Challenges and evolution

Richard Butcher looks back at the challenges the pensions industry has faced during his two years as PLSA chair and how the lessons learnt from these are helping the sector cope with the consequences of the current Covid-19 pandemic

"I'm not a spokesperson for the whole pensions industry, but as chair of the PLSA I want to say how incredibly proud I am of how the industry has coped with all of the challenges generated from the Covid-19 pandemic. It continued to deliver member security through billions of pounds to millions of people without error, omission or delay, despite Covid-19. The core thing that we do – provide security in retirement – continued almost uninterrupted. People did not even have to think about it and that's how good we are."

PLSA chair, Richard Butcher, is certainly right when he says the industry has coped remarkably well with the fallout from Covid-19 this past year. He gives the example of how, like so many other industries, the pensions sector had to suddenly close its offices and instead work from thousands of homes across the country. There were IT challenges at first, he acknowledges, but broadly everything went smoothly. "We learnt that the IT was robust enough," he says. "We have not seen a significant uptick in scamming or data loss.

"The other thing that underpins this is the flows of money into the industry have continued. DB funding has continued, with just some issues round the periphery. Also, DC money continued, so this has allowed us the space to continue to deliver," Butcher adds.

He recommends that the industry learns from this pandemic experience that major shifts are happening more frequently and are not likely to decline in the future, so it needs to be geared up for that.

"However, while Covid-19 is a pretty unique experience to date, we have had other challenges, to a greater or lesser extent, that the industry has had to face just during my two years as PLSA chair," Butcher says.

Financial crisis

He gives the example of the global financial crisis of 2008/9, as, even though it occurred over a decade ago, the lessons from this are still being learnt today. "It impacted the pensions industry in a fundamentally different way to Covid-19. With the global financial crisis, the sector learnt about the importance of robust risk modelling, planning and mitigation. It highlighted a different set of risks, mainly that had to be much more robust with our risk modelling and this improved robustness created many mitigations in place already, which enabled the pensions industry to react so well to Covid-19," Butcher explains.

These lessons included the importance of diversified investment strategies, not having concentration risk and even the simple lesson of not storing documents all in one place, "as we all saw people clearing out of Lehman's with boxes upon boxes of documents as the crash occurred, so do put copies of documents in more than one place".

Brexit and climate change

Like the global financial crisis, Brexit is likely to leave a lasting legacy of change. The transition period may have finished last year but it is "still too early to call" the impact it will have, Butcher says, adding that there will likely be both business failures and new businesses created as a result of the UK leaving the EU.

Another ongoing challenge, and one that continues to rise up the pensions agenda, is that of the role the industry has in helping to mitigate climate change.

As PLSA chair, Butcher has had to consider this issue head on; not least as he was chairing the PLSA Local Authority Conference session that Extinction Rebellion invaded back in 2019.

"*[Extinction Rebellion]* may have unrealistic expectations of how much we materially can do, but it has forced the government and regulators to create a framework for trustees and other asset owners to think about long-term risks. This is about values, not about tree hugging. This is about long-term risk mitigation, and of course climate change is a long-term risk, so this has to be good in the long term," he says.

DB and DC consolidation

As well as determining its role in the fight against climate change, the industry is also adjusting to internal reform, that of consolidation across all fronts, which "is still yet to happen en masse" Butcher says.

There has been a material number of DC schemes consolidated, Butcher notes, particularly at the micro end of the scale. "There is a pretty compelling case for the small to medium DC schemes that are already consolidating into master trusts," Butcher says. "However, I'm not so sure that larger DC schemes will consolidate, as they already enjoy economies of scale and robust governance."

Butcher is also unsure whether DC consolidation will continue to be a one-way journey. He gives the suggestion that a well-known sponsoring company may want to retain their own brand within their pension provision, so if they entered a master trust with £1 billion in assets, which subsequently grew into £6 billion, the sponsor may feel it is large enough to be worth unwinding the consolidation, running the scheme itself in an own-trust arrangement and making the experience more personal.

On the DB side of consolidation, Butcher expects DB master trusts to continue to receive a steady stream of clients. How many clients the new 'superfunds' will receive is still very much up in the air however. While the PLSA has been, and is, a strong advocate of DB consolidation, Butcher does note that the superfunds have been around for about three years and have yet to announce any business.

This is despite The Pensions Regulator describing the regulatory framework of how the superfunds could work in June 2020, with further detail in December – "so the jury's out with DB consolidators", he states. The population of schemes that could be consolidated is pretty small, Butcher says, and therefore he expects DB consolidation to become a feature of pensions landscape "but probably just at the level of buyout, in due course".

However they may fit into the pensions landscape, the new DB consolidators would count as disruptors to the market "if they succeed", Butcher says. If so, they would follow in the footsteps of innovations such as investment platforms, buyouts and the DC consolidators, master trusts, in initially being disruptors, but then being embedded in the pensions landscape.

The pensions industry has not yet worked out just how much of disruptor DB and DC consolidation will be on providers. Butcher says: "It is not good enough for providers to just sell more to fewer and just keep doing the same." As a long-term strategy growing in a declining market just doesn't work, he warns. "The companies that will do well are those that have a pinsharp focus on the opportunities. The best I have seen are those that diversify and do different things, such as branching out into wealth management or going international. The best businesses that will survive this 'great extinction' are those that are agile and diversify, and evolve quickly."

The industry has had what seemed like major crises along the way, which turned out to be little blips, Butcher states. "There have been lessons learnt, with 90 per cent of the industry's learning coming from little blips as opposed to major crises. With each of those little blips the industry has adapted and continues to survive," he adds. "Each little crisis has helped the industry evolve in a Darwinian way."

Evolution

This latest, not-so-little-crisis of the Covid-19 pandemic will also play its part in evolving the industry, Butcher expects.

While we are hopefully getting out of the woods with Covid-19 in a medical sense, it is likely to create an increase in financially vulnerable members, he warns, highlighting that some may have implemented freedom and choice on their pensions savings to see them through financial hardship now. In the future there may be an increase in companies offering DC provision closing down, increasing the number of small pots, and a 'mini-rush' of DB schemes entering the PPF, as furlough and other initiatives wind down, along with the government looking towards the £2.5 trillion of pensions assets to invest in the long economy, "so we will see more government intervention".

"For the industry itself, the biggest residual risk as we continue into lockdown is the physical and mental wellbeing of the people working in the pensions industry. As well as the compassion side, as no one wants to see anyone suffering, it is also a business risk. If people are isolated, it is harder to see oversights and omissions, if they are frayed around the edges and missing things. The industry has coped really well with Covid-19 but we are not out of the woods yet," Butcher says.

He suggests that the industry and wider economy have been moving towards 'joint enterprise' for a number of years, with Covid-19 being a good learning point for the benefits of this, and which in turn will help create a stronger, more resilient workforce.

"Industry shifts will continue to occur and there is a warning from all of these crises that if we become complacent, we will become victims to these changes," Butcher states. "Collectively and individually we have to continue to challenge ourselves to do better if we are going to continue to play a part in this industry. If we become complacent we become obsolete."

Written by Laura Blows