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Authors
John Dunkley
Mike Whittaker

The Pensions Regulator's guidance on moving to a DB superfund

Following the interim guidance for DB consolidation vehicles (superfunds) published earlier this year, The Pensions Regulator has now issued guidance for trustees and sponsors of DB pensions that may be considering transferring liabilities to a superfund.

This guidance sets out the Regulator's approach to regulating transfers to superfunds, as well as what trustees and sponsors are expected to take account of when considering a superfund transaction.

Background

A superfund allows for the severance of all or part of an employer's liability to a DB scheme through a bulk transfer of a ceding scheme's liabilities. The employer covenant is generally replaced by a capital buffer held in a "special purpose vehicle", comprised of investor capital and contributions from the original employer(s).

DB superfunds provide an additional option to employers and trustees of DB schemes considering securing member benefits. Superfunds are not subject to the same "solvency II" requirements as insurance companies – this means the contribution required by the employer is likely to be lower than the cost of buying out, however, the level of security offered is also lower than buy-out.

The DWP is expected to set out a legislative framework for DB superfunds. (Exactly when this might happen is unclear, although the Pensions Minister has recently raised the possibility of a further Pensions Bill next year to provide for this legislation.) In the meantime, the Regulator has introduced an interim regulatory regime for assessing and supervising superfunds and has now published guidance for trustees and sponsors considering a transfer to a superfund.

Superfund transaction gateway principles

The Regulator expects employers and trustees to be able to evidence why a transaction is in the best interests of members and how the following three “gateway principles” are met:

1. A transfer to a superfund should only be considered if a scheme cannot afford to buy out now.
2. A transfer to a superfund should only be considered if a scheme has no realistic prospect of buy-out in the foreseeable future, given potential employer cash contributions and the insolvency risk of the employer.
3. A transfer to the chosen superfund improves the likelihood of members receiving full benefits.

The role of sponsors

Prospective ceding employers will often be funding the additional capital that may be required to meet the superfund’s entry price and facilitate the transfer (although this capital could also be provided by an entity in the employer’s wider group, or an external party).

Transferring to a superfund is considered to be a Type A clearance event by the Regulator, so ceding employers will be expected to apply for clearance before a transfer to a superfund occurs. (As a reminder, a clearance statement gives assurance that, based on the information provided in the application, the Regulator would not consider it reasonable to issue a contribution notice or financial support direction against the applicants in relation to the transaction.)

While ceding trustees will need to either decide to transfer, or to agree to the transfer of members out of the pension scheme, sponsors are expected to ensure the trustees have everything they need – such as the necessary time, resources and information – to consider a transfer.

The Regulator generally expects employers to pay for the professional advice that trustees need to help consider any proposed transfer, including reports on the employer covenant. Sponsors should also take their own advice about the transaction.

The role of trustees

Transferring members and assets out of a scheme to a superfund is a significant decision. It is important that the trustees are content that the gateway principles are satisfied, and they can provide a rationale for their conclusions.

In carrying out due diligence, trustees should take a proportionate approach, considering the resources available to their scheme and their employer, and the potential benefit to members and the sponsor. However, in general the Regulator would expect due diligence to include the following:

- Consideration of other available options to improve the scheme’s position.
- An understanding of the scope and timing of the Regulator’s assessment, including asking the superfund for the summary outcome of the assessment and making any further enquiries thought necessary.
- Whether the superfund is right for the members, given the members’ experience and the scheme’s circumstances.
- Consideration of what the superfund is offering, their associated fees (including all transaction and transition costs), their funding and investment objectives, their methods for implementing and

achieving those objectives (including their investment management proposal) and the risks to achieving those objectives.

- Where member enhancements are being offered, undertaking appropriate due diligence of these proposals, including professional advice where appropriate.
- Reviewing any modelling outcomes that the superfund produces with the trustees' advisers.
- Whether the transfer is in line with the Regulator's gateway principles and the trustees understand the risks introduced by the transfer, as well as how the transfer to the superfund results in improved member positions.
- Consideration of the risks attached to any residual liabilities left in the scheme.

Advice

Any decision to transfer to a superfund should have been subject to appropriate and proportionate discussions and review, including challenge. Trustees should assess their expertise and consider appointing an independent trustee, particularly in view of the complexity of the considerations necessary to proceed with a transaction.

Trustees should obtain appropriate professional advice in considering and undertaking a transfer to a superfund. This will include appropriate and proportionate actuarial and professional covenant advice in relation to their scheme's current position and the gateway principles, in addition to legal advice.

Scheme members

Given the planned change to their scheme's circumstances and in relation to their link to the employer, members might consider transferring their pension savings or accessing their funds by retiring from the scheme when they would not otherwise have done so. The Regulator highlights once again that it will not normally be in the interests of members to transfer their benefits to a defined contribution pension scheme and believes that superfunds meeting its expectations offer a secure destination for schemes and members.

Trustees should therefore be open and transparent with members about the planned transfer to a superfund throughout the process.

Other available options

Trustees and employers should consider why it is preferable to move to a superfund than stay with the employer and look for other forms of support to improve member security in the longer term. These issues should already be under consideration by trustees as part of their ongoing long-term planning for the scheme, but it is particularly integral if they are considering a transfer to a superfund.

There are many forms of support available to pension schemes, including other consolidation options such as entering a DB master trust, other capital-backed arrangements, and options that provide access to economies of scale and improved governance and support without immediately severing the employer support. How appropriate these options are will depend on the circumstances of the scheme and employer. The Regulator expects to see some consideration of these options as part of the employer's application for clearance.

What trustees and sponsors can expect from the Regulator

While the Regulator believes that superfund transfers can be a good option for some pension schemes, this will depend on the particular circumstances of a ceding scheme. When assessing a clearance application, the Regulator will therefore look at the process leading to, and the rationale for, the trustees' decision to transfer.

Applicants should allow at least three months from submitting a clearance application for the Regulator to come to a decision. Trustees and employers should notify the Regulator as soon as possible that they are considering transferring to a superfund, so that it can start to engage with them at the earliest possible stage. As part of the process, employers will be able to submit a draft clearance application to allow the Regulator to discuss any issues arising at an early stage and raise any queries related to their circumstances.

While it is assessing a clearance application, the Regulator will also engage with the relevant superfund in a supervisory capacity to ensure the scheme meets its expectations. Early notification of the trustees' intentions will also, therefore, assist the Regulator in carrying out its assessment of their chosen superfund in a timely manner.

Buck comment

As the regulatory regime develops, we are seeing an increasing number of trustees and sponsors actively consider a potential superfund transaction. The Regulator's guidance is extremely useful in helping these schemes navigate the complex process that lies ahead and provides an important step toward enabling the first transactions.

The gateway principles provide a good starting point for trustees and sponsors who may be considering whether a superfund transaction may be suitable for their schemes. In some cases, it will be clear that a superfund may improve member security (e.g. where the employer's outlook is bleak) and in others it will be clear that a superfund is not suitable (e.g. where a scheme is already close to full buy-out funding). In other cases, detailed analysis will need to be undertaken to assess whether a superfund could improve member outcomes when compared to other options.

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