden to meet the criteria, and 10 will incur a higher burden to meet the criteria.
- f. In January 2018, the Regulator published updated statistics that showed that 6 Master Trusts have left the market since January 2017.

²⁶ All of these figures are based on the Regulator’s expertise after having held industry visits to all existing Master Trust schemes. When visiting Master Trusts the Regulator asked them about whether they intended to remain in the market going forward. The numbers here, and any further grouping of Master Trust schemes, is based on responses to these questions and the Regulator’s assessment of these schemes.

We have, therefore, updated the figures for the summary sheets but not in the main body of the assessment, as the policy will have affected these schemes before they left the market. This change in the number of Master Trusts in the market is in line with the number estimates used in this Impact Assessment.

Figure 3: The assumed level of burden for different Master Trusts to attempt to meet the authorisation criteria

Relative level of burden	Number of Master Trusts
Lower	49
Higher	10

- g. throughout the Impact Assessment we have assumed a wage of £25.08 per hour for trustees, scheme strategists and scheme funders (based on ASHE 2016 wage level for a professional, uplifted by 27% to account for non-wage costs).²⁷ We believe this is appropriate as the people that operate Master Trust schemes will also make the changes required by the policy, these people need to be sufficiently skilled to fulfil such roles and are likely to demand a wage premium over other professions.
- h. We have assessed that Master Trust schemes will experience the costs of this policy in the time period demonstrated in figure 4 below. This is because the costs of some transitional requirements were not monetised alongside the 2017 Act.

²⁷ Office for National Statistics: 'Annual Survey of Hours and Earnings 2016', table 2, October 2016. <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/annualsurveyofhoursandearnings/2016provisionalresults/relateddata>.

Option appraisal: costs and benefits

50. Figures below are rounded to the nearest hundred where possible, some calculations may not sum due to rounding.

Option 0 - Do Nothing

51. Schemes choosing to take part in voluntary MTAF accreditation process will incur costs but no scheme is required to do so.

52. Without intervention the risk to members is high, relative to other options considered. Currently 9.9 million members with over £16 billion assets are managed in Master Trust schemes,²⁸ and £5.7 billion of assets are managed in schemes without Master Trust Assurance.

53. This option is the weakest in terms of maintaining confidence in the market. Industry, the Regulator, and Parliament all recognise existing gaps in member protection and the threat this poses to pension savings.

²⁸ The Pensions Regulator: 'DC Trust: a presentation of scheme returns 2016/17'.

Option 1- Retain the existing provisions for minimal protections of Master Trust members' savings within the Pension Schemes Act 2017 and voluntary process for assurance by independent audit (MTAF).

Prohibition measure

54. The 2017 Act has introduced a prohibition on trustees from increasing charge levels, or imposing new charges on members or charging members for a transfer when a Master Trust leaves the market. There is also a prohibition on the trustees of a Master Trust which receives a bulk transfer of members from a failing Master Trust from passing on to members the costs from the failing Master Trust or charging members for the transfer.
55. The intention is that the money to pay for these activities will instead be met through access to funding or capital which will, if the Act is implemented, need to be held in accordance with the new financial sustainability requirements in the regulations. When the Act became law, the prohibition measure applied to Master Trusts experiencing a triggering event going forward but also retrospectively to those Master Trusts that had experienced a triggering event on or after the date of introduction of the Bill on 20 October 2016. This measure was intended to mitigate against the significant risks that introduction of the Bill could trigger departures from the Master Trust market of those schemes that would not intend to seek, or would not expect to achieve, authorisation.
56. If option 1 were followed, this prohibition measure would continue to have effect, but there would continue to be no requirement for Master Trusts to hold capital for the purpose of leaving the market. This would increase the chance of disorderly exits, as Master Trusts may not have the funds to pay for activities associated with winding up the scheme.
57. As the cost of wind up would vary across Master Trusts due to a range of factors, including the number of members in the scheme, the assets under management and any existing funding strategies, it would be difficult to make robust assumptions about the impact of this measure.
58. Any Master Trusts winding-up during the appraisal period (voluntarily or as a result of not gaining authorisation) would not be able to increase charge levels on members to meet the cost of winding up.
59. The prohibition affects where schemes, and the funders standing behind the schemes, can take or find the money to pay for additional costs in relation to winding up and other costs following a triggering event. Once the authorisation regime comes into force, intended to be in October 2018, the capital to be held as a part of the financial sustainability requirement is designed to be used for

wind up costs. This should mean that a scheme will have the capital required to wind up if it needs to, and would not need to pass this cost on to members once the regime is in place.

60. This may incur costs to the scheme funder or the scheme in the transitional period. The prohibition itself does not require schemes to wind up, the trustees of the Master Trust will have a choice as to whether they will wind up the scheme or not. In these cases it is reasonable to assume that those who choose to wind up would only do so if the benefits covered the costs of wind up, and therefore we estimate zero direct impact. There will be an indirect cost to business of the revenue that is lost by not being able to raise charges on members for the Master Trusts that choose to wind-up during this period. Any loss to business as a result of this measure results in a corresponding indirect benefit to consumers who will no longer see their charges increased. In other cases (see wind up section), there will be a cost of wind-up, but not as a result of the prohibition measure. This measure will also represent a saving to individuals as a scheme will not be able to increase charges against them or level new charges while winding up the scheme.
61. The impact of this measure will be that a Master Trust cannot pass the cost of wind up onto their members, potentially increasing the cost to the Master Trust while lessening the burden on individuals. It is difficult to anticipate the extent to which a Master Trust that, in the absence of this measure, would have passed some or all of the cost of a wind up on to its members, but we have assumed that all if not a significant proportion would have done so. Preventing this detriment to members is one of the primary purposes of the 2017 Act.
62. The introduction of this measure may in itself have changed some of the market dynamics, but given the very small number of schemes that are currently planning to, or are in the process of, winding up, it is not possible to disaggregate those that are doing so in reaction to the 2017 Act and those that would have done so anyhow. Information is not available on the extent to which these schemes or any that may wind up in the appraisal period would have been likely to increase charge levels to meet the cost of transferring members out of the scheme and exiting the market.
63. The prohibition measure does not prevent Master Trusts from introducing or increasing charges on employers. We do not currently have any information, however, that suggests that any Master Trusts have increased or introduced employer charges as a result of this measure, or intend to do so in the future as a result of authorisation.
64. Another transitional requirement of the 2017 Act means that any scheme wishing to wind up after introduction will have to notify the Regulator of their intent to leave the market and provide a schedule of the charges in

relation to members so they can be supervised accordingly to ensure that members' interests are protected.

65. Under option 1, where the provisions of the 2017 Act remain in place but the authorisation regime is not commenced, Master Trusts will have to follow the current process following a triggering event, which includes:
 - a. notifying the Regulator that there has been a triggering event;
 - b. providing the Regulator with a schedule of administration charges, for the purpose of ensuring compliance with the prohibition measure;
 - c. capping charges at the level specified in the schedule.
66. Intelligence supplied by the Regulator suggests that six triggering events have occurred since the prohibition measure commenced. These are largely due to schemes choosing to exit the market, at which point the scheme was required to notify the Regulator of their decision to wind up, as this constitutes a triggering event.
67. We have assumed that 28 Master Trusts will experience a triggering event during the period between the provisions of the 2017 Act came into effect (2016) and when the market is expected to reach a steady state (2018), as they will take the decision to wind up their schemes (17 that would wind up anyway and 11 that will choose to wind up once the full requirements of the authorisation regime are known). The three Master Trusts that will apply but not be authorised will submit their applications after 1 October 2018 and will, therefore, have to follow another process.
68. The Regulator will not require providers to send any more than a short email to inform them of the decision to exit the market. For these 28 Master Trusts we have assumed that, as with significant events, one member of staff will spend 30 minutes drafting and sending an email to the Regulator to notify them of the occurrence of a triggering event.
69. Until the full regime is commenced, a provision in the 2017 Act places the responsibility on the scheme funder for meeting any costs of a wind up, that cannot be met otherwise. This will not be an additional burden as the level of costs that might need to be met would be unchanged, however the 2017 Act makes explicit that these costs must fall on the scheme funder and not the members. Once the full authorisation regime is in place this explicit requirement does not apply, as the scheme will have demonstrated how it would meet such costs as part of the Regulator's assessment that it is a financially sustainable scheme (one of the authorisation criteria).

28 triggering events x 30/60 time taken to notify the Regulator x £25.08 wage rate = £350

70. As the scheme should already have the information required to produce a schedule of administration charges, we expect that this requirement will necessitate one member of staff spending two hours refreshing the information and sending it to the Regulator.

28 triggering events x 120/60 time taken to produce a charges schedule x £25.08 wage rate = £1,400

71. Any lost revenue due to a scheme not being able to increase member charges during this time would be dependent on the scheme's choice to increase charges in that year under the counterfactual. Due to the strong competition in the Master Trust market, we do not believe that this is likely to happen on such a scale that would warrant attempting to calculate it here.
72. In every year from 2018/9 we have assumed that there will be three triggering events per year. This will be due to some further schemes leaving the market and some schemes experiencing events that they are required to notify the Regulator of. Without the further powers afforded to the Regulator by the authorisation regime, it will not be able to effectively manage these risks in order to prevent a disorderly exit from the market.
73. The cost of a triggering event will be the same as in previous years, although the number occurring has reduced.

3 triggering events per year x 30/60 time taken to notify the Regulator x £25.08 wage rate = £38

3 triggering events per year x 120/60 time taken to prepare charges schedule x £25.08 wage rate = £150

74. The cost to business as a result of this measure is £188 in the fourth and each subsequent year of the appraisal period.
75. In respect of the 17 Master Trusts that would have exited the market under the counterfactual (see figure 2), as they would leave the market regardless of the extra burden placed on them by the authorisation regime, we believe that there is no direct cost to business.

Familiarisation

76. We have assumed that all schemes will have familiarised themselves with the primary legislation, consisting of both the general requirements for authorisation, and the specific prohibition requirement. It is estimated that this is a one-off cost and will take a trustee for each of the 87 Master Trusts around 4.5 hours of work to read and digest somewhere in the region of 40 pages of information, based on the average reading speed of around 300 words per minute. We have used the wage assumption explained in para 46e.

Familiarisation with primary legislation

87 Master Trusts x 4.5 hours spent familiarising x £25.08 wage rate = £9,800

Direct costs and benefits to business (O130)

77. The equivalised annual net direct costs to business (EANDCB) of option 1 are estimated at £0.01m under the current best estimate of the costs imposed by the requirements set out in the 2017 Act. These are assessed over a 10 year period from 2016/17.

Option 2: Introduce new compulsory authorisation process

78. The costs in the following sections refer only to the existing 87 Master Trusts, impacts on any new Master Trusts are covered in a later section, as referenced earlier, we have assumed that 59 Master Trusts will apply for authorisation and 56 will be authorised.

Figure 4: Assumed year of impacts

Year	2016/17	2017/18	2018/19	2019/20-2025/26
Appraisal period year	1	2	3	4-10
Event	Bill introduced Oct 2016	Regulations laid	Authorisation Regime comes into force 1 Oct 2018	Steady state market
Number of Master Trusts in the market	87	70	56	60 (56 existing and four new entrants)
Cost	Familiarisation with primary legislation Triggering events - transition	Familiarisation with secondary legislation and guidance Triggering events	Application fee Cost to the Regulator Fit and proper persons Business Plan Scheme funder Systems and processes Continuity strategy Wind up costs Triggering events	Cost to the Regulator Financial sustainability Triggering events New Master Trusts
Benefit		Fraud compensation levy		Fraud compensation levy

Prohibition measure

79. As with option 1 above, the prohibition on trustees from increasing charge levels, or imposing new charges on members or charging members for a transfer when a Master Trust leaves the market will remain in place until the authorisation regime is commenced, intended to be on October 1st 2018. There is also a prohibition on the trustees of a Master Trust which receives a bulk transfer of members from a failing Master Trust from passing on to members the costs from the failing Master Trust or charging members for the transfer.

Additional Familiarisation Costs

80. In addition, when the policy is implemented, the remaining 70 Master Trusts we assume are interested in applying for authorisation will need further (one-off) familiarisation of the exact requirements for authorisation as set out in the secondary legislation. On average this is assumed to take a further four hours of work for three people who operate each Master Trust, based on reading approximately 35 pages of information at an average speed.

70 Master Trusts (excluding those that would leave under the counterfactual)
x 4 hours spent familiarising x 3 people at each Master Trust x £25.08 =
£21,000

81. It is possible that Master Trusts may want to seek legal advice on the how the scheme can meet the requirements set out in the Regulations. This is optional however, and we do not consider it to be a direct cost to business. The cost of seeking legal advice will depend on whether the scheme has in-house counsel or not.
82. The total cost of familiarisation is estimated to be **£9,800** in the first year of the appraisal period (the same as Option 1) and **£21,100** in the second year of the appraisal period.

Preparing an application

83. When a Master Trust makes an application for authorisation, they will have to:
- a. prepare and submit the relevant products and information to support their application which will be considered by the Regulator.
 - b. pay an application fee to the Regulator to cover the cost of assessing and processing the application.
84. There is a requirement to provide a number of pieces of information to support the application as specified in the 2017 Act. These include the scheme's latest accounts, the latest accounts of each scheme funder, the scheme's business plan and the scheme's continuity strategy. Regulations will specify other information to be included in the application and the application fee payable to the Regulator. The Regulator can consider further information after the point of application but is not compelled to do so.

85. The exact amount of the application fee has now been agreed and will take the following approach:
 - a. a flat fee for new Master Trust schemes;
 - b. a flat fee for transitional Master Trust schemes.
86. Two fees have been chosen because it is expected that, on average, the work involved in processing an existing Master Trust application will be substantially higher than processing a new application, requiring a higher fee. The reasoning for this includes, for example, the Regulator's intention to have higher engagement with existing Master Trust schemes, reflecting market risk, known issues and the greater likelihood of additional information being required during the processing window.
87. Some Master Trusts or their funders may have to identify where the funds to cover the application fee will come from. This may require a professional who is familiar with the finances of the scheme and has an understanding of the payment process to the Regulator. Based on intelligence from the Regulator we have estimated that this professional will take a maximum of six hours to carry out this task, we therefore assume that the average time taken is 3 hours, at an hourly rate of £25.08 as above. This results in a cost of £75 for each of the 59 Master Trusts applying, and a total cost of £4,400 in the third year of the appraisal period only.
88. For existing Master Trusts, the Regulator will set the application fee at £41,000 per scheme.²⁹ Based on this, the cost for these 59 Master Trusts would be £2,419,000 in the third year of the appraisal period.
89. The authorisation fee for Master Trusts established after the introduction of the authorisation regime which is intended to be on 1 October 2018 (also known as "new Master Trusts") will be charged £23,000, this will be fully costed in the 'new Master Trusts' section below.
90. The total cost of this part of the policy, for existing Master Trusts who choose to seek authorisation, is estimated to be **£2,423,500**³⁰.

Fit and proper persons

²⁹ It is not certain exactly which schemes will apply for authorisation, we have had to make a judgement at this stage based on the Regulator's information of the number of members in these schemes and how many will apply.

³⁰ This figure includes NEST in the calculations – although NEST is out of scope in the final figures.

91. As a part of their application for authorisation by the Regulator, certain people who hold a position of responsibility at the Master Trust will have to meet the fit and proper person's requirement. This requirement consists of three tests. All relevant individuals will have to supply their personal information to the Regulator for an integrity test and conduct test.³¹ Furthermore, some people in key positions at the Master Trust could be subject to a competency test, namely the trustees and scheme strategist. One person could occupy more than one of these roles or more than one person could occupy a single role.

Integrity and conduct tests

92. This requirement is expected to be self-certifying in the first instance, with the Regulator verifying the information received through further checks. This will mean each relevant person filling out an application form which will be collated by the scheme when the application is submitted. This form will allow the Regulator to check:
- a. bankruptcy (both individual and whether they have been involved in managerial decisions of a company which has become insolvent, gone into liquidation or administration.
 - b. criminal records
 - c. appropriateness for being a trustee - whether pensions or otherwise (e.g. charitable trust) - and including any disqualification from being a Director.
 - d. any adverse finding or any settlement in civil proceedings, particularly in connection with investment or other financial misconduct.
 - e. any contravention of the rules of any other regulatory authority
 - f. any other relevant information available from other regulators
93. We have estimated that sixteen people at each Master Trust will have to complete the integrity and conduct tests.³²

³¹ The roles included in the need to complete a fit and proper person test may include; a person who establishes the scheme, a trustee, any person who has the power to appoint or remove a trustee, a person who has the power to vary the terms of the trust under which the scheme is established, a person who has the power to vary the scheme, a scheme funder, a scheme strategist and anyone else specified in the reg.

³² This consists of; one person who establishes the scheme, five trustees, two people who have the power to appoint or remove a trustee, two people who have the power to vary the terms of the trust,

94. The FCA has a fit and proper test for those carrying out a 'senior managers' function within the scope of their authorisation regime. In the cost benefit analysis³³ for this change, they estimated that each individual that would need to be checked would spend 45 minutes preparing their information. As there are additional elements to FCA's tests compared with the Regulator, we have, therefore, assumed that for the Regulator's tests individuals will spend 30 minutes collecting the required information.
95. At a wage rate of £25.08 as stipulated above the total cost to business is:

16 people at each Master Trust x 30/60 time to collect information x £25.08
wage rate x 59 Master Trusts completing applications = **£11,800**

Competency tests

96. Master Trust trustees and scheme strategists will need to complete a competency test. In the case of trustees, this will check that they have a basic level of knowledge of pensions in general and, where appropriate, understand what is involved in being the trustee of a scheme.
97. Informal consultations with industry have suggested that the trustees would often perform the role of scheme strategist. We have accordingly estimated that six people at each of the 59 Master Trusts that apply will have to complete this test (five trustees and one strategist), to also account for the fact that some schemes will not have trustees performing the role of scheme strategist. Consequently, a total of 354 people will need to take the competency test.
98. Trustees are already required to complete the Trustee Knowledge and Understanding (TKU) through the Trustee Toolkit within six months of taking a job as a trustee. The competency test is expected to require a similar level of knowledge to the TKU, the main difference being that the trustees will need to have this level of knowledge upon application rather than within six months.
99. There is no current knowledge requirement for scheme strategists, so they may have to spend time understanding what is required and learning

two people who have the power to vary the scheme, two people who are the scheme funder, and two people who are the scheme strategist.

³³ <https://www.fca.org.uk/publication/research/cba-extension-senior-managers-certification-regime.pdf>

the information for the tests to be completed before the point of application.

100. The Regulator's 2016 governance survey of schemes found that 75% of trustees of Master Trust schemes had adequate levels of knowledge and understanding.³⁴ We accordingly assume that 75% of trustees will be able to complete the competency test with no extra work, and that 25% will need to spend time studying to pass the test.
101. All insurance firms that service Master Trusts are subject to fit and proper requirements as set out in the Prudential Regulation Authority's and FCA's rules, and several of the senior staff in the Master Trust structure may already have fit and proper checks carried out on a regular basis by their firm. This may lessen the burden for these firms as the evidence that these individuals meet the fit and proper requirement may be readily available. We assume, therefore, that the Regulator governance survey results for trustee knowledge levels also applies to scheme strategists who are not also trustees.
102. We have assumed that 75% (266) of these trustees and strategists will not need any further preparation, and 25% (88) of them will need to do a large amount. Each of the 354 people will also need to spend time completing the tests; the TKU suggests that the tests will take 165 minutes to complete, so we have assumed at this stage that the competence tests will take the same amount of time, in the absence of any evidence to suggest that the tests will be materially different at this stage.
103. For the 88 people who need to complete further work, we believe that they would take 18 hours to familiarise themselves with all areas of the competency test.

For prepared trustees and scheme strategists

266 trustees and scheme strategists completing these tests x 165/60 time
taken to complete the tests x £25.08 wage rate = **£18,300**

For unprepared trustees and scheme strategists

³⁴ TPR: 'Defined contribution trust-based pension schemes research', July 2016.
<http://www.thepensionsregulator.gov.uk/docs/dc-research-summary-report-2016.pdf>

88 trustees and scheme strategists completing these tests x (1080+165)/60
time taken to prepare for and complete the tests x £25.08 wage rate = **£45,800**

104. We also expect the trustee board as a whole to be able to show how they have appropriate expertise to fulfil the functions and they have met these requirements. We expect this test to be based on the information given in the annual Chair's Statement³⁵ and for evidence to be placed in the supervisory return to make clear that the Board maintained its competence. As a result, we do not expect any additional burden as a result of the new regime.
105. The Regulator will use its discretion when deciding whether an individual meets the fit and proper requirement. It is possible that someone might not meet this requirement and will need to be replaced. Evidence suggests, however, that few people fail the FCA's Approved Persons Regime.³⁶ We do not therefore believe that there will be a significant failure rate for the Regulator's fit and proper tests, given the relatively low number of people that will be checked in this policy option compared to under FCA's regime. In addition, the Regulator's Code of Practice will make clear what checks will take place in an attempt to dissuade inappropriate people from taking up or continuing in a position running a Master Trust.
106. Only the trustees and scheme strategist will have to complete competency tests. The one-off cost to business in the third year of the appraisal period as a result of this measure is estimated to be **£76,000**.

Financial sustainability

107. The financial sustainability requirement includes two parts:
- a. requiring a scheme to have an adequate business plan; and

³⁵ Trustees have to provide an annual Chair's statement and this includes information setting out how they will meet the ongoing Trustee knowledge and understanding requirements requirement in the coming year:

"Describe how the requirements of sections 247 and 248 of the 2004 Act (requirements for knowledge and understanding) have been met during the scheme year and explain how the combined knowledge and understanding of the trustees or managers, together with the advice which is available to them, enables them properly to exercise their functions as trustees or managers of the scheme."

³⁶ <http://uk.reuters.com/article/uk-fca-appointments-idUKBRE93B06P20130412>.

- b. requiring a scheme to hold financial resources in sufficiently liquid assets to cover certain costs;

Business plan requirement

- 108. The requirement stipulates that schemes must have a sound business strategy. This will be judged by the Regulator using the business plan, which will contain key information about the finances of the scheme, their objectives, target market, and the assumptions that underpin these estimates.
- 109. The Regulator will use the business plan along with the scheme and scheme funder's accounts, and any other financial statements provided by the scheme funder to determine whether the scheme is realistic in its strategy going forward.
- 110. According to the Regulator's DC trust-based pension schemes research, 100% of Master Trusts with in-house administration refresh their business continuity plan annually; whereas 82% of schemes who use an external administrator refresh it annually, and 18% refresh it every 3 years. This informal survey included responses representing half of the number of Master Trust schemes.
- 111. 45 Master Trusts responded to the survey question asking how often they refresh their business plan. We have assumed that these percentages will be the same for the 59 Master Trusts that will apply for authorisation.

112. The 82% of Master Trusts who refresh their business plan annually may have to make changes to their business plans in the first year to meet the specific requirements set by the Regulator.
113. Where a scheme refreshes their business plan every three years the scheme strategist will be required to review it every year and revise it if there are significant changes in the information. The business plan needs to be approved by any other scheme strategist, the trustees and the scheme funders.
114. A requirement under the regulations is for the scheme to calculate the amount of capital to be reserved in the business plan. Schemes will have to spend time assessing this and adding it to their business plan, which will be a new activity for some schemes.
115. We have estimated that 49 (82%) of the schemes that apply will incur a lower level of cost to update their business plan and have it approved by the scheme funder as they already update their business plan annually. 10 (18%) Master Trusts will incur a higher level of cost as they will have to make more substantial changes to the business plan before it is approved by the scheme funder.
116. For the 49 Master Trusts that will have to make minor changes to their business plans, we have assumed at this stage that two people will spend 18 hours each working together on the business plan. They will then gain approval from the scheme funder.
117. For the 10 Master Trusts that make more substantial changes, we have assumed that three people will need to spend 45 hours each to update the business plan, followed by gaining approval from the scheme funder, or if they don't have a funder, the trustees will approve the business plan.
118. As a scheme strategist could take a number of different forms or could be a business comprising a varying number of people, we have assumed at this stage that five trustees³⁷ will approve the business plan. Two Master Trusts said that this would be the case for their scheme during informal consultations, but it is possible that more or fewer people would be involved in approving the business plan.

³⁷ Several scheme's publicly available annual report and accounts show that they have five trustees; we have assumed that this is the same for all Master Trusts at this stage.

119. At this stage we have assumed that it will take the five trustees two hours to approve the business plan. This is dependent, however, on whether they are content with the business plan straight away or they suggest further revisions.
120. The total estimate of the costs to business for the amendment and the approvals of the business plan are:

Small change to the business plan

49 Master Trusts x ((2 people required to update the business plan x 18 hours taken to update the business plan) + (5 people required to approve the business plan x 2 hours taken to clear the business plan)) x £25.08 wage rate =
£56,500

Large change to the business plan

10 Master Trusts x ((3 people required to update the business plan x 45 hours taken to update the business plan) + (5 people required to approve the business plan x 2 hours taken to clear the business plan)) x £25.08 wage rate =
£36,400

121. The cost to business in the first year as a result of this measure is estimated to be **£92,900**, in 2018/19 only.
122. There were no responses from consultation that suggested this should be changed.

Financial resources to be held in liquid assets

123. This measure will require Master Trusts to hold, or have access to financial resources in sufficiently liquid assets to cover:
- set up and running costs³⁸;
 - the cost of discharging the activities arising from the legal duties set out in the continuity strategy if the scheme experiences a triggering

³⁸ Set up costs will only apply to Master Trusts applying for authorisation after the regime has come into force, whereas the scheme will need to prove that they have enough capital to continue operating if they are not currently breaking even, and to cover future capital expenditure. Master Trusts will not necessarily have to keep any capital aside for these costs.

event that puts its future at risk. For most schemes the worst case scenario could mean transferring all members out and winding up the scheme in the event of the scheme choosing to leave the market, or if authorisation is withdrawn by the Regulator;

- c. following a triggering event the cost of running the scheme on for a period of at least six months and up to 24 months at the Regulator's discretion. Schemes will provide an estimate of what they think is appropriate, with at least six months running costs to be accessible, to be considered by the Regulator before a decision is made.

- 124. It is expected that if a scheme is not operating at a net profit, the gap between revenue and expenditure will be met by the scheme funder, who should have the resources to continue funding the scheme. This could also be met by a loan, if there is no scheme funder present. If the scheme is operating with a net profit they should make this clear to the Regulator, and show how they are planning to continue to be able to pay for running costs and capital expenditure into the future.³⁹
- 125. Schemes will have to spend time assessing the on-going cost of running the scheme, the estimated cost of transferring all members from the scheme, and how much capital they think they will require for running the scheme on in the case of a triggering event.
- 126. The Master Trust authorisation regime has the flexibility to accommodate a wide range of financing arrangements. We are considering consulting on a proposal for schemes that offer money purchase benefits, in conjunction with other benefits. These are DB schemes that have opened a money purchase section and fall within the definition of a Master Trust. They are generally not for profit, operate within the third sector and were established before the legislation comes into force.
- 127. These schemes have a legally enforceable guarantee from their employers to meet the specified costs where the scheme is not generating enough income from administration charges to cover those costs. These schemes would meet the financial sustainability requirement on the strength of a prospective commitment for funds from the participating employers should the scheme experience a triggering event and typically will not have immediate access to alternative sources of capital.
- 128. To protect continuity of saving and to avoid undermining employers' ability to meet the statutory funding requirements for the defined benefits, in the

³⁹ Due to the long-term nature of pension saving, schemes are likely to incur high set up costs when the scheme is established, and initially operate at a net loss until pot sizes have grown enough that the charges on members' pots are greater than the running costs of the scheme.

event of a triggering event, schemes may only be able to rely on the employers financial guarantee up to a maximum specified percentage of the total estimated capital requirement. The balance will need to be secured by some upfront financing with the possibility of topping up the reserves to the level required for financial sustainability over a period of time agreed with the Regulator. This balances a future commitment from employers with the requirement for schemes to have access to realisable assets to meet the costs arising from the activities to discharge the duties in their continuity strategy as they fall due.

129. Each scheme will have to hold or be able to access a different amount of money for the financial sustainability requirement, which will be heavily dependent on a variety of factors. Some of the factors that need to be considered include; the number of members in the scheme, the amount of assets under management, the quality of data, whether the scheme uses a third party administrator or carries out administration in-house, and the net profit/loss position of the scheme.
130. We have used the number of members within schemes to calculate an indicative range and based the cost estimate on the average number of members in the Master Trust.
131. **Largest Master Trusts:** The five largest schemes (by number of members) contain significantly more members than the others, so we have calculated the amount needed to be kept back by them separately. As this contains some commercially sensitive information, it will be available in an addendum to the Regulatory Policy Committee if required for scrutiny, and when the final stage Impact Assessment is submitted. We estimate that these Master Trusts will have to hold in the region of £265m between them in liquid assets where they would not have been required to before. Approximately £145m of this would have been invested in illiquid assets in the counterfactual and will therefore experience lower returns as a result of this policy.
132. **Smaller Master Trusts:** The remaining schemes have an average of 13,000 members each.⁴⁰ For the amount to be allocated for the cost of transferring members out of the scheme, we have used the (unpublished) Sackers report into winding up a DC scheme. The Regulator has adapted these figures as Master Trust schemes have more members and more employers on average than single employer DC schemes so would be

⁴⁰ Information Supplied by the Pensions Regulator

expected to have a different cost profile. Figure 6 shows the estimated average wind-up costs of these Master Trusts.

Figure 6: Estimated wind up costs for Master Trusts⁴¹

Activity	Lower bound	Central estimate	Upper bound
Project planning/project management throughout winding up	£15,000	£22,500	£30,000
Legal advice limited issues relating to going into winding up, triggering winding up, deed of amendment etc.	£3,000	£4,000	£5,000
Investment advice (review of existing options, providers for buy-out policy etc.)	£7,500	£11,300	£15,000
Data review/cleanse (including tracing)	£19,300	£41,800	£64,400
Communications (drafting, advice from lawyers and investment advisers)	£7,500	£11,300	£15,000
Communications (printing and postage – per communication exercise)	£9,700	£14,500	£19,300
Provider terms/arrangements for transferring/turning assets into cash (including investment and legal advice)	£5,000	£7,500	£10,000
Administration (answering member queries and implementing member choices/default)	£19,300	£25,700	£32,200
Completing wind-up formalities	£1,000	£1,500	£2,000
Final report and accounts	£2,000	£3,000	£4,000
Total	£89,300	£143,100	£196,900

133. We have assumed that only the Master Trusts that become authorised will continue to hold the capital, and therefore causing the ongoing opportunity cost. Of the 56 who will incur this cost, 51 are included in the group of smaller schemes, and 5 are the Master Trusts with the most members. Of the smaller group, as per the grouping system mentioned in key assumptions, 10 will incur a high level of cost and 41 will incur a low level.

134. In this case we have chosen the ‘best estimate’ to reflect the low cost schemes and the ‘upper bound’ to illustrate the cost to the high-cost

⁴¹ This table takes evidence from the (unpublished) Sackers wind up report that details estimates of wind up costs for a small or medium DC scheme, as the average Master Trust is significantly larger than a small or medium DC scheme, the Regulator has adjusted costs based on their knowledge of Master Trust schemes. This is the best available information, and any further analysis would involve asking schemes about costs that they may incur if they were to wind up, which schemes are not likely to know at present.

schemes. 41 schemes will therefore keep £143,100 each and 10 will have to hold £196,900 in liquid assets each.

135. For the capital to be kept in the case of running the scheme on for a minimum of 6 months and up to a maximum of 24 months at the Regulator's discretion, we have estimated the running cost of a Master Trust with 13,000 members based on information from three different sized Master Trusts.⁴² Based on this, we estimate that the approximate average running cost for a Master Trust for one year to be £409,500, comprising £195,000 professional costs, and £214,500 administrative costs.
136. These estimates carry with them a significant degree of uncertainty, as the running costs of a scheme depend heavily on a number of different factors, such as whether the scheme uses a third party administrator, or does the work in-house, and scale.
137. We assume that the low cost group has to keep 9 months' worth of running costs (an average of 6 and 12 months) and that the high cost group will have to keep 21 months' worth of running costs (an average of 18 and 24 months), which amounts to £307,100 and £716,600 respectively.
138. Added to the wind up amount to be held, a scheme will have to hold between £450,200 and £913,475. These estimates are heavily dependent on the specific requirements set by the Regulator.
139. In total we estimate that the 51 smaller Master Trusts will have to hold £27,592,400 in liquid assets, of which 55% will have to be moved from illiquid to liquid assets. This means they will get lower returns on £15,160,600, compared against the counterfactual. In total for all 56 authorised Master Trusts we estimate that £268,789,500 will have to be held in liquid assets throughout the appraisal period.
140. As regulations specify that the Regulator must be satisfied that the scheme meets the financial sustainability requirement, it is possible that the Regulator may come to a different conclusion as to how much a scheme needs to keep back when they are considering an application. As we will not know the exact amount until the Regulator has assessed all applications there is likely to be a degree of variation in the final impact of this measure. For this reason we have conducted sensitivity analysis to

⁴² Information provided by TPR

provide an example of how the costs of this measure may differ from the estimates included here.

141. Master Trusts will be able to invest the capital required to be kept aside, albeit in sufficiently liquid assets that are realisable within a period to be specified at a later date. This means that the cost to business of this measure is the opportunity cost of the investment returns that a scheme could have obtained if their asset allocation was not restricted, rather than the amount of capital required.
142. We have used the 2017 UK pension scheme asset allocation⁴³ to show how schemes hold assets under the baseline, and then excluded some assets which we believe may not be sufficiently liquid to be held as part of the financial sustainability requirement. As we know the current allocation of investments for pension schemes, we have assumed that this allocation would remain unchanged under the counterfactual scenario. By doing this we can estimate the value of capital that will be affected by this requirement, and will possibly experience reduced returns compared to the counterfactual.
143. This has been calculated from 2019/20, with compound interest being added in each financial year. Because Master trusts will need to demonstrate that they hold this capital as a part of their application for authorisation, and their application must be made within six months of the commencement of the regime (intended to be 1 October 2018), we have assumed that these costs will start in the fourth year of the appraisal period. This calculation assumes that all schemes that need to keep capital aside as a part of the financial sustainability requirement will not exit the market within the appraisal period once they have been authorised. We believe this is appropriate as by going through authorisation, the scheme will be incurring additional burden and will therefore wish to remain in the market in the medium term.
144. A full explanation of the assets which have been selected as liquid and illiquid has been included in Annex A. The difference in average return between the liquid and illiquid asset allocations that we have chosen for this assessment is 0.83%.⁴⁴
145. It is possible that the Regulator will not require all assets to be kept in liquid investments, certain Master Trusts may have guarantees that the Regulator could take into account when considering the financial

⁴³ UBS: 'Pension fund indicators', January 2017. https://www.ubs.com/uk/en/asset_management/institutional/publications.html

⁴⁴ UBS: 'Pension fund indicators', January 2017. https://www.ubs.com/uk/en/asset_management/institutional/publications.html

sustainability requirement. In addition, some of the permitted assets may be those which would be kept by the Master Trust under the counterfactual. Annex A details that currently 55% of pension scheme assets would be kept in assets that would not meet the capital requirement. We, therefore, assume that 45% of the capital that may be required to be held is already held in liquid assets. Therefore the amount of capital affected by this requirement is 55% x £293= £161m, so the cost to business is calculated as the estimated lower returns on £161m capital.

146. These costs will first occur in 2019/20 as Master Trust schemes will not be authorised until this year.

Figure 7: Cost of the financial sustainability requirement (including NEST), £m

Year	Cumulative investment returns under the authorisation regime	Cumulative investment returns under the counterfactual	Opportunity cost
2020/21	£9.8	£11.0	£1.2
2021/22	£20.2	£22.7	£2.5
2022/23	£30.4	£34.2	£3.8
2023/24	£41.2	£46.5	£5.3
2024/25	£52.7	£59.7	£7.0
2025/26	£65.0	£73.9	£8.9
2026/27	£78.1	£89.1	£11.0
Total			£39.7

Figure 8: Cost of the financial sustainability requirement (excluding NEST), £m⁴⁵

Year	Cumulative investment returns under the authorisation regime	Cumulative investment returns under the counterfactual	Opportunity cost
2020/21	£3.9	£4.4	£0.5
2021/22	£8.1	£9.0	£0.9
2022/23	£11.6	£12.8	£1.3
2023/24	£15.3	£16.9	£1.7
2024/25	£19.2	£21.4	£2.1
2025/26	£23.4	£26.1	£2.6
2026/27	£27.9	£31.1	£3.2
Total			£12.3

⁴⁵ On the advice of the Better Regulation Executive, we have excluded NEST from the overall calculation of the cost to business, but have still estimated the impact on the National Employment Savings Trust.

147. Part of the burden of the capital requirement will not just be how the money could be used if not required to be held in liquid assets by the Regulator, but how challenging it is for the scheme to raise the funds to be held in sufficiently liquid assets. Below is a table of responses from a sample of Master Trusts which have indicated how they plan to raise the capital for the financial sustainability requirement.

Figure 9: Method of raising capital by proportion of members and total schemes

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Indicated source of financial sustainability reserving	Proportion of members	Proportion of Master Trust schemes
Provider reserves	46.3%	68.4%
From members	0.0%	5.3%
Scheme reserves	0.4%	15.6%
Scheme income	0.3%	5.3%
Government loan	52.9%	5.3%
Total	100.0%	100.0%

148. This requirement is to ensure that members' interests can be protected in the case of a triggering event or scheme failure while a suitable scheme can be found to transfer them in to, or while the triggering event can be addressed. Without this measure it is possible that a Master Trust would exit the market in a disorderly fashion, and not find an appropriate receiving scheme for their members. Members may then not be able to move their pension funds, and this money may not continue to be invested in such a way as to maximise financial return.

149. At present, approximately £5.7bn of assets under management are invested in schemes that do not have voluntary Assurance or are not insurer backed. Not requiring schemes to hold this capital could lead to them not being able to afford the costs of wind up and would increase the risk of a disorderly exit from the market. This could in turn lead to a loss of trust in pension saving, cause a risk to the over £16bn of assets saved into Master Trust pension schemes and damage the success of AE.

150. Further sensitivity analysis of this part of the authorisation regime has been conducted below, due to the significant burden that it could place on

⁴⁶ This represents answers from a small sample of Master Trust schemes who were asked this question during the Regulator's proactive engagement with the industry.

a Master Trust if they are required to hold more capital than estimated here.

151. There are significant long-term benefits to the scheme of having capital reserved in the case of a triggering event that may cause the Regulator to believe that the scheme is at risk. Having this capital set aside means that schemes are more likely to be stable, less likely to be unable to pay for resolving the triggering event (if they are opting for continuity option 2),⁴⁷ or being unable to cover their costs while looking to transfer all members out of the team.
152. The total cost to business (including NEST) as a result of both parts of the financial sustainability requirement rises from **£1,226,000** in the fourth year of the appraisal period to **£10,970,000** in year ten.

Scheme funder

153. The scheme funder requirement stipulates that the funder of a Master Trust scheme will have to submit their full audited accounts along with their application, and approve the business plan and continuity strategy of the scheme. These costs are included in the financial sustainability section of this Impact Assessment.
154. We believe that ten scheme funders might not have their accounts audited under the baseline, these scheme funders will have to have their accounts audited before they are sent to the Regulator. The former Department for Business, Innovation and Skills estimated the cost to business of an audit to be £7,700.⁴⁸ This has been updated to 2017/18 using data from the Office of National Statistics, the cost in 2017/18 prices is therefore £8,000.⁴⁹ The business would also have a professional spend four hours preparing the accounts, at an hourly rate of £25.08, also based on the former Department for Business Innovation and Skills' Impact Assessment

⁴⁷ When a Master Trust experiences an event that may have put the scheme at risk, they must notify the Regulator (if they have the choice) of which continuity option they intend to follow. Continuity option 1 is to transfer all members out of the scheme into another authorised Master Trust and wind up the scheme. Continuity option 2 is to try and resolve the triggering event, and continue operating the scheme.

⁴⁸ Department for Business, Innovation and Skills: 'Audit exemptions', March 2014.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/348795/bis-14-1059-revised-impact-assessment-on-reform-of-audit-exemptions-26-march-2014.pdf.

⁴⁹ Office for National Statistics: 'CPIH All Items Index: 2015=100', November 2017,
<https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/l522/mm23>.

155. Intelligence from the Regulator suggests that there would likely be less than ten scheme funders that would not already have had their accounts audited, where a scheme funder can be identified.

156. For the purposes of this assessment, however, we believe the cost to business of this measure is **£80,900**.

10 Master Trusts that have to audit their accounts x (£8,000 cost of audited accounts + £50.16 cost of preparing the accounts) = £80,900

157. Scheme funders that carry out activities not related to the Master Trust of which they are the funders will have to submit additional financial reports at application and thereafter on request from the Regulator as part of its risk-focussed supervision.

158. Some of the further information required to be sent to the Regulator may include:

- a. the reasons why the scheme funder wishes to be exempted from the requirement;
- b. a description of those activities of the scheme funder which do not relate directly to the Master Trust scheme;
- c. details of the legally enforceable financial support which the scheme funder will provide to the Master Trust scheme;
- d. the following financial information in respect of the scheme funder;
- e. actual turnover, gross margin, overheads and operating profit for the previous 12 months;
- f. cash at bank for the previous 12 months, including any undrawn overdraft facility or revolving credit facility;
- g. forecast and actual profit and loss for the previous 12 months;
- h. budget for the year to date and any variation against that budget;
- i. cash resources;
- j. cash flow forecast for the following four quarters;
- k. operating costs;
- l. inter-company loans;
- m. any significant risks to which the scheme funder is exposed and its strategy for mitigating those risks;

159. This list was consulted on. The list of activities did not change as a result of this and so nothing has been altered in this area for the final impact

assessment. Clearly, the impact of providing such information will depend heavily on how much of this information the scheme funder already has available, and what will need to be created separately.

160. This cost is not expected to be large – for a sense of scale, if half of the funders (28) carry out other activities and each has to spend 18 hours collating the information at a wage cost of £25.08 per hour then this will cost **£12,600** in total.

Systems and processes

161. The systems and processes requirement of the authorisation regime seeks to enable the Regulator to decide whether it is satisfied that the systems and processes used in running the scheme are sufficient to ensure that it is run effectively.
162. The regulations will set out what the Regulator must take into account and are intended to give schemes clarity as to what “sufficient” systems and processes include.
163. The systems used in running the scheme include requirements such as :
- a. the type and functions of the IT systems used in running the scheme
 - b. standards that those IT systems must meet; and
 - c. the maintenance of those IT systems
164. The requirements for processes used in running the scheme include:
- a. records management;
 - b. risk management;
 - c. resource planning;
 - d. processes relating to transactions and investment decisions;
 - e. processes relating to the appointment and removal of trustees and their professional development;
 - f. processes relating to member communications.
165. Both systems and processes may contain overarching themes such as security and accuracy.
166. While the regulations will indicate what the Regulator will focus on when assessing the systems and processes requirement, they are not intended to duplicate requirements which already exist in previous pension legislation. For example, regulations already contain requirements around the number and type of trustees a scheme must have in place. These

regulations do not replicate this; they seek to establish that schemes have given consideration to what is needed to manage the processes around it effectively, including arrangements for making decisions if trustees are ill or unavailable.

167. These regulations do not mandate the use of certain IT systems and are about minimum standards rather than gold-plating. The expectation is that schemes will have the right systems and processes in place to deliver what is set out in their business plan. Intelligence from the Regulator's contact with schemes suggests that the main burden for many Master Trusts will be evidencing how they meet the requirements rather than implementing significant changes.
168. The Master Trust Assurance Framework and other third party assurance, accreditation or quality standards will not provide a "tick in the box" for satisfying the systems and processes requirements. However, schemes that meet these standards may already have collected a lot of the information which will need to be provided to the Regulator. We anticipate that some of the third party assurance schemes may, in light of the upcoming Master Trust authorisation regime, develop their standards to better align with what will be the requirements for authorisation. They will, therefore, provide a better route by which schemes can obtain independent advice on their readiness for authorisation and for the future to help maintain compliance with the authorisation criteria. Schemes that currently use such frameworks will do so for a variety of reasons and it is reasonable to assume that many will continue to do so.
169. While many Master Trusts may have begun the process of evidencing that they meet these requirements before the regulations come into force, intended to be in October 2018, we will consider it to be a direct cost to business in this Impact Assessment.
170. At this stage we have assumed that the cost of this requirement will be equivalent to the cost of gaining certification through the Master Trust Assurance Framework and making any changes necessary in order to be certified. One Master Trust indicated that it had cost them around £100,000 to pay the MTAF fee and make the required changes. We believe this to be at the higher end of the potential cost of this measure due to the size of the Master Trust, so have, therefore, considered a range of £50,000-£100,000 for Master Trusts that do not already have assurance (37). The mid-point (£75,000) is considered to be the best estimate at this stage.
171. Having assurance does not mean that the Master Trust will automatically meet the requirement and there may be further costs to the 22 schemes

already on the Framework. We are assuming that this cost will be around 10% of the cost for those who have not had assurance previously, though some may have to go further than this and some may not have any additional cost.

172. These standards, however, are thought to be the minimum required to ensure schemes are well run and protect members' interests. In order to be operating in the market, schemes should already be of a standard that should not be putting members at risk.
173. In addition to this we estimate that one person at each Master Trust will have to spend 27 hours each collecting this evidence and showing that the scheme meets the requirements. This represents our best estimate at this time, and further information will be sought during consultation. The overall cost to business is therefore calculated as:

Master Trusts with Assurance

22 Master Trusts with Assurance x ((£7,500 cost of demonstrating that the Master Trust meets the systems and processes requirement) + (27 hours taken to demonstrate this x £25.08 wage rate)) = £179,900

Master Trusts without Assurance

37 Master Trusts without Assurance x ((£75,000 cost of making changes and demonstrating that the Master Trust meets the systems and processes requirement) + (27 hours taken to demonstrate x £25.08 wage rate)) =
£2,800,100

174. The total cost for this measure is therefore between £2,000,000 and £3,960,000, with a best estimate of **£2,980,000** in the third year of the appraisal period only.

Continuity strategy

175. The continuity strategy is one of the components of the application which will have to be submitted to the Regulator. The regulations specify what schemes should focus on when completing the continuity strategy, principally:

- a. The level of charges in relation to members⁵⁰
 - b. How members' interests will be protected in the case of a triggering event
 - c. How communications with employers and members will be managed
 - d. Who is accountable for decision making
176. This is intended to detail how the Master Trust will ensure the continuity of savings for members in the case of a triggering event. It will also provide the Regulator with a record of member charge levels, so they can effectively enforce the prohibition on increasing charges on members in the case of a triggering event.
177. As with the business plan above, we have assumed that 49 of the schemes that apply will incur a lower level of cost to update their continuity strategy as they already update their business continuity plan annually. 10 Master Trusts will incur a higher level of cost as they will have to make more substantial changes to the plan.
178. All Master Trust schemes should have access to the level of member charges; the strategy should set out these charges in a format specified by the Regulator, and explain how members' interests will be protected.
179. With the Regulator's insight, we have estimated that it will take two people 9 hours for the 49 schemes that incur a low level of cost, and 18 hours to prepare the continuity strategy for the ten schemes that need to undertake more work. Further guidance on the content that may be included in the continuity strategy will be detailed in the Regulator's Code of Practice.

Low cost schemes

49 Master Trusts with lower cost x (9 people x 2 hours taken) x £25.08 =
£22,100

High cost schemes

10 Master Trusts with higher costs x (18 people x 2 hours taken) x £25.08 =
£9,000

⁵⁰ This requirement links to the restriction of schemes from being able to increase charges when the scheme is at risk, and will help the regulator provide oversight over this prohibition.

180. The total cost for all 59 existing Master Trust schemes will be **£31,100** in the third year of the appraisal period only.

Wind up costs

181. As outlined above, we estimate that 14 Master Trusts will leave the market as a result of the secondary legislation. This could be for several reasons; including that the Master Trust has weighed up the costs and benefits of remaining in the market under the new regime and decided to leave, that they initially apply for authorisation and then withdraw their application at a later date, or that the Regulator chooses not to authorise the Master Trust, causing it to wind up and exit the market.
182. While in some cases Master Trusts will make a conscious decision to leave based on the costs and benefits of remaining in the market, because these schemes would have remained in the market under the counterfactual, we believe that there is a direct cost to business for all of these schemes.
183. It is difficult to accurately estimate the scale of these costs; some of these schemes will exist as part of a larger business, and therefore might not incur some of the costs associated with closing a business. We expect that many of the Master Trusts choosing to leave would do so because they do not expect to reach appropriate scale in the medium/long term, and it would not be viable for them to take on the added burden of making changes associated with authorisation.
184. Although the Department for Work and Pensions does not hold information on whether each individual Master Trust scheme is making profit or not, current assumptions, based on intelligence provided by the Regulator, are that many are earning more from charge revenue than their ongoing costs. Some Master Trusts are established as not-for-profit organisations intended as a savings vehicle for members, and not as a commercial entity. For these reasons we do not believe that there will be a significant loss of profit as a result of the authorisation regime. Instead, we believe that the greatest cost to business will be where a Master Trust scheme decides, or is required to wind up. If a Master Trust is self-sustaining and meets all of the authorisation criteria it is likely they will be authorised by the Regulator.
185. We have assumed that all of the Master Trusts that leave the market would be of average size (13,000 members), when the five largest schemes are excluded, in the absence of better information at this time.

The costs will therefore be the same as the wind up costs required to be kept for the financial sustainability requirement. These were calculated by using the adjusted costs from the Sackers wind up report and detailed in figure 6 above.

186. The report estimates some of the costs involved in wind up (see financial sustainability section). These include activities such as data cleaning, answering member queries and project planning explicitly for small or medium size single employer schemes. These schemes, and therefore the estimates in the report, do not reflect Master Trusts specifically, and Master Trusts have many more members on average, so will incur higher costs in many aspects of wind up.
187. Master Trusts may benefit, however, from economies of scale in many aspects, and, as many Master Trusts have been created later than single employer schemes, are likely to have newer systems, which could in turn lower wind up costs.⁵¹ Therefore, the costs from the report have been adjusted by the Regulator to better reflect the make-up of Master Trusts.
188. We estimate that each of the 14 Master Trusts will therefore incur costs of between £89,300 and £196,900, with a total cost to business of £1,249,800 - £2,755,900, with a best estimate, assumed to be the mid-point, of **£2,002,900**.

New Master Trusts

189. Once the regime comes into force in October 2018, any Master Trusts set up after this date will not be able to take on any members until they have been authorised by the Regulator. It should be less complex for new Master Trusts to complete the application process as they can set it up in accordance with the requirements in the Regulator's Code of Practice, as they will not yet have any members.
190. Intelligence from the Regulator suggests that a new Master Trust may enter the market every 2-3 years after the commencement for the regime in the 3rd year of the policy, as the AE market stabilises. For the purpose of this assessment we have assumed that a new Master Trust will enter the market in the 4th year of the appraisal period, and every other year from then on.

⁵¹ Information provided by TPR, based on the set-up date of Master Trust schemes.

191. New Master Trusts may incur costs above that of the counterfactual scenario due to the requirements of the Master Trust Authorisation Regime. Some requirements may stipulate a minimum standard for activities that a scheme would carry out under the baseline, for example the systems and processes requirement, while others will require a scheme to do something that it might not otherwise have done, such as creating a continuity strategy.
192. We assume that Master Trusts established after 1 October 2018 will still have to familiarise with the exact requirements of the authorisation regime in order to meet the criteria. This means that three members of staff will spend four hours each familiarising, at an hourly rate of £25.08.

3 people who will need to familiarise x 4 hours spent familiarising x £25.08
wage rate = £300

193. These schemes will also have to pay an application fee to the Regulator, as they are expected to be easier to assess compared to existing Master Trusts that already have members in the scheme. The Regulator will set the application fee at £23,000. This will apply to all of the expected 4 Master Trusts that we assume will enter after the commencement of the regime.
194. People involved in running these schemes will need to meet the fit and proper criteria. We have consequently assumed that they will incur the same costs as all other Master Trusts in meeting this requirement, which is between £1,200 and £1,400, with a best estimate of £1,300.
195. Although new schemes will be required to keep a business plan, knowing the requirements in advance mean that the scheme will be able to create the plan, which we think they would have created anyway,⁵² with the specific requirements in mind. We therefore believe that they will incur the same cost as an existing Master Trust that has to make minor revisions to their business plan, £900.
196. Any new scheme will have to estimate the amount of capital required for its financial sustainability, based on the membership projections provided in the business plan and be able to access that capital. As we do not know how many members a new Master Trust may take on after AE has

⁵² The Pensions Regulator's governance survey shows that Master Trust schemes do regularly keep business plans without them being required.

fully rolled out, it is uncertain how much capital a new Master Trust may have to be able to access. For this reason, we have assumed that they will need the same amount as the low cost option for an existing Master Trust with 13,000 members, estimated to be £450,200.

197. This would be to cover the set-up and running costs of the scheme while it does not have sufficient revenue to cover costs, and to cover the costs of wind up if necessary, and to have the capital to run the scheme on for a minimum of 6 months and a maximum of 24 months at the Regulator’s discretion.
198. We have calculated the opportunity cost of holding this capital in liquid assets in the same way as the financial sustainability costs above, and estimate the cost to business to grow from £2,100 in year four to £42,200 in year ten of the appraisal period. This takes into account compound interest and the year in which each Master Trust enters the market.

Figure 10: Opportunity cost of the financial sustainability requirement

Year	Financial sustainability opportunity cost
1	£0
2	£0
3	£0
4	£2,100
5	£4,400
6	£9,100
7	£14,500
8	£22,600
9	£31,800
10	£44,200

199. Intelligence from the Regulator suggests that the businesses that have indicated their intention to set up a Master Trust after the introduction of the regime will already have their accounts audited. At this time we assume that they will already have their accounts audited, and there is no increased cost to business as a result of this measure.
200. While schemes will be able to set up their systems and processes with the exact requirements of the criteria in mind, they will still have to evidence that they meet these requirements. For this reason we have assumed that

the cost of making changes and evidencing the systems and processes requirement will cost between £50,000 and £100,000 per Master Trust, with the best estimate being £75,000.

201. For the continuity strategy requirement, although many schemes already refresh this annually, the legal requirement to do so in a specific format will create an added burden for new Master Trusts. This is assumed to be the lower bound of the cost that other Master Trusts will have to spend on changing the continuity strategy, or £450.

202. The total cost to business in each year for new Master Trusts is shown in figure 10 below.

Figure 11: Total cost to Master Trusts that are set up after the commencement of the regime

Year	Total cost
1	£0
2	£0
3	£0
4	£27,500
5	£4,400
6	£34,600
7	£14,500
8	£48,100
9	£31,800
10	£69,700

Triggering events and implementation strategies

203. Primary legislation specifies a list of incidents that are classified as triggering events, these include when:

- a. the Regulator issues a determination notice that a Master Trust either has not been authorised or that authorisation has been withdrawn;
- b. the scheme funder experiences an insolvency event, or becomes unlikely to continue as a going concern where they are unable to have an insolvency event;
- c. a scheme funder ends or decides to end the relationship with the Master Trust;
- d. the scheme funder, strategist or the trustees decide that the scheme should be wound up, where the person deciding has the power to do so under scheme rules;

- e. an event occurs that permits or requires the scheme to wind up, as specified by the scheme rules;
- f. the trustees decide that the scheme is at risk of failure and so it is necessary for one of the continuity options to be pursued.

Master Trusts following continuity option 1

204. As we assume that three Master Trusts will exit the market after applying for authorisation, they will be experiencing a triggering event after commencement of the authorisation regime, but before the market reaches a steady-state. As they experience a triggering event after the commencement of the regime they will have to follow a different process to Master Trusts that leave before commencement. They will, therefore, have to follow the processes for continuity option 1, and there will be a cost to each of the schemes in carrying out the responsibilities required during a triggering event period. These include:
- a. notifying the Regulator that there has been a triggering event;
 - b. creating an implementation strategy, and having it approved by the Regulator;
 - c. notifying all employers that the scheme has experienced a triggering event, and how they plan to transfer members out and wind up the scheme;
 - d. notifying all members of the choices available to them;
 - e. periodically reporting to the Regulator about the scheme's progress in addressing the triggering event.
205. These three Master Trusts will have to notify the Regulator of the occurrence of a triggering event, and spend time writing and clearing documents to send to members, employers and the Regulator.
206. The implementation strategy will need to be prepared by schemes that have a triggering event, and will be specific to the continuity option⁵³ that they have chosen, or are required to take due to Regulator action. Triggering events are not common within pension schemes, and have much greater consequences than significant events, which can happen as a part of regular business.

⁵³ In the case of a triggering event, a scheme will usually pick one of two continuity options, unless the Regulator specifies they must pursue continuity option 1. Continuity option 1 specifies that the scheme will transfer all members out to another scheme and wind up, continuity option 2 states that the scheme will take actions to resolve the triggering event.

207. The strategy has to set out how members' interests will be protected while the scheme winds up, and must also set out the levels of administration charges faced by members, in order to ensure compliance with the prohibition measure.
208. The implementation strategy will also have to include details of the scheme to which they propose to transfer existing members of the scheme to (when known), and detail when they expect to transfer existing members from the scheme.
209. The Regulator has to approve the implementation strategy, which will have to be submitted by the scheme within 28 days of the triggering event.
210. We believe that a Master Trust could have three members of staff spending 45 hours planning and writing the communication to employers, have the same number of people spending 27 hours writing the implementation strategy, and spend five hours writing the communications to employees.
211. We have assumed that these documents will all have to be cleared through the trustee board before being sent to their intended recipients (either by paper or via email). We have assumed, as with the business plan that this will take the five trustees two hours to clear these three documents. The scheme will also have to produce a charges schedule, as above.

Cost of notifying the Regulator

3 Master Trusts experiencing a triggering event x 0.5 time taken to notify the Regulator x £25.08 wage rate= £38

Employer communications

3 Master Trusts experiencing a triggering event x 3 people involved in creating employer communications x 45 hours spent creating the document x £25.08 wage rate = £10,200

Implementation strategy

3 Master Trusts experiencing a triggering event x 3 people involved in creating the implementation strategy x 27 hours taken to create the implementation strategy x £25.08 wage rate = £6,100

Member communications

3 Master Trusts experiencing a triggering event x 3 people involved in creating the member communications x 5 hours taken to create the communications x £25.08 wage rate = £1,100

Charges schedule

3 Master Trusts experiencing a triggering event x 2 hours taken to set out the charges schedule x £25.08 wage rate= £150

Time for approval

3 Master Trusts experiencing a triggering event x 5 people required to approve the documents x 2 hours taken to approve the documents x £25.08 wage rate = £750

212. Although employers and members are to be sent information about the triggering event, they are not required to read or act on the information, as we assume the Master Trust will resolve the triggering event during this period. We have, however calculated the possible cost of spending half an hour reading and digesting four pages of information, based on average reading speeds.

213. The Department for Business Energy and Industrial Strategy estimates that there are approximately 5,498,000 businesses in the UK, which employ around 26,204,000 people.⁵⁴ We therefore estimate that the approximate average number of people that work in a business is 5. As we know that the average number of members in a Master Trust scheme (excluding the five largest) is 13,000, we assume that there are approximately 2,700 employers with members in each of these schemes.

⁵⁴ Department for Business Energy and Industrial Strategy: 'Business population estimates for the UK and regions 2016', October 2016

Employer cost of reading communications.

2,700 employers that will need to read the letter per triggering event x 30/60 minutes taken to read the letter x £25.08 wage rate = £34,200

Employee cost of reading communications

13,000 members that will need to read the letter per triggering event x 30/60 minutes taken to read the letter x £25.08 wage rate = £163,000

214. This means that the total cost of a triggering event where the Master Trust is following continuity option 1 is approximately £203,300, where both members and employers will have to read a letter. Costs to individuals are not included in the Business Impact Target; the cost to business of each of these triggering events will be £52,500, leading to a total cost to business of £157,600 in the third year of the appraisal period only.

Master Trusts following continuity option 2

215. We have assumed that once the market reaches a steady-state (2019/20), if a Master Trust experiences a triggering event within the appraisal period they will choose, wherever possible, continuity option 2 and resolve the triggering event rather than winding up the scheme and exiting the market.
216. Intelligence from the Regulator suggests that they expect less than ten triggering events over ten years once the market has reached steady state, due to the authorisation and supervisory regime mitigating some of the causes of triggering events. For the purpose of this assessment we have assumed that there will be one triggering event each year after the market has reached steady state, from 2019/20 onwards.
217. In these cases, schemes will have to communicate with employers as in the continuity option 1 scenario above, but not members, so will not incur the cost of communication with members. The cost to these Master Trusts is the same as for Master Trusts following continuity option 1 (£6,100 per triggering event) but without the cost of member communications (£370 per triggering event). The costs to business in each year during which these triggering events happen totals **£5,700**.

218. Master Trusts following continuity option 2 will have to communicate with employers but not members, and those employers we have assumed will read the information. The total cost for triggering events where the Master Trust is following continuity option 2 is **£39,900** in every year between the 2019/20 and 2025/26.
219. The difference between the cost of the two processes arises through a Master Trust following continuity option 2 not having to send letters to members.
220. There will be more information in the Regulator's Code of Practice, but it seen as disproportionate to update these costs given the date of publication and scale of costs.

Pause orders

221. The 2017 Act gives the Regulator the power to issue a pause order to a scheme if the scheme is in a triggering event and the Regulator is satisfied that either:
- a. making a pause order will help the trustees carry out the implementation strategy, or;
 - b. there is or is likely to be an immediate risks to the interests of members or assets under the scheme if a pause order is not made.
 - c. it is necessary to issue a pause order to protect the generality of the members of the scheme.
222. Regulations set out the time limits in which the trustees or managers have to carry out the requirements contained within the pause order. The regulations also specify that where a pause order has been applied the trustees or managers have a duty to carry out the wishes of the members within 3 months of the pause order ceasing to have effect.
223. A pause order has the power to, for example:
- stop any new members being taken on by the scheme,
 - stop further contributions or payments towards the scheme by or on behalf of any employers or members, or any specified employers or members
 - stop any payments out of the scheme to members
 - stop transfers or transfer payments out of the scheme.
224. It is difficult to accurately assess the counterfactual in this situation, as it is not certain how many Master Trusts will experience an event that would

cause the Regulator to issue a pause order. These are expected to be used only in exceptional circumstances.

225. It is possible that a scheme left the market in a disorderly manner, which could negatively impact members and their assets. While Master Trusts may lose some revenue from not being able to take contributions or payments from members whilst the pause order is in place, the financial sustainability requirement should, under option 2, ensure that the scheme has the capital in order to resolve the issue at hand or wind-up the scheme appropriately.
226. The scale of the opportunity cost of this measure would depend heavily on the scale of the contributions coming in to the Master Trust during the period of the pause order. The loss of revenue compared to the baseline would also depend on the number of employers and members that expected to join who now couldn't.
227. As a scheme has to be experiencing a triggering event and there needs to be an immediate risk to the interests of members or assets for a pause order to be placed on a scheme, this would most likely amount to a contravention of the law. We have assumed in this case that there is no direct cost to business of this measure, as any costs associated with not following the law are not considered to be direct impacts on business for the purpose of the Business Impact Target.

Fraud compensation levy

228. Occupational pension schemes can make a claim upon the fraud compensation fund where certain conditions are met. These conditions include that the value of the scheme's assets have been reduced and there are reasonable grounds for believing this was due to dishonesty. At present all the scheme's participating employers have to be insolvent (or the equivalent for those employers who are unable to become insolvent) for the scheme to make a legitimate claim. As most Master Trust schemes have multiple employers who are unconnected to each other, it is unlikely that all employers in a scheme will become insolvent at once, which is the circumstance required for the scheme to be eligible to make a claim on the fraud compensation fund (FCF).
229. The Regulations therefore make adjustments to the legislation on fraud compensation, to make it more appropriate for authorised Master Trusts. As Master Trusts are used, or intended to be used, by multiple employers who do not need to have a connection to each other, we are removing the

employer insolvency requirement for authorised Master Trusts. However, for authorised Master Trusts to make a legitimate claim upon the fraud compensation fund the scheme funder will have to be insolvent (or the equivalent of insolvency) and the scheme will have to be pursuing continuity option 1.⁵⁵

230. We are removing NEST's⁵⁶ exemption so its members can benefit from protection from the FCF. To reflect the lower risk that authorised Master Trusts present due to authorisation and closer supervision from the Regulator, the cap for authorised schemes will be lower than for schemes that are not authorised. Authorised schemes will have a levy cap of 30p per member, as opposed to the up to 75p per member that might be paid by other occupational schemes.

231. The fraud compensation levy is raised as and when the Pension Protection Fund (PPF) Board requires the money and it only charges the amount that it is likely to need. In 2012/13 the PPF raised 25p per member from the levy and then did not raise any more until 2017/18 when it is again raising 25p per member⁵⁷.

232. With the removal of the NEST exemption the overall amount raised by the PPF Board through the levy is not expected to change. However, since NEST was set up by the Government and is partially funded by a loan it is not included in the Business Impact Target (BIT). This is based on the advice of the Better Regulation Executive.

233.

234. As of 31 March 2017 NEST had a membership of 4.5 million⁵⁸ and is expected to grow further with AE. As a result of this there will be a saving within the BIT (explicitly to Master Trusts excluding NEST) from this measure of over £1,350,000 (4.5 million * 30p).

235. The fraud compensation levy was collected three times in the ten years before the start of the appraisal period (in 2010, 2011 and 2012). We have, therefore, assumed that the levy will be collected three times within the appraisal period.

⁵⁵ Where the scheme is transferring all members out of the scheme and winding it up.

⁵⁶ NEST was set up by the government to ensure every employer has access to a high-quality workplace pension scheme.

⁵⁷ <http://www.pensionprotectionfund.org.uk/About-Us/Pages/FraudCompensationFund.aspx>

⁵⁸ http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/NEST-Corp-ARA_2016_2017.PDF.pdf

236. The levy has already been collected once during the appraisal period, in 2017/18. As these regulations will not come into effect until the intended date of October 2018, there will not be any benefit to business if the levy is collected before that date.
237. We have assumed that the fraud compensation levy will be collected in years three and four of the appraisal period, as the previous collections were made in consecutive years.
238. We do not think that many Master Trusts will have been authorised by the end of 2018/19, as they can only apply from 1st October 2018 and the Regulator has six months to consider an application. Consequently we believe that there will be a benefit to business of £1,350,000 in year four of the appraisal period only. Until a Master Trust is authorised, it will be liable to pay the same level of the levy as under the counterfactual. The levy paid in year two of the appraisal period and the levy we assume will be paid in year three will lead to no direct or indirect cost to business.

Costs and benefits to individuals

239. Improving trust in pension saving is vital to the long-term policy goal of ensuring that people are saving adequately for retirement. By setting minimum standards for Master Trust schemes to operate, the Government aims to prevent a major scheme failure and thereby improve individuals' trust in private pension saving for later life.
240. People are not always best equipped for planning for the longer term and forecasting what they will need to save for the retirement lifestyle they want to have. The rationale for AE is that people are defaulted into saving, and opt out rates are currently low, with an overall opt out rate of 9%.⁵⁹ A failure of a major Master Trust would be likely to knock overall confidence in pension savings and may prompt a greater proportion of people to opt out of future AE contributions and therefore pension saving altogether.
241. The powers granted to the Regulator will allow for proactive engagement with Master Trusts, especially in the event that a scheme is at risk. This should protect member's interests and safeguard their savings.

⁵⁹ Department for Work and Pensions: 'Employer Pension Provision Survey 2015', March 2016. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/584593/rr919-employers-pension-provision-2015.pdf.

242. Any (real or perceived) gap in the regulatory framework may undermine confidence in the system and put at risk the success of AE in delivering an additional 10 million individuals newly saving or saving more, increasing annual workplace pension saving by £19.7 billion a year.⁶⁰
243. The key impact on members relates to anyone whose assets may have been at risk of being lost in an uncontrolled exit under the baseline. These individuals' savings will be better protected as a result of this policy. The authorisation criteria will improve the stability of the scheme, while the reporting requirements will allow the Regulator to proactively engage with Master Trusts when they are likely to be at risk of failing.
244. There is reliable evidence on the current size of membership across Master-Trust schemes (9.9m), the total value of assets under management (£16bn), and forecast growth in members, but the likelihood of scheme failure under the baseline is unknown. Evidence from the Regulator suggests that there are approximately £5.7 billion of assets under management that are in Master Trusts that both haven't received Master Trust Assurance, and are not insurer-backed schemes (which are subject to Prudential Regulation Authority Solvency II regulations).
245. We also expect the value of assets in Master Trust schemes to grow considerably as pots increase in value over time, AE rollout completes and minimum total contributions increase from 3% to 8% in April 2019.
246. There is an expectation that in the baseline scenario some Master Trusts will choose to leave the market and there will be consolidation leading to a smaller number of Master Trust providers in the market. There could potentially be the benefit of further economies of scale for authorised Master Trusts, which could lead to lower charge levels or higher investment returns, as long as members are adequately protected. It is also possible that some single employer schemes will be transferred into existing or new Master Trusts in the future, further increasing economies of scale for the schemes which those members are in.
247. There have been two recent failures of Master Trust schemes; both relatively small schemes with around 7,500 members in total, that the Regulator has indicated were straightforward cases to manage. In these cases members' assets were transferred into other pension schemes

⁶⁰ Department for Work and Pensions: 'Automatic Enrolment: 2016 evaluation report', December 2016.

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/576227/automatic-enrolment-evaluation-report-2016.pdf.

without any significant known member detriment, although this risk remains for other schemes.

248. It is possible that Master Trusts may choose to pass on to members or employers the cost of applying for authorisation and making any necessary improvements to meet the authorisation criteria. Some Master Trusts may not have other sources of income from which to raise the capital to meet the increased cost of the authorisation regime other than member and employer charges. The authorisation regime may lead to higher charges on members and employers in these schemes, but they can do so over a period of time to smooth the impact on members;
249. While this is possible, there are several reasons that lead us to believe that this is unlikely to happen at this time, some of these are that:
- a. AE schemes must remain within the 0.75% members' charge cap. a Master Trust that is being used for AE cannot raise the member charges in the default fund above this level;
 - b. Now that AE has almost completed rollout across all employers, the main source of membership growth for Master Trusts will be from other schemes and new-born employers enrolling their employees. We believe that the end of AE rollout means that competition will shift from new memberships to retention and acquisition of existing memberships. Current evidence suggests that there is significant price competition among Master Trusts, with charge levels currently well below the 0.75% cap⁶¹;
 - c. a certain number of Master Trusts are expected to leave the market, once they have experienced a triggering event, their members' charges will be capped, so they will not be able to pass on any of the cost of wind up to members;
 - d. consequently we think it is unlikely that schemes will significantly increase charges to cover the costs of authorisation;
 - e. NEST has a public service duty placed on it, so should charge its members the lowest amount possible. This is likely to help sustain price competition among Master Trust schemes looking to serve the AE market.

⁶¹ Department for Work and Pensions: 'Pension Charges Survey 2015: Charges in defined contribution pension schemes', December 2015.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/483179/Pension_charges_survey_2015_charges_in_defined_contribution_pension_schemes.pdf.

250. The benefits of individuals saving into a well governed scheme have not been monetised. The relative complexity of calculating individual benefits of improved governance was determined to be disproportionate.

Wider Impacts

Competition

251. The market for DC occupational pensions is not perfectly competitive,⁶² with a weak buyer side of the market. We do expect there to be fewer competitors as a result of this policy, but this is to ensure that members are saving into well governed schemes.
252. While the market is generally expected to consolidate, there are a number of factors that will drive the size of the overall market and how it is dispersed amongst authorised Master Trusts, single (or connected) employer occupational pension schemes and personal pensions. All employers must have enrolled all eligible workers into a workplace pension scheme by April 2018. Once this AE market is in a steady-state, we believe that there will be high levels of competition for any new business and for existing business to move to new providers. So it is not possible to forecast the number of authorised Master Trusts that will remain. However, for the purposes of this Impact Assessment we have assumed that 31 existing schemes will either not seek authorisation or will fail to be authorised compared to the base year number of 87.
253. There is some evidence of market consolidation already underway. There have been several recent exits of Master Trusts; all of which were relatively small schemes. In these cases the member assets were transferred into other pension schemes without any significant known member detriment. Since the 2017 Act required Master Trust schemes to notify triggering events, there have been 6 notifications. The Regulator is working with these schemes to resolve the event or ask the trustees to wind the scheme up.
254. The costs imposed by authorisation could prove to be a barrier to entry for someone wishing to set up a Master Trust pension scheme. These requirements represent a set of minimum governance standards for schemes to meet, it is consequently imperative that Master Trust schemes meet this requirement in order to protect members' interests.

⁶² Office of Fair Trading: 'Defined contribution workplace pension market study', September 2013. http://webarchive.nationalarchives.gov.uk/20131101172428/http://oft.gov.uk/shared_oft/market-studies/oft1505.

255. Current price competition in the market suggests that the increased burden of authorisation will not cause a significant shift in the competitive landscape, as schemes seek to retain and increase membership levels.
256. If competition were to decrease significantly in the market, however, it may mean that Master Trusts would face less pressure to maintain low prices in order to remain competitive. This means that costs for employers and employees could, in theory, increase. We do not consider this to be a likely eventuality, however, due to the charge cap and the general movement in the direction of employee charges being significantly downwards, as well as the continued likelihood of several large Master Trusts competing for market share.

Benefits to Master Trusts

257. It is possible that firms will also benefit from the authorisation regime, as they will be able to use it as a 'badge' through which to reassure customers of the quality of their services (Master Trusts also compete with other types of pension scheme, particularly contract-based schemes). Without the authorisation regime they may have had to invest more in systems or engage in advertising to sustain current levels of business. Some Master Trusts that expressed their support for the 2017 Act, said that it would reduce the possibility of a Master Trust failure causing a loss of trust in the industry.
258. The aim of the measures set out in the 2017 Act is to maintain or improve consumer trust in pension saving by ensuring the safety of Master Trust schemes. This trust should also stand to benefit the businesses that operate these schemes, as greater trust in the industry should lead to increased pension saving.
259. By increasing the Regulator's powers, we are aiming to mitigate the risks of a Master Trust failing, which could lead to a disorderly exit from the market. If this were to happen under the baseline, the scheme and any of its backers would have to invest significant time and money while exiting the market. This policy is intended to protect Master Trusts as well as the members in the schemes.
260. By specifying the contents of the business plan in secondary legislation, trustees could be better equipped to assess value for money, which could improve outcomes for the scheme and its members.
261. Master Trust schemes are vital to the success of AE as a low cost option for small and micro employers who are taking up their enrolment duties.

Authorisation will lower the risk of individuals' and employers' trust in pension saving falling in the event of a scheme failure, which in turn could increase the amount of assets in schemes compared to the baseline. This could be due to greater trust in pension saving causing employees to increase their contributions, or that under the baseline a loss of trust in pensions saving could lead to higher opt-out rates, which are currently at an average of 9% across employers.⁶³

Costs and benefits to the Regulator

262. The Regulator may experience reduced costs as a result of pro-active on-going supervision rather than reacting to a failing Master Trust. This could mean that the Regulator has to direct less resource towards Master Trust supervision in the event of an unexpected failure. As this is difficult to calculate it has not been monetised at this stage. The Regulator has reported that it has had to invest significant time in supervising the two failures of Master Trust schemes so far.
263. The Regulator estimates that it will incur costs of £2.6 million in the third year of the policy. The total cost to the Regulator will count as a direct cost to business, as the majority of this will be paid for by Master Trust's application fees which have already been counted as a direct cost to business, however, we have calculated the cost in this section as the difference between the cost to the Regulator and the amount recovered through application fees. In each subsequent year the amount to be paid to the Regulator will be recovered through the general levy, minus any application fees already costed as a direct cost to business in that year. The cost to business in the third year of the appraisal period is therefore **£176,500**.
264. We estimate that the ongoing cost to the Regulator will be £1,475,000 from the fourth year of the policy onwards, minus the application fee to new Master Trust in every year that one enters (years 4, 6, 8 and 10). In these years the cost to business will be **£1,452,000**, in every other year (years 5, 7 and 9) the direct cost to business is **£1,475,000**.
265. The cost incurred by the Regulator is to assess all Master Trusts that apply for authorisation, supervise the exit of Master Trusts that are not

⁶³ Department for Work and Pensions: 'Employers Pension Provision Survey', March 2016. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/584593/rr919-employers-pension-provision-2015.pdf.

authorised, and for the ongoing supervision of Master Trusts once they are authorised.

Risks and assumptions

266. The key risks are:

- a. The uncertainty of likelihood of Master Trust failure, the number of members and size of assets at risk – at this stage we have estimates of the existing and likely future scale of the market, but we do not have reliable estimates to quantify the risk of failure
- b. The costs to business of meeting the authorisation criteria is a difficult task due to the likely costs varying with each individual scheme. The authorisation regime has been set out in secondary legislation and the impact assessment reflects our best estimate of the costs at this stage. However, the regulations are not prescriptive as to how business should meet the standards and therefore the likely business impact will be different from this.
- c. The impact of intervention on the size of the market. We can reasonably assume that additional requirements will reduce the number of potential market entrants and may lead some existing Master Trusts to exit, but there is considerable uncertainty of the precise level of future market consolidation. This is an important assumption since a large determinant of the EANDCB for subsequent secondary legislation will be calculated as an average cost(s) per scheme.
- d. Since this Impact Assessment was originally prepared, some new evidence relating to wage rates and the number of Master Trusts in the market has been published. The median hourly wage rate for a professional from the Annual Survey of Hours and Earnings has risen from £25.08 in 2016 (provisional results) to £25.43 in 2017, once uplifted by 27% to account for non-wage costs.⁶⁴ To change this throughout the assessment would amount to an approximately £11,000 difference in costs to business across the whole appraisal period. Due to the relatively small impact of this change on the overall cost, it has not been included here.

⁶⁴ Office for National Statistics: Annual Survey of Hours and Earnings.
<https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation2digitsocashetable2>.

Direct costs and benefits to business (OI30)

267. The equivalised annual net direct costs to business (EANDCB) are estimated at £5.1m under the best estimate of the authorisation regime if NEST is included in the Business Impact Target. These are assessed over a 10 year period from 2016/17. A summary of impacts is shown in figure 11 below.
268. As the Better Regulation Executive has advised us that NEST is not included in the Business Impact Target, the EANDCB over the ten year appraisal period is £2.7m. A summary of impacts is shown in figure and 12 below.
269. We believe a ten year appraisal period to be most appropriate due to a large number of impacts occurring at commencement of the authorisation regime, and once schemes break even the amount that they need to keep for the financial sustainability requirement will reduce. The benefit to individuals and schemes will continue to persist into the future, however.

Sensitivity analysis

Figure 14: Results of the financial sustainability sensitivity analysis

<i>Change in net costs to business if optimistic/pessimistic assumption used instead of central estimate (£ millions)</i>						
	Year 1			All years		
	Change if pessimistic assumption used	Central estimate	Change if optimistic assumption used	Change if pessimistic assumption used	Central estimate	Change if optimistic assumption used
Financial sustainability requirement	0.59	0.49	0.39	14.84	12.37	9.90

270. The above sensitivity analysis shows the effect on the cost to business of the financial sustainability requirement if the cost were 20% higher or lower than has been calculated in this assessment. we expect that a change would cost Master Trust schemes £2.47m over the ten year appraisal period.

Small and Micro Business Assessment

271. Master Trusts tend to have far more members than single employer schemes, but the companies or bodies that establish and stand behind them vary in size. Many Master Trust schemes will have less than 50 employees. However, the scheme funder may well operate as an insurance company, financial services provider or pension industry consultancy and have many more than 49 employees overall. Other schemes were established by a group of unconnected employers (themselves large or small) while the scheme itself is a very small employer. For this reason, the exact number of small or micro businesses (defined as having up to 49 FTE and 10 FTE employees respectively, as per the Better Regulation Framework Manual) in this market is unknown. We expect both types of companies to operate in this sector.
272. It is possible that a small or micro business would operate or wish to establish a new commercial Master Trust scheme. For example, many schemes will contract out the scheme administration to a third party provider, which is where much of the employment is likely to arise. However, it is not appropriate to exempt them from authorisation requirements as some risk arises from the potential scale of the membership, not the number of employees. A Master Trust with a small number of employees could operate a Master Trust with thousands of members with significant assets. If any Master Trust were to fail, it could lead to reduced trust in pension saving, exempting small and micro employers is not a viable option for this policy
273. The Regulations will disapply the requirements for authorisation from certain relevant small schemes, often known as Small Self-Administered Schemes (SSASs) that would otherwise fall within the definition of a Master Trust. These schemes must have fewer than 12 members and all the members (or company directors if the sole trustee is a company) must be trustees. In order for authorisation requirements to be disapplied where a relevant small scheme has two or more members, the members or directors must make up the majority of trustees, which gives them greater control and ensures an interest in achieving the best outcome for members. In these circumstances, it is disproportionate to require such schemes to be authorised.
274. Not all SSASs will necessarily be used by small businesses, but they are a popular form of pension scheme for small and micro businesses. They often open membership to family members as well as the immediate employees or workers of the small firm that established them.
275. In certain circumstances it is possible that single member pension schemes may fall within the definition of a Master Trust. For this to apply, it would need the scheme to have two or more unconnected employers.

We think the number of cases in which this would arise in a single member scheme are extremely limited but have addressed it by disapplying authorisation requirements in certain circumstances.

Monitoring and evaluation

276. The Department is working closely with the Regulator with regards to monitoring the impact of the authorisation regime. The Regulator continues to monitor the pensions market and emerging risks within it. This is going to be essential in ensuring the regulations are having the desired impact – protecting the members of Master Trust pension schemes.

Table 12: costs and benefits to business (including NEST) £m, 2016/17 prices

Year	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
Familiarisation	£0.01	£0.02								
Application fee			£2.42							
Cost to TPR			£0.18	£1.45	£1.48	£1.45	£1.48	£1.45	£1.48	£1.45
Fit and proper persons			£0.08							
Business Plan			£0.09							
Capital requirement				£1.23	£2.49	£3.80	£5.29	£6.97	£8.85	£10.97
Scheme funder			£0.08							
Systems and processes			£2.98							
Continuity strategy			£0.03							
Wind up costs			£2.00							
Triggering events	£0.002		£0.16	£0.04	£0.04	£0.04	£0.04	£0.04	£0.04	£0.04
New Master Trusts			£0.00	£0.03	£0.00	£0.03	£0.01	£0.05	£0.03	£0.07
Fraud compensation levy			-£1.35							
Total	£0.012	£0.021	£8.02	£2.75	£4.01	£5.33	£6.82	£8.51	£10.40	£12.53

Table 13: costs and benefits to business (excluding NEST) £m, 2016/17 prices

Year	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
Familiarisation	£0.01	£0.02								
Application fee			£2.38							
Cost to TPR			£0.22	£1.45	£1.48	£1.45	£1.48	£1.45	£1.48	£1.45
Fit and proper persons			£0.07							
Business Plan			£0.09							
Capital requirement				£0.49	£0.91	£1.27	£1.68	£2.14	£2.65	£3.22
Scheme funder			£0.0809							
Systems and processes			£2.97							
Continuity strategy			£0.03							
Wind up costs			£2.00							
Triggering events	£0.002		£0.16	£0.04	£0.04	£0.04	£0.04	£0.04	£0.04	£0.04
New Master Trusts			£0.03	£0.03	£0.00	£0.03	£0.01	£0.05	£0.03	£0.07
Fraud compensation Levy			-£1.35							
Total	£0.012	£0.021	£6.66	£2.01	£2.43	£2.80	£3.21	£3.68	£4.20	£4.79

Annex A – Financial sustainability calculation

Figure A: Asset allocations of UK pension schemes⁶⁵

10-year returns (2006-2016) % p.a.			
Type of asset	Nominal returns	Allocation	Nominal returns based on allocation (baseline)
UK equities	5.60%	17.58%	0.98%
Overseas equities	9.50%	31.87%	3.03%
Overseas bonds	8.30%	5.49%	0.46%
UK bonds ⁶⁶	7.67%	34.07%	2.61%
Cash	1.30%	2.20%	0.03%
Property	3.90%	8.79%	0.34%
Total		100%	7.45%

Figure B: Returns based on liquid assets (option 1)

10-year returns (2006-2016) % p.a.			
Type of asset	Nominal returns	Allocation under authorisation	Nominal returns based on allocation (option 1)
UK bonds	7.67%	75.61%	5.80%
Cash	1.30%	4.88%	0.06%
Property	3.90%	19.51%	0.76%
Total		100%	6.62%

Based on the allocation of funds, we estimate that under the baseline that a pension scheme investing their funds would earn average returns of 7.45%. Under option 1, where the scheme is required to keep this capital invested in sufficiently liquid assets (highlighted in green) we estimate that nominal returns would be 6.62%. The opportunity cost of keeping this capital in sufficiently liquid assets is the returns that it could have gained if schemes were allowed to keep the capital in any assets. Figure 8 (p. 45) details the compound opportunity cost of the financial sustainability requirement based on the amount of capital that we estimate all schemes to have to keep.

⁶⁵ UBS: 'Pension Fund Indicators 2017', January 2017.

https://www.ubs.com/uk/en/asset_management/institutional/publications.html. The 'other' category in the allocation has been redistributed across the other assets as it is not clear whether they may be liquid or not.

⁶⁶ This asset consists of index-linked bonds, corporate bonds and gilts, based on an equal allocation of each.