DB CONSOLIDATION SURVEY – SUPERFUNDS

SUPERFUNDS HAVE THE POTENTIAL TO SHAKE UP THE FUTURE OF DB PENSIONS CONSOLIDATION – WE ASKED THE INDUSTRY WHAT IT REALLY THINKS

So-called 'Superfund' consolidation, which seeks to replace the employer covenant with upfront funding and a capital buffer (the Superfund covenant), has been gathering pace:

- The 2018 White Paper suggested that Superfunds represent a new end-game funding option for pension schemes;
- The Department for Work and Pensions (DWP) is considering whether to develop a new regulatory regime for Superfunds (NB: consultation end 1 February 2019); and
- The Pensions Regulator (TPR) may receive clearance applications on these transactions.

Over December 2018 and early January 2019 (before close of the DWP consultation) we collated the opinions of trustees, sponsors and advisors in the industry on this topic as part of our inaugural survey on consolidation. Key findings include:

1. **52%** consider that Superfunds will become more commonplace in the future for certain schemes, but only 11% are willing to be early adopters. A third are unlikely to ever explore a Superfund.

2. **60%** consider that the regulatory regime should ensure Superfunds provide a relative improvement in covenant rather than targeting a long-term probabilistic measure of success, an option supported by only 14%.

3. **27%** of schemes could be excluded by the five year 'gateway' (a mechanism in the DWP consultation that could prohibit schemes from Superfund entry if insurance buy-out is a 'realistic prospect')

Lincoln PENSIONS
Part of the Cardano Group

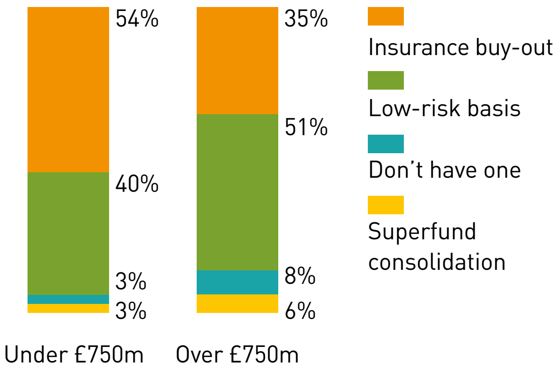
QUOTES FROM RESPONDENTS

On potential benefits of Superfunds:
"...[for specific schemes the] key benefit is an improvement of security for members [that] otherwise wouldn't be accessible"

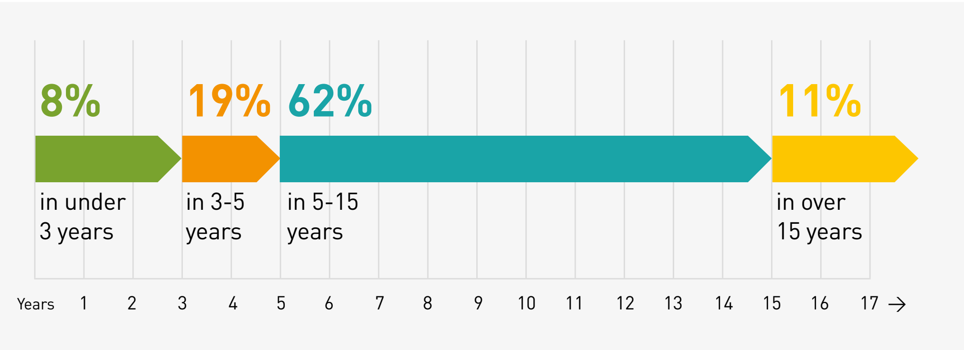
On potential drawbacks of Superfunds:
"How, as a trustee, could you get comfortable with, and be protected from, the failure of such a move?"

CURRENT END-GAME FUNDING OPTIONS

Schemes are now typically being funded on the expectation of eventually achieving an insurance buy-out or running-off their obligations on a low-risk funding basis that reduces the reliance on the sponsoring employer. Understandably, only a few respondents currently have Superfund consolidation as an end-game strategy.



Up to 27% of those surveyed anticipated that they will be able to meet their end-game funding target within a five year period. This could potentially prohibit them from entering a Superfund, as envisaged by the five year 'gateway' mechanism included in the DWP consultation. This figure would fall to 8% if the gateway period was three years instead.



SUPERFUNDS AS A NEW END-GAME FUNDING OPTION

Respondents appear to believe the market for end-game options is changing, with 52% expecting that transition to Superfunds will become commonplace for certain schemes.

52%
Commonplace for certain types of schemes

35%
A highly unusual approach applicable for a very small number of schemes

8%
Very commonplace with widespread take-up

5%
Not adopted / other

If Superfunds become established, around half of respondents appear willing to explore them as an option, while only 11% are prepared to consider them now. However, for a third of respondents Superfunds are unlikely to ever be an option, perhaps reflecting an increased likelihood of reaching a buy-out or due to a strong existing covenant.

46%
Superfunds could be an option you consider in the future but you would not want to be a first mover

33%
Superfunds are not something you are likely to ever consider

11%
Superfunds are an option you are currently considering or plan to consider in the future

10%
Don't know

WEIGHING UP THE PROS AND CONS

Increasing the security of members' benefits (akin to covenant strength) is seen as the most important potential benefit offered by Superfunds, followed by access to additional capital and better pricing than insurance options.

Respondents seemed most worried about the possible failure of a Superfund, as well as the uncertainty currently surrounding the regulation of Superfunds and the views of members and other stakeholders.

REGULATORY CAPITAL FRAMEWORK

The DWP consultation currently proposes Superfunds target a minimum probabilistic measure of success (eg 99% likelihood of meeting benefits over the life of the obligations), yet only a minority of respondents (14%) showed a preference for such an approach. Instead, nearly two thirds believe that the regulatory regime should focus on ensuring Superfunds provide a relative improvement in covenant strength.

60%
The Superfund covenant should be stronger than the employer covenant available to the transferring pension schemes

21%
All Superfunds should target the same minimum level of covenant strength which is defined as the capital in excess of the insurance buy-out cost

14%
All Superfunds should target the same minimum level of covenant strength which is defined as a % probability of paying benefits in full

5%
Don't know / other

ROLE OF COVENANT ADVICE

The DWP consultation asks if external covenant advice should be an essential component in the process of evaluating a Superfund transaction; nearly all respondents believed it is "essential", with three quarters suggesting it should be mandatory for trustees to get covenant advice.

75%
Covenant advice should be mandatory

22%
Covenant advice should be prepared on a 'comply or explain basis'

3%
Covenant advice should not be required

Contact Darren Redmayne or Adolfo Aponte to find out how we can help:

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