Finding the consolidation sweet spot

The omission of defined benefit consolidation legislation from the upcoming Pension Schemes Bill is a bump in the road for the two main commercial consolidators, but time must be taken to balance member security, employer affordability and investor profitability

Summary
- Creating a new legislative regime for defined benefit consolidation has been a tough task for the Department for Work and Pensions as it struggles to find the 'sweet spot'.
- The Pensions SuperFund expects TPR's pre-authorisation regime to be ready "by the end of November" and the DWP consultation response "by year end".
- Lack of endorsement from the government runs the risk of negatively impacting the commercial consolidators' future pipeline.
- Concerns over how it will work alongside the bulk annuity market may have added to the delays.

When rumours trickled out over the summer that defined benefit consolidation was not going to be part of the upcoming Pension Schemes Bill, many thought it was another example of government kicking an initiative into the long grass.

However, given the complex and non-uniform nature of commercial consolidators, the government was quick to reassure the industry that this was not the case.

Last month, the Department for Work and Pensions (DWP) DB consolidation lead, Des Healy, said that the government was yet to find the 'sweet spot' on legislation for the superfunds, unable to find the balance between 'member security, employer affordability and investor profitability'.

So, with The Pensions SuperFund (PSF) and Clara Pensions waiting in the wings, and the former with two seed deals already in place, what will happen next?

The sweet spot

Balancing the new legislation on the three pillars mentioned by Healy is no small feat, and Baker McKenzie pensions partner, Jonathan Sharp, believes gaining the member trust must come first.

"There needs to be a level of trust for pension schemes to be willing to transfer their members to the superfund, and for the confidence of members themselves, that the superfund will be able to deliver the promised benefits," he says.

There is industry-wide consensus that an updated operating framework is needed to be put in place, and the fact that commercial consolidators are able to operate under the current legislation has caused worry in some factions, particularly given the delays.

Commenting in the weeks leading up to the Queen's Speech, Work and Pensions Committee chair, Frank Field, said he had written to Pensions Minister Guy Opperman to ask if it would be included, saying that more workers could be 'robbed' from their entitlement if it wasn't.

However, both of the consolidators have been keen to stress their willingness to work with the regulator and the DWP in order to ensure members come first.

PSF managing director for deal origination, Peter Cazalet, says: "The PSF can already transact under the existing legislation and it should, and will, voluntarily submit potential transfers for The Pensions Regulator's (TPR) clearance/pre-authorisation.

"The lack of clarity around the regulatory regime for consolidation requires us to work very closely with TPR to ensure that clearance, and a future pre-authorisation regime, is as comprehensive as possible."

Despite this, Royal London director of policy, Steve Webb, believes that the government delay in introducing updated legislation was less to do with member security, and more to do with Treasury concerns that the consolidators would "compete unfairly" with bulk annuity insurers.

"The regulation of pension superfunds has been left in regulatory limbo. It is one of the biggest failings of UK pension policy that the department with lead responsibility for pensions can be thwarted in bringing forward sensible reforms by an over-mighty Treasury that has no vision for pensions," he says.

While Sharp doesn't immediately agree, he believes that legislators have had to give extra thought to how the new consolidators will act alongside bulk annuity insurers.

"One interpretation of the fact that superfund legislation wasn't included in the pensions bill is that it was seen as too controversial to receive smooth passage through parliament, and that it could be portrayed by some as a poor man's buyout," he explains.

However, the regulator and the DWP are adamant that it is the pure complexity of the process that has caused the updated legislation to be left out of the Pension Schemes Bill.

TPR had previously told *Pensions Age* that it hoped to have the superfund assessment completed by the end of the year, however, the signs are that it may take longer.

In an update, the regulator told *Pensions Age*: "Until the assessment framework is finalised, we are in no position to assess the funds and any associated transactions.

"In any transaction, we expect all proposals to have the full support of the scheme trustees and provide better outcomes for members. We are working extremely closely with the emerging superfunds throughout, who are aware of the complexity around the process."

According to PSF, the regulator will advise on an "interim pre-authorisation regime" towards the end of November 2019, while the DWP intends to respond to its December 2018 consultation "by the end of the year".

"Clearance of the seed deal is expected shortly after that," Cazalet adds.

With the lack of government endorsement however, will the omission of updated legislation from the Pension Schemes Bill damage the consolidators commercially?

Will trustees still be attracted to consolidators?

While Sharp doesn't believe that the latest setback will stop the industry from taking off, it has at least slowed down the process.

"The lack of legislation means there isn't the same level of endorsement for superfunds by the government, and so the development of the industry and attraction for new entrants may be slower than would otherwise be the case, as there's uncertainty about exactly how the superfund regime will operate," he says.

Despite this, Cazalet believes the schemes that want to make it happen are willing to wait: "The pension funds we are discussing consolidation with are prepared to lay the groundwork for consolidation in expectation of that regime, which will provide a cost-effective alternative to insurance buyout."

The Pensions SuperFund has two seed deals awaiting clearance from the regulator. The first, a flexible apportionment arrangement was presented to TPR in May, while the second, a scheme-to-scheme merger, has also been agreed, according to the group.

"Behind these there are a substantial number of schemes in the pipeline where the PSF is in discussions with trustees, sponsors and advisers," he adds.

Clara Pensions has previously said that they have a number of schemes interested in their version on consolidation, but that the schemes would rather see the first deals hit the market before they make the move.

According to Sharp, getting the requirements for superfunds to operate wrong by making them too stringent, would be more damaging than the current delay.

"If the requirements are too stringent then the market won't take off, for instance if the pricing for superfund entry is similar to an insurance buyout," he says.

"Commercial providers will only enter the market if they can make a profit from running the superfund. However, the two points are linked as the greater the solvency requirements the harder it may be for a provider to extract profit from the superfund.

"On that analysis it suggests it might be difficult to predict exactly how the regime will operate once it has been through parliament."

Cazalet and PSF understand that it is not going to be a walk in the park. Steps such as the data quality audit, asset portfolio assessment and contractual benefit definition all take time, but the longer the government takes to establish a stable framework for the super schemes, the more damaging it could be for the industry.

Written by David Andrews, a freelance journalist