Think you know consolidation – think again

The pension industry was surprised that the pensions bill delivered as part of the Queen's Speech on 14 October had no mention of the defined benefit superfunds, the vehicles that look to transfer covenant and therefore discharge trustees and corporates of their obligations.

While this is a form of consolidation, recent commentary and coverage has tended to focus on these superfunds as the main way to consolidate. We thought we'd use the opportunity the pause has given us to step back, and question whether too much of the focus has been at the wrong end of the consolidation spectrum.

DWP Green paper (February 2017)

Cast your mind back to the Green paper from the DWP in February 2017 – Security and sustainability in defined benefit pension schemes. The main question on consolidation posed then was:

"Should Government act to encourage, incentivise, or in some circumstances mandate the consolidation of smaller schemes into vehicles with greater scale and better governance in order to reduce the risk to members in future from the running down of closed, especially smaller, DB schemes"

Note the focus on smaller schemes, improved governance and access to economies of scale, which was broadly welcomed throughout the industry.

PLSA DB Taskforce – case for consolidation (March 2017)

In parallel, the Pensions and Lifetime Savings Association ("PLSA") had set up a DB Taskforce to look at challenges faced by DB schemes, looking at sustainability and helping schemes to run off more efficiently. Their paper on "the case for consolidation", released in March 2017 (just after the Green paper) had a greater focus on the case for superfunds and covenant transfer. This is a much more complex area, with harder decisions for trustees and corporates to make, not to mention potential changes to legislation and regulation.

DWP White paper (March 2018)

It is perhaps unsurprising that by the time the White Paper was released in March 2018, the focus had shifted almost entirely to superfund consolidation, with little mention of the other forms of consolidation. During 2018, the two main superfunds, Clara and Pensions Superfund, were launched, with the DWP releasing its consultation on a new legislative framework for superfunds in December 2018 (which closed in February 2019 – you can see some commentary on the regulatory implications here superfunds blog).

Consolidation – not just superfunds

Superfunds are a very interesting addition to the pensions' landscape, and may well be an option for some schemes. However, for many schemes, other forms of consolidation offer significant benefits that can be realised in the short term, which will help them on their journey to ensuring member's benefits are paid. We highlight some of these below.

Cost benefits

As an example of the benefits, the PLSA as part of its cost and transparency initiative, has estimated that on average around 75% of fees incurred by pension schemes are investment manager costs. This will be proportionately higher for smaller schemes; consolidating schemes and increasing purchasing power will drive these costs down.

Governance and operational benefits

In July 2019, The Pensions Regulator ("TPR") released a consultation on the future of trusteeship and governance (see future-trusteeship-governance-consultation).
The opening paragraph outlines TPR's vision:

"Our vision for the future of occupational pensions is one where all savers are in schemes that have excellent standards of governance that deliver good value. Over time we think this will mean having fewer, but better governed schemes in the market. This will be good for savers – they should benefit from more efficiently run pensions, with the right people in place to make better investment decisions."

While the focus in the document was on DC consolidation, the principles apply to DB consolidation too; TPR also highlighted that superfunds are only one of many different ways to consolidate. Giving more schemes access to high quality governance and administration support through consolidation will be a good way to ensure members are supported.

There is a danger that with the focus on superfunds, and the time it will take to prepare any new regulations, schemes are being put off from considering whether any form of consolidation may be appropriate. For some schemes, this will lead to worse outcomes for their members, and so it is time for the debate to shift back to considering all the different forms of consolidation.
I will post a follow up article covering these different forms.

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