HYMANS ROBERTSON

Consolidation of defined benefit pension schemes

Consultation Response

January 2019

Hymans Robertson LLP

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Overall opinion

We are supportive of the development of commercial consolidators or superfunds. They should lead to better outcomes for many DB members than the current environment. If they can be the trigger that persuades corporates to pay significant cash injections into their DB schemes in return for a clean break, then this will lead to better funded schemes, a vast improvement in member security, and far lower risk to the PPF. There is a cohort of schemes that is already close to buy-out (we estimate 12% of the FTSE350 could already buy-out). We are fully supportive that schemes such as these, with a strong probability of achieving buy-out in the short term, would not be right for consolidation. These schemes should instead be aiming for the significantly higher protection of member security offered by insurers. However, consolidators give the opportunity for the next wave of schemes to become fully funded on a low risk basis. This is where the employer can afford the cash injection to fund the move to a consolidator (we estimate 9% of the FTSE350 could transfer to a consolidator with less than 1 month's earnings). Getting the clean break in exchange for the cash injection gives a real incentive to employers to agree to do this.

It's worth noting that consolidators don't fix the problem for schemes where the employer simply can't afford to fund the deficit. So we could be left with a cohort of poorly funded schemes with weak employer covenants for which the PPF may be the inevitable outcome. The take-off of commercial consolidators, however, will reduce the risk to the PPF overall, thereby improving its ability to absorb these remaining schemes with the real affordability constraints. Additionally, the evolution and accreditation of DB Master Trusts gives a way for these poorly funded schemes with weak sponsors to significantly reduce running costs and access efficient investment strategies. This should improve their ability to bridge the deficit over time, and in time they could potentially become sufficiently well-funded to go into a commercial consolidator or the insurance regime.

Our answers to the consultation questions are set out in this document. Questions answered 'no comment' are outside our core area of expertise, or we have no substantive views. Our response largely focuses on areas related to the pension regime and actuarial modelling.

Our details

Alistair Russell-Smith, FIA, Head of Corporate DB
Kieran Mistry, FIA, Actuary
Tom McMullen, FIA, Actuary

Hymans Robertson LLP
London
EC2Y 5EA

Telephone:
020 7082 6000

Email:
alistair.russell-smith@hymans.co.uk

kieran.mistry@hymans.co.uk

tom.mcmullen@hymans.co.uk

What category best describes you or your organisation?
Professional Advisers

Defining Superfunds

(1) Are these characteristics wide enough to define a superfund? If not, how could superfunds be defined for the purposes of a future regulatory regime?

The characteristics outlined in the consultation document are, in our view, wide enough. However, the third bullet refers to the capital buffer being funded by "external investment". This capital buffer may be part-funded through contributions from ceding employers, and the definition should be amended to reflect this.

(2) Given the differences of superfunds and traditional DB occupational pension schemes, what are the additional risks and challenges associated with TPR regulating superfunds?

The additional risks and challenges include:

- Allowing a clean break at lower than the Section 75 debt, which requires care and could have unintended consequences.
- Having failure triggers and early warning systems (as proposed) becomes more important when there is no employer behind the liability. TPR will need to ensure triggers are set at sufficient levels and investment strategies have an appropriate level of risk.
- The size and management of the capital buffer is a new challenge.
- The potential scale these superfunds could reach if they are a success could also pose new risks / challenges (e.g. they could become 'too big to fail').
- Ensuring appropriate trustee behaviours becomes even more important with superfunds.

Authorisation criteria

(3) Are the proposed authorisation criteria the right ones for the superfund regulatory regime?

No comment.

(4) Are there any circumstances in which it would be advantageous, or necessary, that the authorisation criteria are not applied to the whole superfund but instead to individual segregated sections when the superfund scheme is sectionalised?

For all but financial adequacy, our view is that the authorisation criteria can be set at whole superfund level rather than for individual sections, as long as the rules and governance for each section are the same. However, combined, overall financial adequacy checks for a sectionalised superfund does not accurately reflect the security of members' benefits within each section. These should therefore be applied at a section level.

Supervisability

(5) Are these restrictions the right ones to ensure that superfund corporate structures are transparent and compatible with regulatory supervision? Are there any other measures that would aid TPR's ability to supervise superfunds?

No comment.

(6) Should the corporate entities of superfunds be permitted to be established as partnerships or should they be required to be set up as a UK limited company?

Being set up as a UK limited company may have advantages, in particular flowing through corporate governance requirements on the board to ensure appropriate behaviours.

Fit and proper persons

(7) Should TPR have a discretionary power to require evidence that individuals outside the superfund structure meet the fit and proper persons requirement?

Yes. There are clear parallels between this and the approach taken by the PRA in relation to insurers and under the SMCR. We believe a consistent approach for TPR in relation to superfunds would be reasonable.

Given the potential overlap of such external individuals with those required to meet the fit and proper persons requirement by the PRA, cross-sharing of information with the PRA may provide efficiencies for TPR.

(8) Would these requirements be sufficient to allow TPR to identify those subject to a mandatory fit and proper persons requirement?

No comment.

(9) Should TPR have the power to interview individuals for the purposes of the fit and proper test?

Yes. In our view TPR should have the power to interview individuals for the fit and proper test to aid their assessment of the individual.

Roles within the superfund subject to a mandatory fit and proper persons requirement

(10) Are there other areas that should be included as part of the mandatory fit and proper persons requirement?

The fit and proper test should be applied to any key decision maker at the superfund. Having a restrictive list in legislation of who the test will apply to may not fulfil this requirement. For example, due to differing job titles and structures of each superfund. We suggest flexibility is included within legislation, which may include the ability for TPR to “assess any individual seen as a key decision maker”. Two additional areas that may be included that are not noted in the consultation document are as follows:

- The superfund’s administration function, which will be central to ensuring clean data and the smooth ongoing running of the Superfund and avoiding administration fraud.
- The superfund’s in house actuary would have a key role in (for example) assessing incoming assets and liabilities and setting appropriate bases. We note that this person would have to meet professional requirements through the IFoA, which may be viewed as sufficient to fulfil the fit and proper requirements.

The fit and proper persons test

(11) Would introducing a set of standards of conduct for the superfund’s corporate board be proportionate?

It may only be necessary to introduce conduct standards for the corporate board if similar requirements do not already apply through existing corporate governance requirements.

(12) What in your view should form the basis of any standards of conduct?

No comment.

The competency test

(13) In your view, are there any other elements that should form part of a potential integrity test, conduct requirement or competency test?

No comment.

Governance

(14) Should there be a minimum requirement on the proportion of independent NEDs on the superfund's corporate board or should this be left to TPR discretion? If so, what would be a suitable proportion?

We expect it would be cleaner to specify a minimum requirement on the proportion of NEDs on the corporate board. However, if a superfund's corporate entity is registered as a UK company then the UK Corporate Governance Code will apply which would impose requirements for NEDs on the corporate board. This Code specifies that a minimum of 50% of the Board are NEDs and we view this as a suitable minimum to ensure they have appropriate representation on the Board.

Member representation

(15) Should superfund trustee boards consist entirely of independent trustees?

Yes. Our view is that the time requirements and expertise required to be a trustee of a superfund, together with the need for independence of the board given the commercial nature of superfunds, means that independent trustees are best suited for superfund trustee boards.

(16) Should there be a non-affiliation requirement for the appointment of trustees to a superfund's trustee board?

Possibly. However, a non-affiliation requirement would restrict the pool of trustees and, particularly as the DB market contracts, it may well be that many independent trustees have other roles with service providers to the superfund. If all the trustees are independent trustees they should have sufficient professional judgement to manage any conflicts.

(17) Should superfund trustee boards be subject to the MNT/MND requirement?

No. Given the need for a significant investment of time and a high level of expertise to allow quick, efficient decision making this is not necessary. In addition, appropriate representation would be difficult for sectionalised superfunds which may have a large number of groups of members of varying sizes to represent.

(18) Should superfunds be required to establish member panels? Would such panels be an effective and proportionate way of ensuring that members' views are represented?

We are supportive of member panels where MNTs are not present on trustee boards. These provide an efficient way to gauge members' views on various issues. In our experience this can give valuable insight into areas such as member communications. There are a number of large, multi-employer DB and DC schemes where this approach works well.

Conditional authorisation

(19) In your view, would the areas outlined in this section enable TPR to assess the effectiveness of a superfund's systems and processes? If not, what alternatives would you propose?

No comment.

(20) Are there other areas that should be included as part of the systems and processes requirement for superfunds?

No comment.

Insurance type framework

(21) Should superfund financial adequacy be regulated through a pensions based funding requirement approach with an added test of probability of success or an insurance based approach using a Solvency II type balance sheet?

Financial adequacy should be regulated through a pensions regime. Using an insurance based approach would muddy the water between superfunds and insurers.

(22) Which of the suggested models would best ensure appropriate financial adequacy, and balance the interests of the various parties? Are there elements of other options that you think should be combined with your preferred option?

The stochastic modelling approach (i) is most proportionate in our opinion, possibly with regulations or guidance on calibrations and key assumptions to ensure models are fit for purpose.

Introducing a common long term objective will be challenging if some superfunds are running off and others are insuring. Although a common long term objective is not appropriate, each superfund should set its own long term objective and it will be likely to need to do this under the new funding code of practice.

Using approach (i) with some further minimum standards as advocated by approach (iii) could be a good blend and provide additional protection. It is critical that the final approach is proportionate. Solvency II has been expensive to implement for insurers and the superfunds will need to incur these costs without having significant volumes of business at this point.

(23) Does a 99% probability of paying or securing members' benefits over the lifetime of the scheme adequately protect members' benefits, and effectively balance the competing priorities of employer affordability and member security? If not, what would an appropriate probability be, and why?

A 95%+ chance may be suitable as an *initial* target upon which to base the *initial* level of capital to hold against a particular tranche of liabilities for a superfund. Very well capitalised pension schemes with low risk strategies can demonstrate these types of targets over time (assuming surplus capital is held within the superfund until buyout, as is the intent under Clara's proposed structure). We have demonstrated this concept within our publication* looking at the Clara model's impact on member benefit security. Superfunds that run-off rather than insure would be likely to need a shorter defined timeframe over which the probability of paying benefits is assessed, both to make the calculations manageable and to not lead to overly onerous capital requirements.

However, a 99% probability of paying or securing members' benefits is likely to be an unhelpful *rolling* test of consolidator strength. In practice, in some future scenarios for intentional risks being run by superfunds, this may be a hard level to maintain. That is because whilst consolidators may be designed to hold the relevant amount of capital at outset, they may have more limited capital raising ability thereafter if the solvency level weakens. In such a scenario, the original capital will have helped to avoid the extreme outcome where not all benefits can be paid, but at the same time the probability of success would weaken due to the weakened funding position.

Nevertheless, the initial capital will have performed its role in protecting members' liabilities. Increasing the probability of success back up to 99% at that point may not be attainable for the superfund.

In saying that, we believe that probability of success is a valid metric to monitor over time, but a more accommodative lower bound may be required (to recognise that a valid future path for a successful consolidator could see a deterioration in this metric). A pragmatic rule of thumb might be that a probability of success below 80% (slightly over 2/3rds) could be seen as moving into amber territory for further scrutiny.

Regulation may need to stipulate whether investor capital could be withdrawn based on certain thresholds within this framework (or possibly other metrics like solvency levels). Indeed, the possibility of future capital withdrawals may need to be tested in the modelling framework itself. The modelling referenced below assumed no capital would be withdrawn until after buy-out of the liabilities (as is the proposed business model for Clara, but this may differ for a run-off style superfund).

Furthermore, we note that the modelling referenced here captures the financial risks embedded in the investment strategy and in the liabilities, but not some other risks like longevity risk and regulatory risks (e.g. GMP equalisation), albeit some additional scenarios tests were applied to the modelling results to attain a feel for potential impact. A modelling framework could, nonetheless, be extended to other risks like longevity. This illustrates that any industry modelling tests may well require some guiding principles to help consistency and transparency. One option is to adopt a pragmatic model-approval scheme as under Solvency 2 (internal model approval).

* Publication: https://www.hymans.co.uk/news-and-insights/research-and-publications/publication/db-consolidation-a-closer-look-at-clara-pensions/

(24) Should a superfund have a long term objective to secure benefits with an insurance company?

No. This would lead to herding of superfunds to a common structure and reduce competition and innovation in the market. If run and regulated effectively, with risks managed appropriately, superfunds can (and should be allowed to) operate as run-off vehicles.

(25) Is the proposed authorisation basis suitable for this purpose? If not, what basis, if any, would you propose for this purpose?

We are generally supportive of structuring the basis for various financial adequacy tests and reporting requirements around the expected buy-out cost. However, as noted above, in our view it is not appropriate to define buy-out as a long term objective for consolidators.

Based on our experience of buy-out pricing, the basis proposed to estimate buy-out pricing does not accurately reflect the actual pricing we would expect to see from insurers. In particular:

- A gilt flat discount rate would likely over-value the buy-out cost for pensioners and under-value the buy-out cost for deferreds. We expect superfunds will primarily aim to take on deferred liabilities, with pensioners secured with bulk annuities given very attractive insurance pricing, meaning overall the proposed discount rate may significantly under-value the true buy-out cost. It would be more appropriate to adopt a split discount rate between pensioners and non-pensioners.
- The 7.5% margin is too broad brush, and should be adjusted based on the superfund's circumstances, such as approach to managing longevity risk, prudence in other assumptions, and importantly its size.

The proposed basis should also allow for broad movements in long term insurance pricing, which has been both volatile and subject to broader trends in recent years.

(26) Is a 97.5% probability of being 100% funded on an authorisation basis by the earlier of 2040 and the date the scheme reaches its estimated peak cash outflows consistent with the principle of a superfund having a 99% probability of paying or securing members' benefits at all times?

We have not been able to consider this in detail as it is likely to require heuristic testing in a modelling framework for different superfund strategies. Please refer to the answer given in question 23 for further, related, considerations.

(27) Is the earlier of 2040 and the independently assessed point at which the superfund's membership reaches peak maturity a reasonable target date?

Hardcoding of a target end date is linked to having a common long term objective which we do not think is appropriate for superfunds. However, it would be sensible for individual superfunds to set target dates themselves based on their own objectives and cashflow profile.

(28) Are the additional minimum standards in (iii) needed, in order to ensure a high level of protection for member benefits? In particular, are the additional minimum standards (that the superfund scheme itself is funded to 87.5% on the authorisation basis) required for every scheme entering a superfund?

No comment.

(29) Should superfunds be required to publish an annual balance sheet using market valuations and including liabilities valued on a buy-out basis together with a buffer fund based on the Solvency II approach?

Superfunds should be required to publish funding details on a standardised basis to enable like-for-like comparison of their financial health.

Schemes reaching buy-out funding

(30) Should superfunds be required to secure benefits with an insurance company as soon as practicable, once the scheme assets reach the buy-out level of liabilities?

While we would expect some superfunds to adopt this approach (particularly in sectionalised schemes) as a means to release the capital buffer to be returned to investors, our view is that this should not be mandatory. If the superfund is able to continue to demonstrate financial adequacy they should be able to continue running off (as per answer to (24)). The approach should fit in with the long term objective of the superfund.

(31) Should superfunds be required to maintain a minimum level of scheme funding regardless of approach to financial adequacy? This could include a separate long term objective for the superfund scheme itself to reach a buy-out level of funding but to a lower level of probability than the superfund as a whole?

No. Financial adequacy should drive funding, not a separate requirement to have a minimum level of scheme funding. Introducing additional bases should only be done if essential as it will otherwise lead to confusion.

Proposed test for failure

(32) Is the failure test in relation to the PPF funding level proportionate and what probability of failure is acceptable?

There should, absolutely, be a failure test to prevent excessive risk taking. As per our answer to (23), a less than 1% chance of being under PPF funding over the lifetime of scheme could be very difficult to model, particularly for superfunds running off rather than insuring, so instead limiting the test to some specified medium-long term timescale may be more sensible and some guidance on proxies may be more proportionate. Less than 1% is clearly consistent with a more than 99% chance of paying benefits.

Funding level triggers and responses (superfund triggering events)

(33) What powers should TPR have to intervene should a funding level trigger be breached?

No comment.

Minimum funding: winding up the superfund in extremis

(34) At what level above fully funded on the S179 basis should the winding up trigger be set?

We believe that 5% above S179 funding would be a reasonable trigger point. This is consistent with PPF levy methodology.

(35) Is 3 months an appropriate period of grace to allow for any volatility in investments to recover before triggering a wind up?

We agree that 3 months would be a reasonable period of grace. However, additional triggers relating to repeatedly breaching the trigger should be considered. For example, requiring wind-up if the trigger and 3 month grace period is triggered more than 3 times over an 18 month period.

(36) Is this minimum funding level trigger sufficient to provide adequate protection for the PPF while mitigating the risk that short term volatility might force a superfund into the PPF when it still might have a very good chance of meeting the long term objective?

The minimum funding level trigger provides adequate protection to the PPF. Even if the outcome was a superfund going into the PPF, it would still be well funded with a S179 funding level close to 100%. So over time the PPF would probably still expect the incoming assets to be sufficient to meet the liabilities. The main concern would be avoiding delays in the transfer into the PPF for too long to ensure that PPF drift does not push up the PPF liabilities further.

Tier 1: a trigger to pay any remaining capital buffer into the superfund scheme and to enable a transfer of superfund business to another superfund or to wind up the superfund scheme above minimum PPF levels

(37) Do you agree that there should be a Tier 1 funding level trigger to protect members' benefits at this level?

Yes. There should be a tier 1 funding level trigger to project members' benefits at a PPF+ level and to protect the PPF. It's reasonable for this trigger to tip remaining capital into the scheme. Forcing a transfer to another superfund is likely to be challenging as other superfunds are unlikely to want to take on a stressed superfund.

(38) What would be the best way of expressing this trigger?

The trigger should take account of both scheme assets and the capital buffer. A funding level trigger seems a reasonable approach, although it could also be expressed as the probability of paying benefits falling below a threshold (see our answer to 23 for more on this). The precise level would need to depend on the basis, and care would be needed with interaction with the winding-up trigger if this trigger is on a different basis to the S179 basis.

(39) Is 3 months an appropriate period of grace to allow for any volatility in investments to recover before allowing trustees access to the capital buffer?

Yes. 3 months is an appropriate period of grace. This time period will enable decisions to be made based on a true funding level rather than one derived from short term market movements.

(40) Should TPR have the power to intervene and require wind up or transfer if they believe the trigger has not been acted on in the best interests of members?

Yes. TPR should have the power to intervene and require wind up or transfer if they believe the trigger has not been acted on in the best interest of members. This will help to protect members' benefits and the PPF.

Tier 2: a trigger to prevent new business being written

(41) Is this a reasonable basis on which to prevent new business being written, or should this be left to the discretion of the superfund trustees on the basis they should not be accepting new business if it would have a detrimental effect on existing superfund members?

It should be part of the trustee process and decision making to stop accepting more transfers (i.e. new business) if it would have a detrimental impact on existing members. Having independent trustees would help ensure this is part of their governance process. This is particularly the case for sectionalised schemes, where some sections may have fallen to below the threshold that would be used to prevent new business being written. The incoming scheme members would form their own section which meets financial adequacy tests and the new business does not impact on members in other sections.

Tier 3: a trigger to restrict when profit can be taken either by investors or members

(42) Is it reasonable to only allow investors to take a profit after they exceed the requirements for authorisation and if so on what basis?

There needs to be a restriction on when investors can take profits. If stochastic modelling is used for financial adequacy, then it makes sense to link to this with a higher threshold for profit extraction.

Additional protections from excessive or inappropriate profit taking

(43) Is it reasonable to retain investor profits for a period to mitigate against profits being from market volatility rather than genuine outperformance?

Yes. It would be reasonable to mirror the grace period before trustees can draw from capital under (39). It will be important that profits are extracted at the correct time, that it reflects true profits and does not weaken the financial stability of the superfund. This will help achieve this and ensure profits are genuine rather than as a result of short term volatility.

(44) Should superfunds be restricted from taking profit until the funding level is above that required to secure a buy-out?

Given the protections that should be in place on the capital buffer for the trustees/members, it feels reasonable to use this approach. However there must be allowance for the capital buffer and the scheme assets within this assessment.

Sectionalised schemes

(45) Is it reasonable to allow a sectionalised superfund to take profit or write new business if one or more sections are inadequately funded?

If a superfund is fully sectionalised, with each section having its own capital buffer, then it is reasonable to take profits from a well-funded section even if other sections are less well funded. Otherwise it will impede investment in the first place as investors will be likely to invest in specific sections and expect a return on this investment depending on the performance of that section, not have their capital at risk of the performance of other, completely unrelated sections.. This would prevent superfunds thriving.

(46) In relation to the criteria for financial adequacy and funding level triggers discussed above, should each segregated section within a sectionalised scheme:

> **a) be considered separately for financial adequacy purposes and also considered separately for the funding level triggers**
> **b) be aggregated together (along with the capital buffer) for assessing financial adequacy but each section is considered separately in relation to funding level triggers**
> **c) be considered separately for assessing financial adequacy but be considered together as a whole when assessing whether the collective scheme funding position meets any of the funding level triggers; or be aggregated together (along with the capital buffer) for assessing financial adequacy and considered together as a whole when assessing whether the collective scheme funding position meets any of the funding level triggers?**

Each section should be considered separately for both financial adequacy and funding level triggers given our comments in (45) regarding cross subsidising profits and capital between sections.

Control of assets and access to the capital buffer

(47) Does this approach provide adequate protection for members, while effectively balancing the interests of the investors?

Yes. The proposals in paragraph 152 of the consultation document adequately protect members' benefits by aligning current DB occupational pension investment requirements to the scheme and buffer assets. This will help to ensure no excessive risk taking in the investment of these assets.

(48) What are the minimum requirements on a buffer fund in order for the scheme to be able to rely upon the assets being available in the event they are needed?

In our view, neither of the options proposed are appropriate in addressing deficits that may arise within the superfund. An alternative could be a similar framework to the current DB funding regime, where Recovery Plans are implemented to correct deficits over an appropriate time frame. This would balance the objectives of the scheme and the superfund better. The timeframe should be a short period for superfunds.

Option 1 may result in assets being paid into the scheme which may not be required. Assets being paid into the scheme prematurely only to be drawn back out at some future point would be likely to result in a tax charge on those assets being payable by the corporate entity. This would significantly reduce returns for investors, and therefore the viability of superfunds.

Option 2 could result in practical problems around how the trustees would be able to control assets within the buffer fund – for example, which assets they gain control of and what they can invest in. There may be scenarios where the trustees' involvement in investing buffer fund assets could imbalance the investment portfolio and lead to investment losses.

(49) Should there be minimum standards on the capital buffer to ensure it can be relied upon in stressed situations?

Yes there should be minimum standards for the capital buffer. The level of investment risk taken in the buffer and the liquidity of the investments allowing the trustees to change the investment strategy quickly is critical here, and is a key area to apply standards.

Evidence required to demonstrate that financial sustainability requirements are satisfied for authorisation

(50) Is it reasonable and proportionate to require superfunds to provide detailed fund guidelines, and does this provide the regulator with sufficient information?

Detailed fund guidelines should be available on request by TPR, however it may not be proportionate to provide this as a requirement. A more proportionate approach would be that outlined in Q54.

Modelling

(51) Should superfunds be required to submit their modelling for TPR to review, or should TPR develop a model against which they can assess all superfund proposals?

Superfunds should submit their modelling to TPR for review.

(52) Should TPR have a 'fall back' model for cases when the modelling provided by superfunds is not adequate?

Not initially, although this could be developed later if it is felt to be necessary.

Reporting

(53) Should there be any other reporting requirements of either the corporate entity or pension scheme to ensure effective supervision?

No comment.

(54) Should the corporate entity and pension scheme have to disclose their strategic asset allocation and investment risk limits so that TPR can effectively supervise the investment strategy?

Yes. This would be a proportionate approach as it will help TPR effectively supervise the investment strategy and monitor investment risk taken within the superfund. The strategic allocation rather than detailed guidelines (as mentioned in Q49) will enable effective oversight and will identify key areas to TPR immediately, which may not be as apparent in detailed guidelines. We note that it would be preferable for any changes in the investment strategy to also be notified to TPR.

Public disclosure

(55) Should superfunds be required to regularly publish publicly available material on their financial position and operations?

The consultation proposes annual valuations are submitted to TPR along with quarterly updates on the funding position. We agree that this is required to help TPR to monitor financial stability and the security of members' benefits. However, public reporting should be considered separately and these requirements may need to be different to avoid too onerous a regime. We believe annual reporting would be better for this purpose.

Significant events

(56) Would the proposed events outlined in Table 1 meet the aims of the significant events framework?

The proposed events look reasonable. There could be some parameters around a change in the business plan to ensure only material changes are reported to avoid too onerous a regime. For example, it may not be proportionate to report minor business changes in the superfunds Human Resources department.

(57) How could we define 'significant deterioration' in relation to investment performance and funding level?

It would make sense to link 'significant deterioration' to the method used for setting the other triggers, so that the 'significant deterioration' becomes an early warning of potentially hitting one of the triggers. This will ensure consistency across the monitoring of financial stability.

Skilled persons reports

(58) Should TPR's executive arm have the power to unilaterally commission a skilled persons report in relation to superfunds with TPR acting as the end user?

Yes, TPR's executive arm should have the power to commission a skilled persons report without needing to go through the determinations panel which is a long and drawn-out process. This would be consistent with enabling a faster regulator.

Responding to market risk

(59) Would an enforceable Code of Practice be sufficient to allow TPR to respond quickly and proactively to emerging market risks and supervise effectively?

No comment.

(60) In your view, what areas of a future code should be enforceable?

No comment.

(61) Would the proposals outlined in Chapter 4 allow for the effective regulation of superfunds? Are there any other powers needed for TPR to intervene where necessary to effectively regulate superfunds?

No comment.

Covering the costs of supervision

(62) Should superfunds be subject to a bespoke levy to fund their ongoing regulation?

Yes.

Superfund gateway

(63) Do these principles achieve the policy aim?

Yes. Overall the principles achieve the policy aim, and we agree that prescribing too much on the gateway could lead to unintended consequences such as sponsors intentionally not funding schemes to a buy-out level.

On the second of the principles, some parameters or guidance should be given to trustees on how confident they should be on the scheme's ability to reach buy-out over the time specified. As drafted, the gateway test excludes schemes which are 'assessed by the trustees as being able to afford buy-out in the 'foreseeable future''. In practice, trustees will not be able to determine that their scheme will be able to achieve buy-out in future with certainty, so some principle around likelihood is required.

(64) Is 5 years a reasonable timeframe to assess a scheme's potential to reach buy-out in the foreseeable future?

There should be sufficient flexibility to consider a *reasonable* timeframe. Whilst 5 years may be appropriate in some circumstances, there may be schemes and sponsors where this period is too long. For weak covenants it may not be appropriate for trustees to assume they will receive 5 years of deficit contributions from the employer when making this assessment, and the value of getting that cash (and possibly more) upfront is significant. In addition, future buy-out market pricing is highly uncertain and speculative, and a key risk for pension schemes looking to buy-out in future. 5 years may therefore be reasonable as a guide, but it should not be prescriptive.

(65) Are there any other important factors that trustees should take into consideration as part of the transfer to a superfund?

Factors for trustees to take into account should more clearly state consideration of the pre and post position is important, e.g. consider the pre and post funding position on a solvency basis. The key question for trustees should be: is the loss of the employer covenant offset by the upfront cash, the improved funding level, the lower risk investment strategy and the capital buffer support? Covenant support provided by the capital buffer post transfer is not in the list of factors stated in the consultation document.

A specific area not covered here that would ideally be included, is transfers to superfunds from non-associated multi-employer schemes (in particular, last man standing variations) where some of the guidance points do not fit.

(66) Should a scheme looking to join a superfund be required to meet a specific minimum funding level at the point of transfer, for example 87.5% funded on the authorisation basis?

We assume that this minimum funding level allows for the sponsor contribution that may be paid directly into the superfund scheme, rather than requiring that this contribution is made into the originating scheme prior to transfer. If so, a minimum funding requirement for incoming schemes is reasonable, and should be set in a consistent way with the financial adequacy requirements.

(67) If you think there should be a minimum scheme funding level for entry to a superfund, should it be based on the authorisation basis or a buy-out basis? What percentage minimum funding threshold do you think would be appropriate?

If the minimum funding requirement is a funding level, we think this should be based on a buy-out basis.

Covenant advice

(68) Should external covenant advice be a mandatory requirement of the superfund transaction process? In what circumstances would covenant advice not be required?

Yes. We believe external covenant advice should be mandatory. However, the scope of this advice should be proportionate for each scheme. For example, a small scheme with a very large deficit being funded by a very weak sponsor should not need a highly detailed review. The requirement should therefore be principles-based rather than highly prescriptive.

(69) Should it be a requirement for those providing covenant advice to be regulated by either the FCA or the Financial Reporting Council?

No comment.

Transfers to a superfund

(70) Do you agree that the current legislation regarding bulk transfers should apply to transfers to a superfund? Please give an explanation for any changes you recommend to the legislation.

The current requirement for the actuary of the ceding scheme to confirm benefits are broadly no less favourable is arguably a trivial piece of work as benefits will be mirrored in the superfund (though we note that discretions will likely need to be codified, similar to insurance buy-ins and buy-outs). It may be worthwhile prescribing more in legislation or guidance what issues should be taken into account in this certification and the link with covenant advice. TAS300 which is the actuarial guidance relating to bulk transfers is not prescriptive in this regard.

TPR's role

(71) Should TPR decide whether each scheme transfer to a superfund can proceed or only have the power to prevent a scheme entering a superfund if they judge that the principles set out in the gateways are not being met?

We agree with the second of these two approaches - that TPR should only have the power to prevent a scheme entering a superfund if they judge that the principles set out in the gateways are not being met.

(72) What checks should TPR do on a proportionate and objective basis to satisfy itself a transfer to a superfund is likely to be in the best interests of members?

The key areas that we think that are important to check are:

- The scheme's funding level on a solvency basis pre transfer as a proxy to understanding how close the scheme is to buy-out.
- The improvement in scheme funding level post transfer, i.e. how material to the scheme finances is the employer's cash injection?
- How does the employer's cash injection compare to the value of ongoing contributions to which they were already committed? Cash injections more in excess of contributions already committed are clearly more significant.
- A covenant check, perhaps linked to the existing covenant grouping carried out by the regulator.

(73) What further powers should TPR be given to allow it to regulate effectively both superfunds and transfers to superfunds? Please provide reasons for any additional powers suggested.

The issues below may not necessarily need additional powers, but an area not covered elsewhere in our response, but is relevant with transfers to superfunds, relates to trustee powers and benefit levels.

Typically a key consideration for pension scheme trustees when agreeing to a bulk transfer is the balance of powers in the receiving scheme. It may be that guidance would be helpful for trustees setting out what they should consider if there is a different balance of powers in the superfund.

There may also be a risk of the superfund taking a more commercial view on areas like discretions, member options and possibly changing benefit indexation, and it may be that some protections are required around these sort of areas to give ceding trustees comfort. One approach could be for these types of actions to be notification requirements to TPR with additional intervening powers if required. In most cases the superfund trustees should help to prevent any changes not in the interests of members, but TPR oversight of this may add an additional layer of protection for members and comfort for ceding trustees.

Terminology for DB

(74) Should these schemes continue to be known as 'defined benefit master trusts' or is there a more suitable name that can be used to distinguish them from DC master trusts?

No comment with regards to the change in name. We believe DB Master Trusts have a key role to play in improving governance, risk management and reducing costs for the smaller DB schemes. We are aware that there are perceived barriers stopping certain schemes moving into DB Master Trusts to access these benefits at present. These include evidence of the benefits provided so we are very supportive of encouragement from the government and the industry led accreditation scheme. In addition, we would suggest that making pension scheme's annual accounts available publically would assist sponsoring employers in seeing the potential cost savings of joining a DB Master Trust.