

Transferring legacy scheme benefits to a DB master trust – key considerations

Key advantages

Savings of 20% to 30% on administration costs are possible within a master trust, alongside the benefit of economies of scale in investment management and consultancy fees. While each section of a defined benefit (DB) master trust must undertake its own valuation, there could also be savings from shared or bundled actuarial services. These gains are cherry-topped by certainty of costs if fixed fees can be agreed in advance on an annual or longer basis.

Membership numbers may be thinned as part of the exercise by paying out trivial commutation lump sums and, where your legacy scheme is to be terminated, by winding-up lump sums to members whose benefits are below the relevant value thresholds.

These advantages are particularly attractive to small legacy schemes struggling with the administrative and governance burden of running a closed DB scheme.

Potential pitfalls

On the downside, employers will need to think carefully about what the scheme funding and investment relationship will be like under the DB master trust, especially where the employer has little or no input over who sits on the trustee board. DB master trust providers give assurances about collaborative decision-making and sympathetic responsiveness to the circumstances of an employer changing in the future, but it would be short-sighted not to appreciate that an employer will, in practice, be ceding a level of influence over deficit recovery decisions and choices in asset allocation and asset managers. DB master trusts often require a new section to undergo an immediate valuation, regardless of where a scheme is in its triennial cycle, before joining, and so there's a good chance these issues will be brought into sharp focus sooner rather than later.

What happens if things don't go to plan and an employer wants to leave, or the master trust fails in the long term? The exit terms are unlikely to mirror the rules that applied under the legacy scheme, and the employer may well find the end game for securing member benefits is not in their hands.

Practical issues on transfer

Technical hurdles to overcome on a transfer to a DB master trust include:

1) Ensuring your new section has a 'statutory employer'

For the statutory scheme funding regime and, crucially, to remain eligible for the PPF under a DB master trust, an employer must have some active members in its section of the master trust. However notional this benefit accrual might be, it's a vital feature that needs to be organised and documented.

2) Meeting contracting-out requirements

Under the contracting-out legislation as it stands, contracted-out benefits may only be transferred without member consent to another formerly contracted out DB scheme. Contracting-out legislation does not recognise ring-fenced sections of schemes and so, on the face of it, a certificate relating to another employer under the master trust may be good enough – but transferring trustees and employers will want legal comfort that it is not necessary to have a contracting-out certificate relating specifically to their new ring-fenced section of the master trust.

3) Preserving tax protections

To keep certain member tax protections, a transfer must meet the 'block transfer' conditions under the tax rules.

Where only part of a member's benefits is transferring (e.g. they also have DC AVCs), a transfer will trigger the loss of 'scheme-specific' tax protection for the transferring benefits. Scheme-specific protection allows members to take a tax-free Pension Commencement Lump Sum higher than the standard 25% in relation to their pre-A Day (6 April 2006) benefits if they could have done so under the legacy scheme rules at that date. The transferring scheme is not obliged to offer this facility to members, and may not do so in practice, but even if that is the case, transferring trustees will still want to consider the loss of this potential benefit to members.

Preserving enhanced or fixed protection on transfer should be more straightforward provided the transfer is made in connection with the wind-up of the legacy scheme, but trustees must ensure the relevant conditions are met. ■



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