Institute
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Pension Scheme Consolidation

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Today’s session

- Draw out the practical aspects involved in considering transfers to superfunds
- We’ll therefore imagine a future world in which superfunds are real albeit still nascent
- This is not a for or against … albeit the practical aspects may inform your view on whether or not superfunds are a good thing!
- Format:
  - Each of David, Jane and Mike will introduce angles from the perspective of the trustee board, the trustee legal adviser and the scheme actuary
  - No Q&A during those introductions
  - We’ll then open up to Q&A and debate

TERMINOLOGY: From here, we’ll use the phrase “consolidator” rather than “superfund”

Our future world

1. Pensions Bill was passed
2. Consolidators are authorised and supervised by TPR
3. There is a capital and supervisory regime that means consolidators have a high likelihood of delivering benefits fully but, unlike insurers, there is a tangible possibility that they don't deliver in full
4. PPF applies to consolidators
5. There is a gateway – no transfers to a consolidator if the scheme can reasonably be expected to be able to get to buyout within 5 years
6. Various consolidators in the market. Some act as a bridge to buyout (eg Clara Pensions). Some adopt run off models like insurers (eg The Pensions SuperFund). And there are others!
7. TPR guidance looks very much like what was issued in December 2018

TPR – guidance to trustees, "Transfers to a superfund"
Overview

- Notify TPR at earliest opportunity. Employers expected to apply for clearance
- "*We will need sufficient information from you to support your rationale that the transfer into the superfund is in the best interests of your scheme members*"
- "*As part of the clearance process, we will … ensure the scheme could not achieve a better outcome through other means*."
- "*Trustees should consider all possible sources of value for their scheme*."
- "*You need to make sure your decision to enter a superfund is in the best interests of scheme members.*"

Factors to consider include …		
Funding position and likely development	**Superfund's funding position and its long term objective**	**Legal advice … power to make transfers … conflicts, incl. advisers**
Proximity to buyout	**Independent covenant advice – essential**	**Projected outcomes for members**

Our case study - UK subsidiary of overseas parent

Overseas parent
- Large but weak, has gone through various restructurings
- No direct legal responsibility to fund the UK scheme

DB scheme
- Closed to new accrual in 2011
- £200m of assets. TPs 1/3rd pensioners 2/3rds deferreds
- Fully funded on TP basis of gilts + 1.0%. Assets invested for target net return of gilts + 1.25%
- Estimated buyout cost is £250m, so 80% buyout funded
- Trustees have a long term funding objective of self sufficiency albeit loosely defined at present
- SoC covers only PPF levies and scheme expenses

UK company finances
- The UK subsidiary is a shadow of its past. It can afford to cover PPF levies and scheme expenses, but without much left over
- The UK entity is seeking to reinvent itself. It has some interesting but unproven IP that might be relevant to the developing driverless taxi market

The employer’s proposal

Outline
- Corporate adviser has been working with UK subsidiary and the Prudential Consolidation Fund (“PCF”)
- Proposal is a transfer of the scheme pensions to the PCF, after which the scheme wound up

Financials
- Cost is £225m. Funded by scheme assets + a voluntary payment by the overseas parent of £25m
- A £22m buffer capital supplied by the PCF’s investors
- The PCF is 110% funded on its prudent TP basis

Members
- PCF projects that it has a [99%] likelihood of still being fully funded and capitalised in 15 years
- PCF projects a [1%] likelihood that before year 15 it would have had to wind up with members likely receiving a PPF+ buyout. Winding up in the short-medium term is very unlikely

Timescales
- Execution of the transfer – target December 2019

The trustee perspective

- Starting point to seek to respond constructively to considered Company proposal
- Seek to understand Company rationale for transfer to a Consolidator
  - Risk reduction, given the asymmetric risk it faces
  - Management cost savings / scope to redeploy governance resource given diseconomies of scale (£200m scheme)
  - Desire to focus on active pension arrangements (DC / Master Trust?)
  - Consolidator – proposed selection process and criteria:
    - covenant evaluation of providers (and regulatory regime)
    - proposed arrangements for existing Scheme factors and discretionary benefits
    - arrangements for data and other residual risks
- Comparison with alternative 'standard' paths to settlement
  - liability management (PIE / FRO etc)
  - cost management through moves to Fiduciary Management / sole trustee / bundled advice
  - target of phased buy ins with ultimate goal of buy out or synthetic buy in
- Trustee transaction review process.

Base position is the current Scheme IRM status which is a good funding level, but on a moderate risk basis, weak UK covenant and investment strategy which takes significant risk to target gilts +1.25%. Hence reasonable probability that existing structure will be able to pay benefits in full

The scheme’s legal adviser

- Is the Scheme sufficiently prepared to do the transaction?
  - Are the legal entitlements clear and the data clean?
  - Why does this matter?
- Has the Scheme done everything it can to improve its own chances of buy-out? Is the Consolidator proposal really the only realistic option for the Scheme? Does size matter?
- Is the employer business case good enough? What about the Consolidator’s business case?
- How does the Trustee make the decision?
  - Powers?
  - What does “in the best interests of members” mean?
- Who is signing off the transfer? What responsibility does the actuary have in this process?
- What discharge does the Trustee get? Who is holding the residual risks?

The Scheme Actuary

……it's like a bulk transfer (without consent) but it isn't…….

1. The bar is higher (as per TPR guidance)
2. The receiving scheme is (materially) different – covenant, regime(?) and objectives

Some of the issues to consider include, amongst others:

- Modelling member outcomes - ensuring consistency in any modelling?
  - Regulator expects any analysis to be "*informed by stochastic modelling of the funding of the scheme, supplemented by stress / scenario testing*"
- Funding and ignoring the level (and source) of additional funding
- Quality of data – valuation or "settlement" ready?
- Terms for individual member options
- Need for professional covenant advice (comply or explain)