Pension superfunds: the beginning of the end for bulks?

Jamie Logie and Lizzie Waghorn
Agenda

• Introduction to the defined benefit (DB) and bulk annuity markets
• Options for de-risking DB schemes
• What are pension superfunds?
• Comparison of pension superfunds with buy-in/outs
• Overview of considerations for trustees and regulators
• Conclusion
• Questions
The Defined Benefit Market

- The “DB promise” was initially never expected to get to these levels
- A number of factors have impacted the funding levels over the years:
  - Deterioration of market conditions
  - Improved longevity
  - Disproportionate concentration of DB schemes in sectors that are no longer as robust as they used to be

Source: The Purple Book 2017
## Options for de-risking DB schemes

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<thead>
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<th>Initial de-risking strategies</th>
<th>Intermediate measures</th>
<th>Off corporate balance sheet</th>
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<td>Liability reduction e.g. cash equivalent transfer values (noting that the recent High Court ruling has temporarily stopped this for some schemes)</td>
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<td>Pension Protection Fund</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Only for insolvent schemes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Reduce benefits paid to policyholders</td>
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Reduced risk for Sponsor and Trustee

23 November 2018
Buy-in vs. Buyout

**Buy-in**

- **Insurer**
  - Premium

- **Pension Fund**
  - Assets
  - Liabilities

- **Members**

**Risks Transferred**
- ✓ Longevity
- ✓ Inflation
- ✓ Market

**Risks Retained**
- ✓ Data risk
- ✓ Benefit spec risk
- ✓ Counterparty risk (introduced)

**Buyout**

- **Pension Fund**
  - Assets
  - Liabilities

- **Insurer**

- **Members**

**Risks Transferred**
- ✓ All

Insurance company distributes regular payment to annuitants directly

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**Institute and Faculty of Actuaries**
The bulk annuity market has grown significantly over the last decade.
## A new tool: pension superfunds?

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### Reduced risk for Sponsor and Trustee

- **Liability Reduction**
- **Longevity Swap**
- **Master Trusts**
- **Buy-in**
- **Buyout**
- **Pension Superfunds**
- **Pension Protection Fund**

Can this rival the bulk annuity market?
It’s been getting quite a lot of attention

The Pension SuperFund: Benevolent disruptor or danger to members?

Pensions Expert, 22 March 2018

Pension consolidation: is it all good news?

IPE, April 2018

Unions question emergence of UK pension superfunds

Financial Times, 7 May 2018

'Was I right to swap my pension for £1m?'

Telegraph, 16 April 2017

Ex-PPF chief launches defined benefit pension 'superfund'

FT Advisor, 21 March 2018

Just one-quarter of trustees confident in consolidating DB pension schemes

The Actuary, 28 June 2018

Exclusive: Alan Pickering appointed chair of Clara trustee board

Professional Pensions, 12 September 2018

UK’s first pension consolidator prepares debut deal

SuperFund set for £10m transfer despite concerns over lack of regulatory framework

Financial Times, 11 June 2018

Bust-up increases pressure on Pension SuperFund

Consolidator looks to rebound from loss of top executives and backer

Financial Times, 15 September 2018

Rubenstein quits The Pension Superfund as first deal looms

Professional Pensions, 10 September 2018
Evolution of the superfund concept

September 2017:
- PLSA release DB Taskforce: opportunity for change, introducing idea of superfunds and consolidation

September 2018:
- Clara launches with appointment of independent Trustee board and chairman
- The Pension SuperFund CEO quits

March 2018:
- DWP published white paper on DB sustainability
- The Pension SuperFund launches in the press

20XX: First superfund deal
What is a “superfund”? 
A form of consolidation which allows employers to remove pension liabilities from their balance sheet without paying an insurer to secure the benefits

- Occupational Pension Scheme
- Regulated by the Pensions Regulator (tPR)
- Eligible for the PPF
- Three exist:
  - The PPF
  - The Pension Superfund
  - Clara Pension
- Removes all ties with the original sponsor and trustee
- Driving return from investment return on consolidated asset portfolio
- No change to existing member benefits
Which schemes might be interested?

**Funding Level**
- PPF Funding
- Buyout Funding

**Covenant**
- Weak
  - More likely to be attractive to schemes with a weak sponsor covenant
- Strong

**Scheme Size**
- Small
  - Gap in the market. Small schemes will benefit most from access desirable assets, economies of scale, and improved governance
- Large
  - Appetite of the superfunds may tend towards the large end, to maximise consolidation

Pricing will need to be between buyout and PPF funding levels to be an attractive offering to Trustees and Corporates.
Consolidation is not a new concept

<table>
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<tr>
<th>UNCONSOLIDATED</th>
<th>SHARED SERVICES</th>
<th>ASSET POOLING</th>
<th>SINGLE GOVERNANCE</th>
<th>SUPERFUNDS &amp; INSURERS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multiple sponsors, trustee boards &amp; providers</td>
<td>Use one set of admin functions – achieve economies of scale</td>
<td>Manage asset pools centrally on behalf of schemes</td>
<td>Maintain sponsor link with single governance model</td>
<td>Fully removed from the company’s balance sheet</td>
</tr>
</tbody>
</table>

| Sponsors |  |  |  |  |
| Trustees |  |  |  |  |
| Asset Managers |  |  |  |  |
| Advisors |  |  |  |  |
| Administrators |  |  |  |  |
How does this compare to a bulk annuity?

<table>
<thead>
<tr>
<th>Stakeholder</th>
<th>Buy-in</th>
<th>Buyout</th>
<th>Superfunds</th>
</tr>
</thead>
<tbody>
<tr>
<td>DB scheme members</td>
<td>Some scheme members received the protection of having their benefits insured</td>
<td>Offers the highest level of protection, with insurance policies issued to members</td>
<td>Protection of benefits is increase due to pooling of costs</td>
</tr>
<tr>
<td>Trustees</td>
<td>Still required to monitor the buy-in contract and any remaining scheme liabilities</td>
<td>Trustees are no longer required</td>
<td>Becomes part of the pension superfund, with an independent Trustee Board</td>
</tr>
<tr>
<td>Corporate Sponsor</td>
<td>Cheaper alternative to a full buyout but still reduces the risk of the scheme</td>
<td>No further risk to the sponsor but can come at a high cost</td>
<td>No further risk to the sponsor, since scheme is now off the balance sheet. However, the sponsor is now open to reputational damage if the superfund fails</td>
</tr>
<tr>
<td>Government / Regulator</td>
<td>Part of the scheme will now be regulated by the PRA and the remaining section by the pensions regulator.</td>
<td>Fully regulated by the PRA</td>
<td>Regulated by The Pensions Regulator</td>
</tr>
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How does this compare to a bulk annuity?

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<th>Commercial implications</th>
<th>Buy-in</th>
<th>Buyout</th>
<th>Superfunds</th>
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<tr>
<td>Protection</td>
<td>Some scheme members are protected by insurance companies and their associated regulations</td>
<td>Offers scheme members the highest level of protection</td>
<td>Not covered by the same level of regulation as benefits that are insured</td>
</tr>
<tr>
<td>Cost</td>
<td>Cheaper than a full buyout but offers limited protection</td>
<td>Typically the most expensive solution</td>
<td>Expect cheaper than a full buyout but leaves scheme members with more risk</td>
</tr>
<tr>
<td>Asset Management</td>
<td>Transfer to insurer, potentially constrained by Trustee requirements</td>
<td>Transfer to insurer - now part of the in-force back book</td>
<td>Transfer to superfund</td>
</tr>
<tr>
<td>Admin</td>
<td>Administration still within the pension scheme</td>
<td>Administration fully integrated with insurer</td>
<td>Administration fully integrated within superfund</td>
</tr>
<tr>
<td>Sponsor balance sheet</td>
<td>Liability remains on the sponsor balance sheet – matching asset &amp; liability</td>
<td>Liability removed from sponsor balance sheet</td>
<td>Liability removed from sponsor balance sheet however, may be a greater reputational risk</td>
</tr>
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</table>
What we know so far about the superfunds available

The Pension SuperFund

- Pension scheme liability and assets are run-off over the long term
- Non-sectionaLised – schemes are transferred into one large scheme
- Taking advantage of scale – achieving higher returns with lower costs and greater stability
- Quoted in the press that it is “eyeing about £20bn of business over the next five years”
- Backed by Disruptive Capital

Clara

- Does not aim to be an alternative to buyout but to lower the risk of the journey - viewed as a “bridge for members and sponsors to the insured market”
- Sectionalised – each scheme is treated as it’s own scheme within the fund and become a section of the Clara trust. The objective is to buyout each section as early as possible
- Capital can only be removed from Clara once all members of the scheme have been transferred to an insurance company
- Buyout pricing will be a critical element to the success
- Capital providers unknown
What does the scheme need to consider?

**Potential benefits**

- Cheaper route for sponsors to remove pension schemes from their balance sheets
- Improved effectiveness and sophistication of investment strategies
- Stronger covenant where sponsor is weak
- Reduced “per member” costs
- Improved standards of governance and trusteeship
- Reduced administrative burden
- Cheaper and ‘quicker’ solution compared to a bulk annuity

**Potential challenges**

- Upfront cost to the sponsor
- Less protection than a buy-in/out
- Reputation risk to sponsor if vehicle fails
- Regulatory requirements
- Other innovative solutions becoming available

**Trustees have to get comfortable with…**

- The level of funding and security within the superfund compared to that of the current sponsor
- Swapping corporate covenant risk with scheme default risk within the consolidation vehicle
What are the regulators saying?

“We will be consulting over the coming months on a framework for consolidation, offering industry the opportunity to innovate but ensuring there are robust safeguards in place so members’ benefits are well protected” — Department for Work and Pensions (DWP) White Paper

- Vehicles will require clearance on transactions
- The DWP is carrying out a consultation to encourage and facilitate consolidation
- TPR are preparing for market entry of further vehicles to solve the DB issue
- TPR recognises the need to strike the balance between commercially-viable and protection of members
- Expect funding requirement to be higher than is typical of schemes with a sponsor link but not at the level required of insurance companies
So what will happen to the bulk annuity market?

Quick answer: unclear at this stage…but

- Plenty of business to go around: £1.5tn of assets available
- TPR and DWP are encouraging innovation and the creation of different models to meet the individual needs of schemes
- Depends who the superfunds target – if bridging a gap, then it may supplement the existing insurance market rather than be a direct competitor
- If the business model Clara is offering is successful, it may accelerate buyouts
- If the business model The Pension Superfund is successful, it may reduce the number of schemes going to buyout
- However, we note, all these solutions will be competing for the same capital, investment and hedging opportunities
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