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Is Consolidation the Future for Defined Benefit Pensions?

Reducing risks, saving costs, increasing security

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Welcome from the FT

Chris Flood, Asset Management Reporter, Financial Times

- **Is consolidation the future for DB pensions?**
  Private sector defined benefit (DB) pension schemes present challenges for employers because of their high costs and the demands they place on management time, but employers are starting to take advantage of industry and regulatory changes to embark on the process of "DB consolidation". This is where administrative, actuarial, investment and other services are pooled to create economies of scale, reduce risk, save on costs and increase benefit security. Consolidation has advantages for scheme sponsors (employers), scheme trustees and scheme members (employees).

- **Liability driven investment strategies (LDIs) under scrutiny.**
  Pension schemes' LDI strategies backfired when the British government's mini-budget in September caused bond prices to fall. The fall in prices forced schemes to sell liquid assets so they could post more collateral to cover their losses. The incident shone a spotlight on the investment risks facing DB schemes and how consolidation can help them mitigate, or even remove, those risks.

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Opening remarks

The challenges facing private sector DB pension schemes and why consolidation could be the solution

Brian Denyer, Senior Solutions Director, abrdn

- **abrdn survey on DB consolidation.**
  abrdn conducted a survey on DB consolidation before the LDI chaos of September. The respondents were mainly scheme sponsors and scheme trustees. The survey found that:
  - 79% of respondents were concerned by the high running costs of managing DB schemes.
  - 90% were concerned about the time and cost of complying with regulation.
  - 74% were concerned about their ability to react quickly and make decisions.
  - 62% were concerned about achieving liability risk transfer, in particular the ability to get quotes for an insurance buyout.

- **There are five options for DB scheme consolidation**
  - Consolidated trusteeship (also termed “independent professional trusteeship”). Today, about 40% of DB schemes have a professional trustee instead of an in-house or member-nominated trustee, up from 25% in 2015.
  - Fiduciary management (also termed “investment consolidation”), which is the delegation of some form of investment responsibility. Today, £230bn of DB scheme assets currently have a full or partial FM mandate, up from £70bn in 2015.
  - Master trust, which entails full delegation of a pension scheme to a master trust. Currently, £13bn of DB pension scheme assets are under management in a DB master trust, up from £7bn in 2015. This option has not proved very popular to date but efforts are being made to improve its attractiveness.
  - Superfund. This is similar to a master trust but with the added feature of risk capital being provided to replace the employer’s covenant. This option did not exist in 2015. There are two players now, but so far there have been no superfund transactions.
  - Insurance Buyout. This is the ultimate option, where an employer’s multiple pension schemes’ assets and liabilities are pooled and bought by an insurance company, with the insurer taking on all the risks and payment of pensions. In the three years up to 2022, annual DB scheme buyout transactions were running at £35bn a year, up from £11bn a year in the three years up to 2015.

First Panel Discussion

What DB consolidation options are available?

Description from agenda

Private sector employers faced with the growing risks and costs of DB pensions can carry on as normal, close the scheme, or go down the consolidation route. There are five consolidation options to choose from: independent trustee, investment consolidation, master trust, commercial consolidation managed by a “superfund” and insurance buyout. How does each one work and how do employers decide which would best suit them? Will the recent market volatility impact the trend towards DB consolidation?

- **Superfunds are an important part of the DB consolidation options.**
  Superfunds are a natural progression from fiduciary management and master trusts, and they provide an onward link to insurance buyouts.
- **The role of independent professional trustees.**
  The demand for independent professional trustees to replace a scheme’s in-house or member-nominated trustees is on the increase. This is helping relieve some of the governance and regulatory burdens on schemes.
- **Insurance buyout – the ultimate option.**
  An insurance buyout is seen as the desirable endpoint for most DB schemes. Demand has increased, especially in the last couple of months. Demand will continue to grow because many schemes are now better funded and in possession or better data, both of which are key attractions for insurers.
- **Fiduciary management and master trusts.**
  These options are more suited to smaller DB schemes. It comes down to governance, cost and scale. Multi-billion pound pension schemes probably don’t need a master trust. Medium sized schemes with assets of hundreds of millions of pounds can benefit from master trusts, but those schemes are shrinking in number. Smaller schemes have the most to gain from moving to a master trust.

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Second Panel Discussion

Spotlight on DB master trusts –the practicalities and getting it right

Description from agenda

A DB master trust is a popular consolidation option. In October last year, the Pension and Lifetime Savings Association (PLSA) launched a new self-certification regime making it easier for DB master trusts to provide scheme sponsors and their trustees with more information on how they operate. How does a scheme sponsor go about moving into a master trust and what pitfalls must be avoided to get it right?

- **The benefits of master trusts for DB pension schemes.**
  There are three key benefits: simplification, standards and governance. You need a simple model, you need to know it is going to be easy to transfer into, and you want to know it's going to be well governed. DB master trusts are a commoditised offering. They provide a clear plan with some standardisation and efficiency.
- **The drawbacks of master trusts for DB pension schemes.**
  There are not that many downsides, though one possible drawback for some scheme sponsors is the loss of some control. But really, ultimate control still sits with the sponsor. There are no controls from within the master trustee; the sponsor can take itself out of the master trust.
- **Due diligence is essential.**
  It is important for scheme sponsor to carry out thorough due diligence before entering into a master trust. A master trust should deliver economies of scale, but it cannot deliver cost savings by trying to be all things to all people, so it needs to be a standardised solution. Scheme sponsors need to ensure the funding and investment approach has been explained properly to them to ensure they get true economies of scale and lower costs.
- **The costs of entering into a master trust.**
  The main costs are legal and actuarial. The employer has to be convinced that the benefits outweigh the cost.
- **Understanding how master trusts work.**
  Before moving a DB scheme into a master trust the employer should really understand how it functions. The processes should be standardised and the documentation simple. They should not be over-complicated.
- **The master trust's investment management approach.**
  The approach should be standardised, but standardisation does not mean second best. It is entirely possible to have a framework of investment strategies to enable small schemes to invest and fund their schemes efficiently.

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Thank you