The Quest to Boost Operational Efficiency and Returns in DC Master Trusts

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J.P.Morgan

As governments push for illiquid investments within pension funds, cash allocation and portfolio rebalancing can be challenging for multi-employer pension schemes. A solution, proven in Australia, could provide a welcome antidote.

History

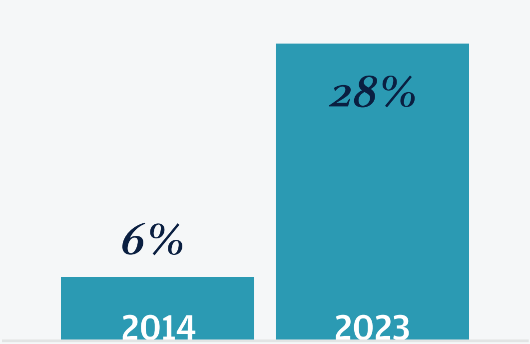
Defined Contribution (DC) Master Trusts have become a cornerstone of the UK pension landscape, offering a cost-effective alternative to single-employer trusts and an efficient way to manage retirement savings for multiple employers and their employees.

Though they emerged as a niche product in the 1970s, DC Master Trusts only started to garner broader adoption in the UK workplace pension market following the 2012 advent of automatic enrolment.[1] As of 2023, Master Trusts are the DC vehicle of choice at 28% of FTSE 350 companies, up from just 6% in 2014.[2]

Scale

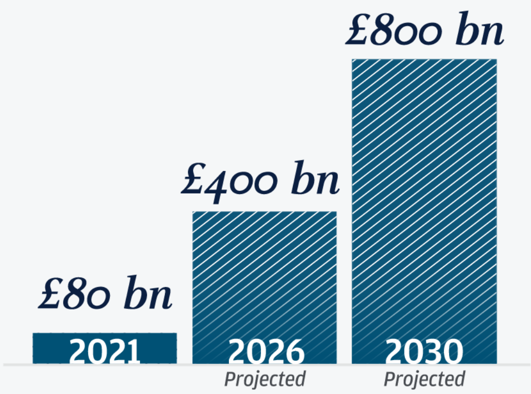
It is a phenomenon that is not losing steam. The DC Master Trust share of the workplace pensions market could expand to £400 bn by 2026, up five-fold from £80 bn in 2021, per Hymans Robertson LLP.[3] In terms of the proportion DC Master Trusts constitute of the total UK pension fund market, that represents a rise from almost 2% of the £4.2 trillion total in 2021[4] to about 10% of the almost £4 trillion current total (the total UK pension market has decreased since 2021).[5] The total DC Master Trust AUM could reach £800 bn by decade's end, according to chancellor of the exchequer Rachel Reeves.[6]

Percentage of FTSE 350 companies with Master Trusts as their DC vehicle of choice



Source: WTW

Size of DC Master Trust AUM in the UK



Sources: Hymans Robertson LLP, Chief Investment Officer

1 *Evolving the Regulatory Approach to Master Trusts, Department for Work & Pensions*

2 *WTW DC Savings Survey, 2023*

3 *The Rise of the DC Master Trust, Hymans Robertson LLP, 2021*

4 *Investment Management in the UK 2023-2024, The Investment Association*

5 *UK Pensions – LGPS Consolidation: a look ahead to 2025, Shoosmiths, Jan. 9, 2025*

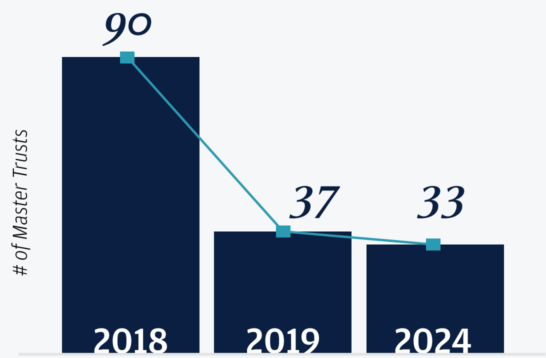
6 *UK Chancellor Plans Britain's Biggest Pension Reforms in Decades, Chief Investment Officer, Nov. 14, 2024*

This increased scale could bolster the sophistication these schemes have in their investment strategies, according to analysis from the Department for Work and Pensions (DWP).[7] That means these schemes could allocate a greater proportion of their capital to private markets and also incorporate model portfolios that target a particular balance of return and risk.

Consolidation

At the same time, while balances in DC Master Trusts have ballooned and their underlying investments have grown increasingly illiquid, the total number of Master Trusts plummeted from 90 to 37 following the 2018 introduction of a requirement that Master Trusts applying to The Pensions Regulator (TPR) for authorisation meet stringent criteria, demonstrating financial stability to handle Master Trust setup and operational costs, "fit and proper" persons are involved in running the scheme, adequate governance and administration, and continuity arrangements in the event of financial difficulties.[8] As of Dec. 31, 2024, the total number of UK DC Master Trusts stands at 33.[9]

The Year of Authorisation



Source: Hymans Robertson LLP, TPR

Since 2018 changes, Master Trusts have had to apply to The Pensions Regulator (TPR) and demonstrate they met the strict new criteria. As a result of this stringency, the number of Master Trusts plunged.

The robust assets under management (AUM) momentum DC Master Trusts are experiencing across far fewer schemes that are themselves invested in more unlisted assets means the administration of these trusts presents significant challenges, particularly in the areas of cash allocation and portfolio rebalancing, along with data management and client reporting. This paper explores the benefits of utilising a "Cash Allocation and Rebalancing Application" (CARA), a solution that has seen success in Australia, in addition to an outsourced data management solution to enhance operational efficiency, streamline liquidity management and asset allocation changes, and attempt to improve investment outcomes for members.

7 *Trends in the Defined Contribution trust-based pension market, DWP, Nov. 22, 2023*

8 *TPR gives master trusts just one chance for authorisation, Professional Pensions, May 25, 2018*

9 *Occupational defined contribution landscape in the UK 2024, The Pensions Regulator, March 4, 2025*

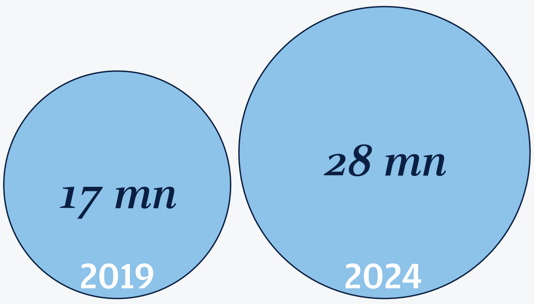
The Challenges of Cash Allocation and Rebalancing in DC Master Trusts

Rising Participation and Auto-enrolment

The UK pension system has undergone significant changes over the past few decades, with a marked shift from Defined Benefit (DB) schemes to DC schemes. DC Master Trusts have emerged as a popular solution, pooling resources from multiple employers to achieve economies of scale and outsourced professional management. Whereas just 17 million participants were enrolled in UK DC Master Trusts in 2019, per the UK Pensions Policy Institute's Survey,[10] that number has since grown by almost 65% to 28 million as of the end of 2024.[11]

That trajectory is headed due north in the UK, with more employers inclined to move to DC Master Trusts: 41% of employers with their own trust schemes are exploring a change to a Master Trust over the next two years.[12] Auto-enrolment with increasing individual participants has flooded DC Master Trusts with a surfeit of cash it must strategically allocate to capital markets.

Number of Participants Enrolled in UK DC Master Trusts



Source: Pensions Policy Institute, TPR

The Rise of Private Assets

At the same time, the UK government is increasingly pushing DC Master Trusts to invest in private assets to attempt to boost their returns and achieve more robust portfolios that can ensure the pension funds can meet their obligations to retirees. Under the Mansion House compact, 11 of the largest DC funds planned to allocate at least 5% of their DC default funds to unlisted equities by 2030, up from 0.5% currently – aiming to boost returns for pension savers and introducing investment capital to buoy UK productivity.[13]

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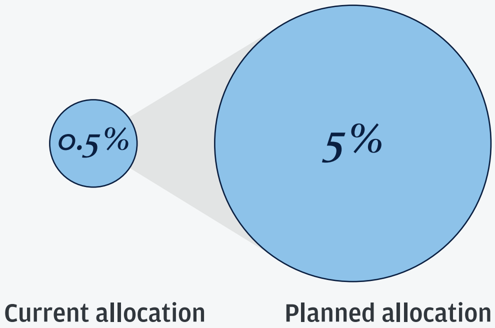

Source: PwC

10 *Policy options for tackling the growing number of deferred members with small pots, Pensions Policy Institute, July 2020*

11 *Occupational defined contribution landscape in the UK 2024, The Pensions Regulator, March 4, 2025*

12 *WTW DC Savings Survey, 2023*

13 *Report to the Pensions & Private Capital Expert Panel, PwC, February 26, 2024*

LTAFs

Contributing to that private market investment momentum is the Long-Term Asset Fund (LTAF), a new open-ended-fund category authorised by the Financial Conduct Authority (FCA) that has launched over the last year in the UK within DC pension schemes. LTAFs allow retail investors access to private assets while also reducing blind pool risk, which means investors have greater transparency into their underlying investments within these funds.[14] This innovative fund structure allows for DC Master Trusts to allocate capital from retirement savers into private markets while delivering protection to investors through liquidity management tools that facilitate a balance between asset-based liquidity and the redemption frequency offered to investors.[15] As of May 2024, almost a fifth (18%) of DC pension schemes in the UK use an LTAF or a European Long-Term Investment Fund (ELTIF).[16]

Operational Difficulties

Despite the many advantages of DC Master Trusts, the surging AUM spread across far fewer trusts and increasing allocation to illiquid private assets means DC Master Trusts face complex administrative tasks that are particularly burdensome in the following ways:

- **Complexity of Cash Flows:** DC Master Trusts deal with a continuous flow of contributions, withdrawals, and transfers. With increased AUM and more participants spread across fewer Master Trusts, managing these cash flows efficiently is increasingly challenging, yet crucial to promoting liquidity and attempting to optimise investment returns.
- **Regulatory Compliance:** Trustees must adhere to stringent regulatory requirements, including those set by TPR and the FCA. Accurate and timely cash allocation and rebalancing are essential for compliance. In 2015, TPR introduced key governance requirements that made trustee boards ensure their default investment strategy is designed in a suitable manner for their members and also assess to what extent charges and transaction costs deliver good value for members.[17] This added oversight requires more onerous reporting. Direct scheme-specific interventions such as TPR letters and scheme advisor recommendations meant trustee boards increased the time they spent on governance or administration from 2020 compared to 2019, with 32% spending more time reading a TPR code or guidance and 30% boosting the time they spent using the trustee toolkit, according to the 2020 DC Trust-Based Pension Schemes Research Report from TPR and OMB Research.[18] Of 216 total DC schemes surveyed, only 16% covered administration quarterly as a dedicated item on the agenda at board meetings, whereas 100% of Master Trusts did so, meaning these DC Master Trusts face more burdensome record keeping requirements.[19]
- **Investment Strategy:** Maintaining the desired asset allocation is vital for achieving the trust's investment objectives. Market fluctuations and cash flows can cause deviations from the target allocation, necessitating regular rebalancing. That is all the more an arduous task given the uptick in private allocations and the target risk-return mix aimed at in model portfolios. Preserving, for example, an allocation of 15% in private assets across five funds while also maintaining adequate liquidity to meet retiree redemptions hinges on nimble reallocation.
- **Operational Efficiency:** Manual processes for cash allocation and rebalancing are time-consuming and prone to errors. An automated solution could significantly enhance operational efficiency.

The development and implementation of a specialised application to address these challenges can help pension funds try to solve their cash allocation and portfolio rebalancing pain points.

14 *The Role of the Long-Term Asset Fund: IA Position Paper, The Investment Association*

15 *How does liquidity work in an LTAF?, Schroders*

16 *Atlas 2024 report, Exploring private markets: A new world of possibilities, Carne*

17 *DC Trust-Based Pension Schemes Research Report 2020, The Pensions Regulator and OMB Research, May 2020*

18 *Ibid*

19 *Ibid*

The Role of a Cash Allocation and Rebalancing Application (CARA)

A specialised application designed for cash allocation and rebalancing can help address the aforementioned challenges by providing the following functionalities:

- **Automated Cash Allocation:** The application can automatically allocate incoming contributions and other cash flows according to predefined rules. This helps ensure that new funds are promptly invested per the required investment allocations whether to a discrete mandate manager portfolio or an unlisted investment via J.P. Morgan's Fund Order Routing and Settlement Service (FORSS) platform.
- **Dynamic Rebalancing:** The application can continuously monitor the portfolio's asset allocation and execute rebalancing transactions as needed. This helps maintain the desired risk-return profile.
- **Regulatory Reporting:** Though regulatory reporting tends to be done off the investor records post all the processing, there are elements of what CARA processes that are used for regulatory reporting such as the ownership structure allowing for look-through reporting. The application populates our platforms to allow for detailed reports and aims to support regulatory compliance, including transaction records, allocation summaries, and performance metrics. This can reduce the administrative burden on trustees and enhance transparency.
- **Integration with Existing Systems:** The application can integrate with the trust's existing administration and investment management systems, improving seamless data flow and helping to reduce the risk of errors. It is also integrated with our custody and accounting systems, allowing one instruction to complete all associated transactions. This is possible via message queuing (MQ) messages or via Secure File Transfer Protocol (SFTP). Such solutions may require a custom build by both parties.
- **Customisable Rules and Strategies:** The application allows for the customisation of cash allocation and rebalancing rules to meet the specific needs and objectives of Master Trusts at different stages of growth and in-house capabilities. This flexibility helps ensure that the solution can be tailored to fit a wide range of investment strategies and policies.
- **Multiple Currency Transfers:** CARA allows for the transfer of amounts in multiple currencies depending on the funding needs across the structure as well as what cash balances are available. This transfer allows for easy management of funding requirements across different investment portfolios in different currencies while maintaining the ownership structures.

The Benefits of Implementing a Cash Allocation and Rebalancing Application

A specialised application designed for cash allocation and rebalancing could improve outcomes and operations for asset owners and their clients:

- **Potential for Enhanced Investment Outcomes:** By endeavouring to achieve timely and accurate cash allocation and rebalancing, the application aims to help maximise investment returns and improve the overall performance of the trust.
- **Operational Efficiency:** Automation reduces the time and effort required for administrative tasks, allowing trustees to focus on strategic decision-making and member engagement.
- **Risk Management:** Daily allocation monitoring and dynamic rebalancing can help maintain the desired risk profile of the Member Investment Options, protecting the trust from undue market volatility and deviations from targeted asset allocations. This is particularly important for institutional investors who need to manage risk carefully to meet their long-term obligations.
- **Regulatory Compliance:** Automated reporting using data elements from the cash allocation and rebalancing process can assist the trust in meeting its regulatory requirements, potentially reducing the risk of penalties and reputational damage.
- **Member Satisfaction:** Boosted operational efficiency (and the potential for improved investment outcomes) can translate into better retirement savings for members, enhancing their satisfaction and trust in the scheme.
- **Scalability:** A CARA solution is designed to handle the complexities and scale of large institutional portfolios. Whether managing a single large fund or multiple smaller funds, CARA can scale to meet the needs of different investment mandates.

Australian Superannuation Funds
Case Study

Streamlining superannuation management with J.P. Morgan's CARA platform

A specialised "Cash Allocation and Rebalancing Application" could address significant challenges experienced in the administration of DC Master Trusts in the UK by automating key processes and enhancing operational efficiency. The use-case and seamless integration of the J.P. Morgan CARA platform in the dynamic landscape of the Australian superannuation market demonstrates its potential efficacy in the UK. The application, which has made a significant impact among our superannuation and asset manager clients, currently supports 26 clients and approximately AUD $1 trillion in assets under administration. CARA is integral to executing cash allocation and rebalancing strategies across a diverse array of portfolios.

Below we examine our capabilities for one Australian superannuation fund in particular, a medium-sized fund around AUD $50 billion that does not have all the in-house systems available and thus outsources notional rebalancing. Here is how CARA supports this superannuation client and others:

Automated Daily Cashflow Management

CARA automates daily cashflow activities for each Member Investment Option (Option) through an SFTP feed from multiple administration platforms. This ensures transactions are accurately applied per Option, with allocations seamlessly distributed through the fund structure to the appropriate asset classes and underlying manager accounts. Smaller daily transactions are consolidated into a cash mandate to optimise fund management by minimising unnecessary fund manager interactions. CARA's cash allocation function applies percentages based on transaction type, offering the flexibility to differentiate between expenses, tax payments, and capital stock transactions. This nuanced approach ensures the most efficient allocation of funds throughout the structure.

Efficient Notional Rebalancing

Post cashflow processing, CARA executes notional rebalancing based on client-defined target asset allocations. This process realigns smaller Options to their target allocations by offsetting them against the default Option, allowing exposure managers to focus solely on managing the remaining exposure differences. CARA's system supports a variety of notional rebalancing approaches tailored to meet the unique structures of individual clients. Whether the goal is to align smaller options to a target and allocate over- and under-valued asset classes to a banker option, or to distribute these over- and under-values across all options based on their ownership within each asset class, CARA provides the flexibility and precision needed to optimise portfolio alignment and asset management.

Streamlined Funding Transactions

CARA simplifies funding transactions for private investment calls, new manager portfolios, existing managers, or income repatriation to the main cash mandate. Clients can easily instruct these transactions using a template that specifies the involved manager portfolios and Options. Transactions can be executed in any currency, with CARA handling notional conversions to the base currency for accounting purposes while managing the required currency in custody.

A Suite of Solutions Beyond CARA

Automated Expense Funding

CARA streamlines expense funding transactions by automatically processing them at the Option level according to predefined allocations. This automation eliminates the need for separate client instructions for funding these payments. Each expense type can be uniquely allocated throughout the structure, tailored to the client's specific requirements and cash management strategies, ensuring seamless and efficient financial operations.

Special Purpose Vehicle Funding

CARA facilitates funding to associated Special Purpose Vehicles (SPVs) that are wholly owned by the superannuation fund, managing segregated assets with precision.

Comprehensive Accounting and Custody Management

CARA handles all accounting and custody transactions between custody accounts, as well as payments to or receipts from the administration account held with the member administrator. With the ability to process and maintain relationships between hundreds of portfolios encompassing diverse investments—listed, unlisted, direct, internally, and externally managed—CARA significantly reduces client effort by leveraging fund structures to simplify client instructions. These structures also allow for the management of regulatory reporting where Option level look through information is required, ensuring consistency across all reporting.

By addressing the critical need for efficient cash allocation and rebalancing amid the consolidation of pension funds and the increased allocation to private assets, DC Master Trusts can better serve their members and potentially achieve their long-term investment objectives. In addition to the CARA solution, J.P. Morgan can deliver data management and portfolio administration needs to asset owners, which is becoming increasingly necessary amid their added allocations to private assets.

Data Management

As pension funds like DC Master Trusts increase the proportion of capital they allocate to private assets, the private-public convergence means that organising, consuming, and integrating data in their portfolios can prove daunting and obstructive to efficient decision-making.

Here are some of our data management key benefits:

Elevated Operational Efficiency

Asset owners address their data challenges and drive operational efficiencies with Fusion by J.P. Morgan, a cloud-native data platform that delivers end-to-end data management, analytics, and reporting solutions. Fusion streamlines access to normalised, interoperable data from J.P. Morgan and third-party data sources.

Integration of Data Across Multiple Portfolio Administrators

Fusion can integrate data across multiple portfolio administrators, including J.P. Morgan Securities Services, to capture granular data attributes gathered through the investment workflows and enrich it with data from leading industry data vendors for private assets.

A Suite of Solutions
Beyond CARA *(contd.)*

Cleaner Data

Through its proprietary data normalisation engine, Fusion optimises and standardises the resulting data in a comprehensive process that it handles algorithmically, with automatic updates, to provide access to the most up-to-date data without the need for manual processes. This allows asset owners to consume and interpret their data while operating at scale as the complexity of their data needs grows.

Native Integration With Data Storage Platforms And Accessibility Through Data Visualisation Platforms

Fusion natively integrates with:

- Snowflake
- Databricks
- AWS
- Google's BigQuery

Fusion makes data accessible...

- ...via API, SDK, and Jupyter Notebooks
- ...in formats including .CSV, JSON, and Iceberg
- ...for use in MS applications, including Excel and PowerBI as well as Tableau

Integration Across Asset Classes

Fusion captures and integrates public and private asset holdings and transactions data across asset classes, including:

- Public securities
- Private equity
- Private credit
- Real estate
- Venture capital
- Infrastructure

Portfolio Administration

Asset owners are under added pressure to share reporting to clients who want visibility into the performance of private holdings, which are non-transparent and require manual processes to ascertain amid the convergence of public and private assets.

Here are some of our portfolio administration key benefits:

Versatile Alternative Fund Services (AFS)

J.P. Morgan's Alternative Fund Services (AFS) business serves the fast-growing asset classes across:

- Private equity
- Private credit
- Infrastructure
- Fund of fund strategies

Automated Portfolio Administration

J.P. Morgan's use of an AI Natural Language Processing (NLP) solution for private markets facilitates automated portfolio administration servicing of private assets without the burdensome manual process. This NLP solution utilises proprietary and open-source technologies to pinpoint relevant data within complex and non-standard documents and isolate it for decision-making purposes. The NLP solution utilised by J.P. Morgan retrieves capital account statements directly from fund manager portals or email attachments, extracts the relevant statement attributes, and submits these to J.P. Morgan's platform that validates capital account statement data. A "human-in-the-loop" is maintained to perform the second of a dual-maker function and our platform performs a systematic reconciliation between the statement-extracted attributes and the data within J.P. Morgan's instance of a portfolio management tool. The NLP solution utilised by J.P. Morgan is further extended to capital call and distribution processing whereby the AI tool is integrated with the J.P. Morgan Markets application Transaction Instruction Manager to automate the entry of the capital event data and create the instructions used to both execute cash wires and perform the classification of the transaction level detail.

Fund-Level Performance Reporting

Especially useful for asset owners invested in more private assets, J.P. Morgan enables fund-level performance reporting through a portfolio management tool, providing insights into cash flow forecasting, tracking funded vs. unfunded commitments, IRR and investment multiple calculations, peer group analysis with the above available through standard and configurable reports, and dashboards and Excel add-in functionalities.

Exposure Reporting into Underlying Companies

Through a third-party data service, J.P. Morgan provides access to aggregated exposure reporting across the full portfolio of private assets, supporting the drilling down into each underlying company's cost, market values, and fundamentals across the different countries and industries into which the underlying funds invest.

In addition to the suite of services J.P. Morgan offers from a data and portfolio administration standpoints, our core CARA solution delivers a comprehensive and sophisticated approach to cash allocation and portfolio rebalancing. By automating these critical processes, CARA enhances operational efficiency, helps manage risk more effectively, and aims to improve investment outcomes. Its integration capabilities and customisable features make it a valuable tool for institutional investors looking to optimise their investment management processes.

As funds grow in scale and complexity along with an increasing exposure to private investments, infrastructure, and property, CARA can simplify the management of the cash processing and rebalancing along with providing flexibility to include overlay asset classes for hedging or exposure management in the rebalancing process.

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