ALLEN & OVERY

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DB superfunds: a new option for legacy pension liabilities?

The government is consulting on a proposed framework for regulating DB 'superfunds'. The Pensions Regulator (TPR) has also released new guidance for trustees, employers and superfunds, in advance of the new framework.

What are DB 'superfunds'? | What are the proposals? | New TPR guidance

What are DB 'superfunds'?

The consultation acknowledges that superfunds may take a variety of structures, depending on the business model. A basic superfund structure will include a corporate body as the statutory employer of a DB pension scheme, which would be eligible for the Pension Protection Fund (PPF), and the 'employer covenant' would not extend beyond a capital buffer provided by investors. In time, trustees of existing schemes will be able to transfer their assets and liabilities to the superfund, which will sever the scheme's link to the ceding employer. The policy intention is for members to be entitled to the same benefits under the deed and rules of the superfund as under the transferring scheme.

What are the proposals?

The government is seeking input on the design of a new authorisation and supervision framework for superfunds – superfunds are already possible under the existing statutory framework, but the government is seeking to impose additional requirements. It wishes to ensure that member benefits (and the PPF) will be sufficiently protected, as well as protecting against superfunds being used as a method for employers to 'offload' DB schemes where it would be in members' best interests to remain in the employer's scheme with the employer making deficit repair contributions. It is therefore seeking to prevent 'regulatory arbitrage' between the existing arrangements to buy out benefits with insurance companies, and the superfund model.

The proposals include the following:

- Superfunds would need to meet a number of regulatory requirements in order to be granted authorisation by TPR. These would be directed at assessing whether a superfund has a viable business model, is financially sustainable, is well-governed, and has a high probability of being able to pay members' benefits. Under current proposals, superfunds would need to demonstrate at least a 99% probability of paying or securing all members' benefits in full. The corporate entity would need to be a UK body corporate with a UK head office and registered office, and there would be various governance requirements including a fit and proper person requirement for relevant directors and senior managers. In designing the authorisation criteria, the government has looked to other authorisation regimes (eg, for DC master trusts).

- Where funding levels fall below prescribed limits, there would be a sliding scale of consequences (from restricting the return of profits to the superfund investors to forcing the scheme to be wound up).

- TPR would operate a supervisory framework which would include annual valuations and quarterly funding updates, and obligations to notify TPR in relation to funding-related triggers, or where there has been a 'significant event'. The government will also consider potential changes to employer debt legislation to ensure that it will apply to a superfund (including any capital buffer) where the superfund terminates its relationship with the scheme.

- Only certain schemes would be able to transfer to a superfund under a 'regulatory gateway'. The government is seeking to exclude schemes with a reasonable prospect of achieving buy-out in the next five years. Transfers would need to be supported by evidence that the likelihood of members receiving their full benefits would be enhanced in the superfund.

The consultation closes on 1 February 2019.

New TPR guidance

To accompany the consultation, TPR has released new guidance for trustees, employers and superfunds in advance of the new authorisation regime. In particular:

- Trustees considering a transfer into a superfund are expected to seek professional advice (including legal advice) and evidence from the superfund about the projected outcomes for scheme members. Trustees are expected to agree to a transfer only where this is in the best interests of members, which is unlikely to be the case where a buyout is a realistic prospect in the next five years. TPR expects to be notified as soon as possible after a decision in principle to make a transfer (eg, at least three months before the planned transfer), and the notification should explain, supported by evidence, why trustees believe that it will enhance member security. The government intends to make a decision to transfer a notifiable event.
- Employers considering a transfer into a superfund are expected to voluntarily seek advance clearance from TPR (and to pay for any professional advice needed by trustees). TPR considers that a transfer to a superfund is potentially a Type A event, and that a transfer will only proceed where a top-up payment (or other mitigation) will fully mitigate any detriment.
- Superfunds considering entering the market are expected to engage with TPR and the PPF in advance. TPR will scrutinise all superfunds entering the market, and expects them to follow the most prudent of the proposals detailed in the consultation.

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