Embracing the future

Summary
• The DC and DB worlds are consolidating, albeit at different rates and in different ways.
• In the short term, opportunities lie in place in DB for advisers and administrators, as trustees look to clean up their data and get schemes ready for the next steps of their de-risking journeys.
• Longer term, demand for bespoke investment solutions will give asset managers new lines of work.

Pension service providers should view consolidation as an opportunity, rather than a threat

There is so much talk about scheme consolidation these days that it can sometimes give the appearance of being a self-fulfilling prophecy.

But as Standard Life Assurance head of UK propositions, Neil Hugh, explains, there are good reasons for companies to look at pooled pension arrangements as the best solution – not only for their balance sheets, but also for the welfare of their employees.

"There are a number of market forces, most notably regulation, technology and environmental, which are converging," says Hugh. "The result of this means scale is more important than ever, and if done well, has the potential to offer more efficiently and consistently run pension schemes."

From a DC perspective, consolidation is taking place at an accelerated level. According to figures supplied by The Pensions Regulator in December 2019, the number of DC master trusts — arguably the best barometer for the state of the DC market — has shrunk from about 90 at the beginning of 2019 to 38.

On the DB side, fund agglomeration has some hurdles to overcome. "A major consideration for DB schemes is that there are a variety of benefit structures for differing pension schemes, which makes bringing them together potentially quite challenging," says Willis Towers Watson head of OneDB, Gareth Strange. "This is further complicated by the responsibility on the employer to keeping paying until the very last member payment is made or passed to an insurer (or consolidator).

"Therefore, DB consolidation is likely to happen in a different way; not by putting everyone in the same scheme, but by consolidating the processes that the schemes are required to do, such as fiduciary investment or the establishment of independent trustees."

The Pension Protection Funds' Purple Book from 2017 lists 5,588 DB schemes, of which 36 per cent have fewer than a hundred members and 44 per cent less than a 1,000. It is these smaller, more numerous, schemes that would be expected to pursue some form of process consolidation.

Given these numbers, the significance of this migration cannot be underestimated. "We're potentially at the start of one of the greatest decades of change in pensions landscape that we've seen since it was set up, as DB schemes look towards their end goals and get in position to do that," says Mercer head of risk transfer, Andrew Ward.

Short-term boost

As Royal London director of policy, Steve Webb, says, consolidation leads to much-needed economies of scale for pension schemes. However, the flip side of reduced costs for schemes is reduced business for those who provide services to pension schemes. "If the experience in countries such as the Netherlands, which have seen considerable consolidation, is anything to go by, those who provide services to schemes may see a contraction in demand at the smaller end of the scale," he says.

A foretaste of what is set to come has already been experienced by many

investment managers, says Russell Investments managing director, head of client strategy and research, David Rae, in the form of the local government pension scheme pooling. This major shift in the UK investment environment has led to a change in the relationship between investment committees and managers.

However, within the private sector, there has been a boost in activity that could keep service providers busy for a good while yet.

In the field of administration, for example, there is plenty of work to be done. "If you're looking to consolidate a DB scheme and transfer risk elsewhere, then you need to do all the cleaning upfront rather than over time," says Ward. "That is a lot of work to get buyout or consolidator ready. Sponsors and trustees realise that the work does need to be done and can't be neglected."

From a consulting side, for many DB schemes the challenge has changed. The focus now is on schemes working out where they want to be in the future. That means creating ever-changeable de-risking journey plans and calculating how to hit long-term funding targets. "There's a lot of work to be done there and clearly if you're doing a transaction in the final stages where you're moving to a bulk annuity provider, there's a whole host of factors that have to be done absolutely correctly as part of that process, which generates work," says Ward.

New opportunities

In the longer term, further, albeit less tangible, opportunities lie in wait.

"The changing landscape, such as the growth of master trusts with huge memberships and the emergence of new models such as collective DC, could provide new opportunities for those who support pension schemes," says Webb.

Returning to data, Hugh picks the need for increased efficiency as a way for providers to support even more member centric propositions – as long as they have the technology to do so.

"One development that we believe will be essential for clients is increased data analytical capabilities," he reveals. "The value-add within such will be ensuring the right type of data is gathered and most effectively used in helping a scheme and its members.

"With schemes being consolidated and growing in size, data plays a vital role in supporting oversight management and providing genuine insights into areas that could benefit from improvement for employers and members. When effective, such analytical capability will enable schemes to take actions to improve member outcomes."

Tailored solutions

It is within the asset management and investment advice sectors that the most change may eventually occur.

In the bulk annuity world, for example, in-house insurance company investment teams are still going to have to outsource much work in order to find the right assets at the right time. Ten years ago, there would have been about £20 billion bulk annuity deals in place, estimates Ward, now, that figure is hovering around the £200 billion mark.

Equally, fiduciary management arrangements represent some £150 billion of pension scheme assets, whereas a decade ago they would have barely covered £10 billion of investments. "With the schemes that are looking to run-off rather than transfer risk, there may be larger mandates in total and fewer of them, but there may be the potential for them to be some more specialist mandates," suggests Ward.

This focus on specialist solutions could give investment houses a new way of interacting with most pension trustee boards and their consultants as well, says Rae: "The asset management industry was for a long time primarily product led. Providers pushed individual commoditised products and pension schemes were typically left on the receiving end. Consolidation is changing the demand dynamic with a much greater focus on providers who can offer tailored solutions that are much more specific to the needs of pension schemes."

For example, as DB schemes have matured, their need for income has increased. With consolidation, the buying decision is no longer based solely on individual asset class but much more focused on the attributes that make the solution effective. Rae also sees larger pension schemes pushing the boundaries and looking beyond traditional investments. With consolidation coinciding with other industry dynamics, like the focus on responsible and impact investing, schemes are looking for providers who can offer much more sophisticated solutions.

"One of the key tenants of consolidation is scale," says Newton Investment Management CCO, Julian Lyne.

"And if you partner with a master trust or a DB consolidator, then that clearly gives you an opportunity to have a strategic relationship and actually attract assets from the end user standpoint that should result in more bespoke solutions that the pricing that scales gives you.

"Clearly there are less clients for us to engage with, but the consolidated asset side is a bigger prize."

In the end, says Strange, everyone has the potential to benefit from consolidation, particularly in the DB space, as the greater buying power from pension fund co-working arrangements will likely lead to greater innovation in service provider offerings across the board.

"The DB space is adapting, with the implementation of full service pension management platforms enabling schemes to reach their objectives by outsourcing the processes that consolidation brings together," he says.

"Ultimately, consolidation should help members, even if the direct impacts won't be obvious to them."

Written by Marek Handzel, a freelance journalist