**Summary**
• Consolidation in the pensions industry continues at pace, not least spurred on by The Pensions Regulator's encouragement.
• Schemes look to consolidate, for instance into a master trust, with the aims of improved governance, communications and economies of scale.
• Larger schemes are also able to benefit from a wider choice of investment options.

# Bigger can be more agile

**Robert O'Connor investigates how scheme consolidation trends (both DC and DB) may affect investment options, attract talent, reassure the regulator and serve their members**

As regulatory and commercial pressures drive master trusts to combine into ever-larger units, the managers of these vehicles are hoping to benefit from stronger governance, more competitive pricing, and increased investment heft.

"I would describe it as a bloodbath going on at the moment," WTW senior director, James Colegrave, says of the wave of mergers, before quickly adding that it is a "positive bloodbath" for the schemes and their members.

Hymans Robertson head of DC provider relations, Shabna Islam, says The Pensions Regulator has a strong interest in seeing single employer trust arrangements move under larger umbrellas. Defined contribution master trusts are "really attractive at the moment," Islam says.

Size can create valuable economies of scale, Islam adds. Her list includes lower fees, better communication with members, and access to more sophisticated investment tools.

Aon head of UK DC solutions, Tony Britton, attributes much of the impetus for change in the market to a push for more effective regulation and a desire to improve customer service. "I don't believe this is just a consolidation story," Britton says. "We continue to see new market entrants creating additional choice."

Aon partner, James Patten, says consolidation on the DB side involves a "smorgasbord of options" such as buyout, commercial consolidation, consolidation of investments and ongoing governance.

"The nature of consolidation has changed over the years as the pensions industry has responded to schemes' changing needs," Patten notes. "What was once focused on the bundling of services with one adviser, he says, has evolved into a wide array of techniques and strategies. It's no longer a case of 'one size fits all', he says.

Colegrave says the trustees of big funds must be aware that the assets they control might attract unwelcome political interest. He is also concerned that some trust managers might see them as a low-cost form of outsourcing without fully considering the specific needs of members.

**Safeguarding members**

The Pensions Regulator executive director of regulatory policy, analysis and advice, David Fairs, stresses the agency's desire to safeguard the interests of members. "Consolidation is happening and while we remain agnostic about the size of the pensions market, we recognise it presents an opportunity for improved outcomes for savers," Fairs says.

For defined contribution schemes, Fairs adds, the regulator wants "a market boasting well-governed schemes offering value for money".

"Trustees of schemes struggling to meet our expectations have a number of options including transferring to a master trust which, thanks to our authorisation and supervision regime, has created a market where savers are better protected," he notes.

For defined benefit schemes, Fairs says, the regulator supports "consolidation where it's in savers' interests and sees their benefits better protected".

"We will work with the market on the further development of innovative models such as superfunds, which have the potential to offer benefits for pension savers and sponsoring employers, such as economies of scale and good governance".

The Pensions Regulator says the "increasing professionalisation of the pensions industry" has been one of the factors in this consolidation. Even small schemes, it states, may be responsible for millions of pounds worth of benefits with greater demands on trustees' time and higher costs for sponsoring employers.

"The most significant difference between DC and DB schemes is that for a single employer DC scheme shifting to a master trust is essentially cost free," the regulator's statement says.

The speed of consolidation has convinced Colegrave that smaller trust-based arrangements will not remain viable past the next few years. There will be little reason for an employer to own a trust unless it has several billion pounds in assets, he argues. "Certainly anything below £1 billion, I think, has a question mark over its future viability."

**Looking ahead**

Looking ahead, Colegrave sees a DC world that will be made up largely of market-dominating master trusts and a small number of owned trusts. Smaller entities, Colegrave says, are likely to find it difficult to cope with "increasingly onerous" regulatory demands. Not only are disclosure requirements becoming stricter, he notes, but The Pensions Regulator is to add to the strain with the release this year of a new code of practice.

Islam expects the current level of 36 DC master trusts in the UK to fall to about half that over the next decade, with mergers peaking over the next three years.

A few years ago, Colegrave says, many small trust-based arrangements were run as something of a cottage industry. Today's bigger units, he said, bring advantages in administration, communications and governance.

Colegrave, who focuses on the DC sector, says bigger schemes will be able to tap into the kind of advice that can help them diversify their holdings in innovative ways.

"The emergence of these master trusts provides professionally run outsourced pension arrangements that are incredibly attractive to employers wanting to offer decent pension provision to their employees at really quite competitive costs," Colegrave says.

There is no need, Colegrave suggests, for a pension fund to be fixated on such traditionally traded instruments as equities and bonds. Instead, he adds, the "almost endless" list of alternatives can include private equity, infrastructure and commodities. Strategies, Colegrave says, will become more sophisticated. Members of pension schemes are in it for the long term. They do not need check their accounts every day with an eye on quick transactions.

While every new investment option vehicle is likely to carry risk, Colegrave believes, these risks can be studied and mitigated. And the effect of diversification is to reduce overall uncertainty, he adds.

Islam agrees on the importance of taking a wide strategic view. Being bigger, she says, master trusts have more access to markets and specialist expertise. She expects these advantages to increase as the amalgamation process continues.

**Closer scrutiny**

Islam agrees that closer regulatory scrutiny of single trusts has encouraged mergers. Trusts, she says, are expected to be well governed, with these expectations intensifying as the trusts grow in size. It is very appealing for smaller companies, she adds, to be able to hand over these responsibilities to specialists.

Colegrave is concerned that some trust managers might see them as a low-cost form of outsourcing without sufficiently considering the specific needs of their members.

The main element in the evolving DC world, Colegrave says, will be a number of master trusts that will dominate the market and a small number of owned trusts. There would be little appeal for an employer to own a trust unless it had several billion pounds in assets. "Certainly anything below one billion pounds, I think, has a question mark over its future viability," Colegrave adds.

Even as regulation becomes more difficult for smaller trusts, Colegrave says, they can expect their burden to increase this when The Pensions Regulator issues a new code of practice this year.

A few years ago, Colegrave notes, many small trust-based arrangements were run as something of a cottage industry. Today's bigger units, he explains, bring advantages in administration, communications and governance. "I would describe it as a process of professionalisation within the DC pension world," he says.

"The master trust authorisation regime has created a market where savers are better protected," the regulator says. "We may see market-led consolidation of the huge oversupply of defined contribution occupational schemes, some of which struggle to meet adequate standards of governance and administration and pose a risk to good member outcomes."

The regulator says it does not object to small schemes per se, but too often, it argues, small schemes fail to provide good governance and good investment prospects. The trustees of schemes that do not meet these standards, the regulator says, should consider consolidation.

**Written by Robert O'Connor, a freelance journalist**