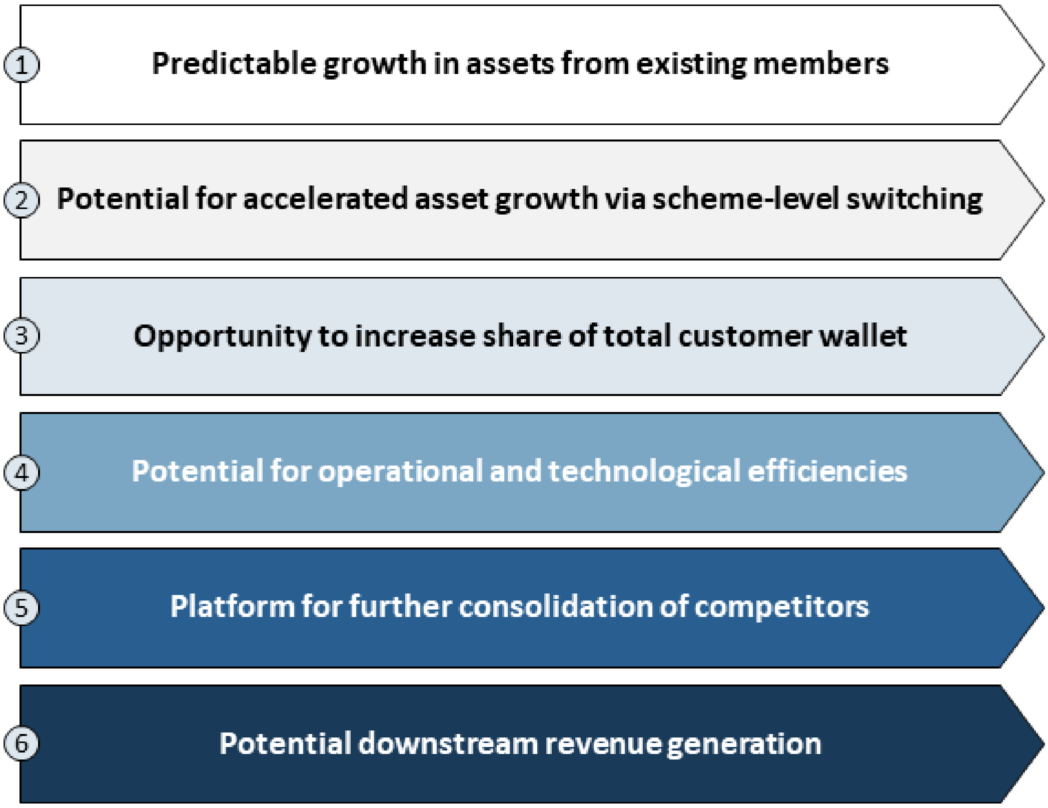
The UK Master Trust Equity Story

March 9, 2022

With growing allocations of private capital into the long-term savings market, small independent Master Trusts offer an opportunity to private equity investors.

The equity story

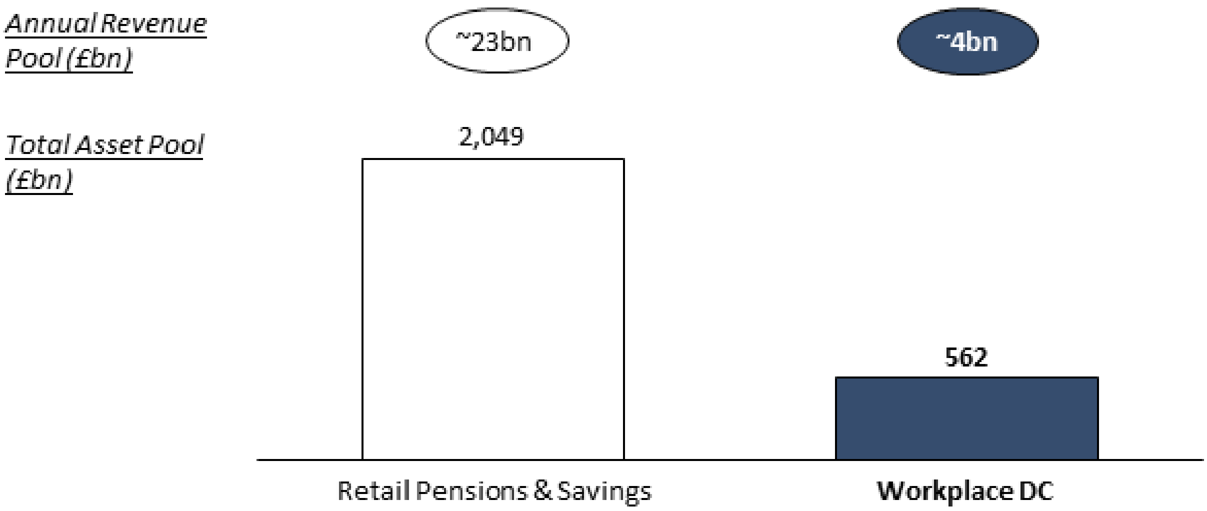
NMG has identified six key factors that underpin the equity story with small independent Master Trust providers:



A flurry of private capital into retail long-term savings

Over the past five years, there has been substantial growth in participation of private equity in the UK long-term savings market. To date, private capital has been largely attracted to the retail channel due to its larger total asset and revenue pools than workplace defined contribution plans ("Workplace DC"), as seen in Exhibit 1.

Exhibit 1: 2020 Long-Term Savings Assets and Revenue Pools (Retail vs Workplace DC)



Source: NMG UK Stock & Flow Model

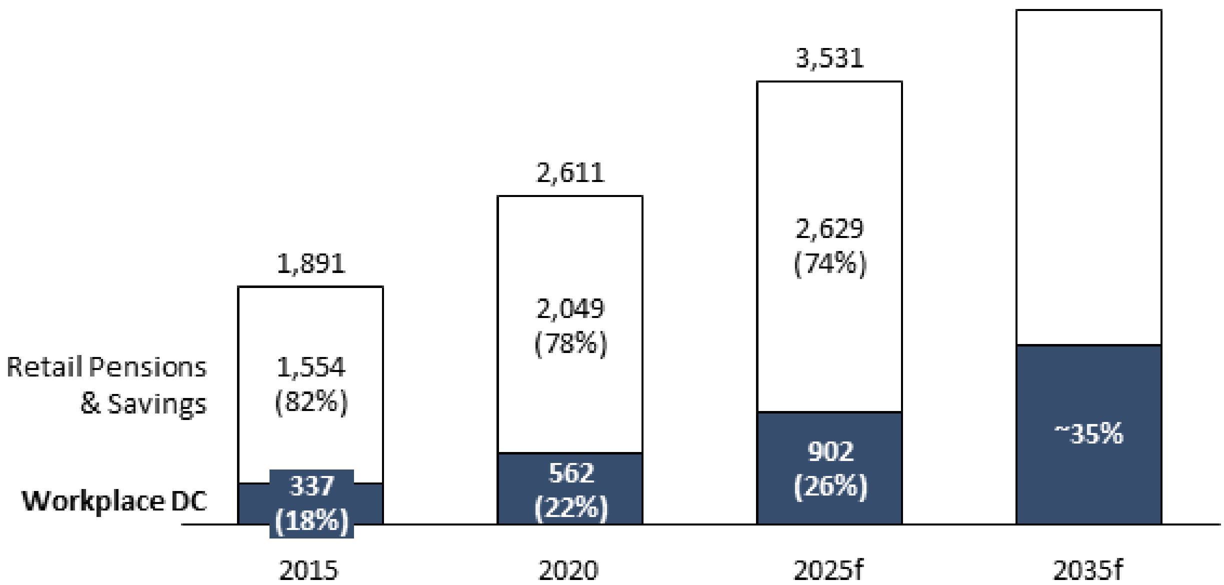
This extent of private equity fund participation has been enabled by the breadth of acquisition targets in the retail channel, c.9,000 retail advice firms and a broad range of independent service providers to retail advisory businesses (including advisory practice management and CRM software, financial planning software, and platform providers).

The growing importance of workplace DC

However, workplace DC has been steadily increasing in importance since Auto-enrolment (AE) phasing-in began in 2012, compelling UK employers to offer opt-out workplace DC pensions to most of their employees.

While most large AE-compliant schemes had been set up by 2015, the ongoing contributions associated with AE drove up workplace DC share from 18% of assets in 2015 to 22% in 2020. With forecast net inflows of ~£15bn pa into workplace pensions, this growth in share is expected to account for 26% of the UK long-term savings market AUM by 2025f as shown in Exhibit 2, and up to ~35% by 2035f.

Exhibit 2: Workplace DC Share of UK Long-Term Savings Market Assets (£bn)



Source: NMG UK Stock & Flow Model

The workplace DC opportunity for PE is in small independent Master Trusts

There are three key types of workplace DC pensions: contract-based, single trust and Master Trust. While contract-based and single trust pensions are controlled by large insurance groups, Master Trusts (MTs) have a range of ownership structures:

- Insurer/Platform-owned MTs (~38% of MT AUM): insurance groups seeking to vertically

integrate into internal default funds and cross-sell into drawdown
- Large not-for-profit MTs (~35% of MT AUM): Government-backed NEST and People's Pension (union-based) offer a simplified proposition typically aligned to the needs of employers of low-income earners
- EBC-owned MTs (~17% of MT AUM): employee benefits consultancies with MT plug-in to internal EB platforms, and seeking to vertically integrate into internal default funds
- Small Independent MTs (~10% of MT AUM): 10 schemes each with <£2bn in AUA, mostly privately/union owned with limited participation in investment economics

Why are small independent MTs seeking private capital?

With large client numbers and (currently) small average customer balances, operational and technological efficiency is a key challenge for Master Trust providers. In NMG's 2020 corporate adviser study, small independent MT providers received lower ratings for operational management and technology than insurer and EBC-owned peers. In the absence of funding for significant admin and tech platform upgrades, the technology and operational performance of small independent MTs is unlikely to improve.

Furthermore, regulatory direction is moving the obligation to provide for scheme members into retirement onto workplace DC providers, with Investment Pathways expected to represent just the beginning of a number of market developments around the at-retirement member proposition.

Despite an overwhelmingly positive growth outlook for the workplace DC segment as a whole, small independent MTs are likely to lose market share in the absence of funding for significant admin, tech platform and retirement income proposition upgrades.

The equity story for small independent MTs

So what makes small independent Master Trusts an attractive target for private equity?

1. **Predictable growth in assets from existing members**, with low member opt-out rates (<10% for small MTs) and inflation-linked contributions (growth in average contributions of ~6% in 2021)
2. **Potential for accelerated asset growth via scheme-level switching**, with regulatory pressure on "member value for money outcomes" expected to drive £5-7bn of scheme-level switching from single trust into MTs
3. **Opportunity to increase share of total customer wallet**, with ~30% of members stating workplace provider as preferred consolidation vehicle for pensions at-retirement
4. **Potential for operational and technological efficiencies** via outsourcing of administration and back-office functions
5. **Platform for further consolidation of competitors** with the opportunity to transfer acquired schemes onto single scalable technology platform
6. **Potential downstream revenue generation** via vertical integration into investments, with >90% of assets held within MT provider-controlled default investment solutions

What are the challenges?

While representing a strong investment story, private equity investment in small independent MTs is not without its challenges, notably through:

- Acquisition – identifying the right targets, successfully engaging with management, pricing bids competitively, and
- Value growth – accelerating asset growth, capturing broader customer assets, managing expense ratios

We will explore both of these challenges in detail in the second part of this Citylogue series.

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