Consolidation – what are we waiting for?

It's fair to say that it has been very quiet on the commercial consolidation front for some time, after much press coverage and industry attention early on. But what has really been going on, and what can we expect to happen next?

The story so far

Cast your mind back to 2018. High profile collapses of companies, such as Tata and BHS, who were supporting large, underfunded pension schemes meant increased scrutiny on the UK's pensions problems. An eye-watering number of very small pension schemes cried out for better governance and were missing out on the efficiencies of larger schemes, to the detriment of their members.

Enter so-called commercial consolidators – vehicles designed to accept pension scheme liabilities for less than the cost of buy-out, providing additional capital to improve members' benefit security, and severing the sponsor's obligation to support the scheme.

Following a highly anticipated Government White Paper in March 2018 signposting the future development of a regime to facilitate commercial consolidation, two vehicles quickly emerged:

- Clara-Pensions – which aims to buy-out schemes it takes on in the medium term.
- The Pensions SuperFund (PSF) – which plans to run-off liabilities it takes on indefinitely.

Much has been written about each consolidator – see our previous closer look reports on Clara and PSF.

Following the White Paper, in December 2018, the Department for Work and Pensions issued a consultation on the authorisation regime and broader legislative framework for commercial consolidators. As has become a theme of the consolidation landscape, we're still waiting to hear back on that one.

At the same time, The Pensions Regulator (TPR) issued guidance in relation to consolidation for trustees and sponsors considering consolidation, and for consolidators themselves. This guidance, alongside obtaining regulatory clearance, forms the interim regime under which transactions can occur ahead of the final authorisation regime coming into force.

Both existing consolidators have since made claims about initial cases that are ready to put pen to paper. The industry has been waiting with bated breath for consolidation to take off, swallowing up underfunded pension schemes that could get their hands on some cash to facilitate the transfer…

Fast forward two years and nothing appears to have happened. No transactions. No legislation. No further guidance. No consultation outcome. No more consolidators appearing.

But things have been moving.

Progress behind the scenes

The Pensions Regulator has been working with consolidators to provide 'pre-authorisation' of their models, following which individual transactions can be submitted for formal clearance. This is the step required for the first transactions to happen under the interim regime, ahead of the final authorisation regime coming into force.

Consolidators are smoothing the kinks in their offerings, changing where needed to align with TPR's direction of travel for the interim regime, and lining up numerous 'seed' cases which will pave the way for other schemes to transfer. New consolidators are gearing up to enter the market.

Trustees are starting to see consolidation as a viable end-game for their schemes once the regime is in place, and potentially before, in the right circumstances. Our recent Trustee Barometer survey shows a 14% increase in the number of schemes targeting consolidation as their end-game since 2018/19.

Sponsors who are struggling may be seeing the cost of consolidation as cash better spent to help remove the drag of their pension scheme on their businesses – particularly pertinent in the current climate.

Advisers are developing tools to help pension scheme trustees and sponsors assess commercial consolidators as an offering vs the status quo, or other consolidation options (e.g. insurance). We are working with a number of pension schemes to understand their options and whether consolidation may be right for them.

What's next?

Watch this space.

A formal authorisation regime for consolidation will most likely need to be included in a future Pensions Bill, and this could take at least a few years. We therefore expect initial transactions to occur under the interim regime rather than waiting for the final authorisation regime.

Pre-authorisation from TPR of both Clara and PSF is expected imminently, following which the first transactions will be quickly submitted for clearance. **We're expecting to see the first deals hit the headlines this year**, though we're admittedly hesitant given previous delays and distractions from COVID-19.

We expect most transactions under the interim regime will have a 'burning platform' meaning the transaction needs to happen now rather than waiting. This could be driven by schemes having an opportunity to access additional capital that wouldn't otherwise be available, or by covenant concerns meaning it is better to act now than wait. Examples include the following situations:

- **Corporate activity**. As part of, or to facilitate, mergers and acquisitions, where the scheme accesses additional capital as part of a wider corporate transaction.
- **Schemes with overseas parents**. Such schemes often have limited recourse to group level support, but this could be made available as part of a consolidator transaction.
- **PPF+ cases**. Here, trustees may be able to obtain a higher level of benefit coverage than available through insurance, weighing this against the lower level of security.
- **Stressed sponsors.** Better funded schemes with major sponsor covenant concerns where the additional capital provided by consolidators would improve security for members compared to ongoing sponsor support.

Economic fallout due to the COVID-19 outbreak is putting incredible strain on many employers, with covenant issues high on the agenda of many pension scheme trustee boards. These schemes will be looking at their options, and consolidation should be in their toolkit.

For sponsors that do inevitably and regrettably fail with schemes that become PPF+ cases, it will become a standard to assess consolidation against the traditional route of insuring as high a level of benefit as possible.

This has already started happening for a number of PPF+ cases, but further actuarial and legal developments are necessary to make this a straightforward option.

Finally, we're hearing rumblings of other consolidation offerings being set up. New entrants, particularly in an emerging and evolving space, mean competition and innovation, which should be welcomed by the industry.

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