STEPHENSON HARWOOD
pensions law group

CLEAR VIEWS

Moving to a superfund

A 'way out' of defined benefit pension scheme obligations?

Superfunds are coming.

With ever increasing costs associated with defined benefit (**DB**) pension schemes and buyouts being out of reach for many, the advent of DB superfunds may offer some employers an alternative.

Whilst a legislative framework for DB superfunds is still awaited, the Pensions Regulator (**TPR**) has recognised that the industry is not going to stand still. TPR has therefore set out its own regime to regulate this area in the meantime.

This brochure sets out some key considerations for trustees and employers to take into account when considering if transferring to a superfund is appropriate for them. It also summarises how the two current superfunds operate as well providing a guide on the process for a superfund transfer in accordance with TPR's guidance.

Our specialist team

Overview

Our pensions group is made up of pension transfer specialists.

Our experts have advised on some of the biggest industry transfers to date. The Stephenson Harwood pensions group is well placed to provide the clear view that you need when considering whether transferring to a superfund is appropriate, and in holding your hand through the process should you decide to go ahead.

Our superfund transfer specialists

Philip Goodchild
Partner

T: +44 20 7809 2166
E: Philip.Goodchild@shlegal.com

Stephen Richards
Partner

T: +44 20 7809 2350
E: Stephen.Richards@shlegal.com

Graham Wrightson
Partner

T: +44 20 7809 2557

E: Graham.Wrightson@shlegal.com

Mark Catchpole
Consultant

T: +44 20 7809 2059
E: Mark.Catchpole@shlegal.com

Naeem Noor
Senior Associate

T: +44 20 7809 2092
E: Naeem.Noor@shlegal.com

Katie Whitford
Associate

T: +44 20 7809 2378
E: Katie.Whitford@shlegal.com

Further details of our pensions team, plus our wider specialists in pensions tax, investment and funds, covenant restructuring and insolvency and data protection, can be found at www.pensionshub.com.

This brochure does not constitute legal advice. Information contained in this document should not be applied to any particular set of facts without seeking legal advice.

Why transfer to a defined benefit superfund?

Transferring to a DB superfund is one of a number of ways to de-risk. It allows an employer, with the consent of the trustees, to transfer its defined benefit pension scheme to a third party superfund provider. When compared with other de-risking opportunities, the biggest benefit of a transfer to a superfund is that it severs the link between the employer(s) and the scheme at a price which, in theory, should be more affordable than a scheme buy-out.

Transfer to a superfund v other methods of de risking

	Buy-out	Scheme merger	Transfer to a DB master trust	Transfer to a DB superfund
Breaks link between scheme and original employer	Y	Y (although only possible if there is a receiving scheme willing to receive merging scheme)	N	Y
Affordable to the employer	N – the most expensive option	Y (compared to scheme buyout)	Y	Y (compared to scheme buyout)
Provides benefits of scale in terms of reduced governance and administration costs	N/A	Y	Y	Y
Provides the possibility of a better diversifications of investments	N/A	Y	Y	Y

What is a superfund?

Key characteristics

In its consultation[1], the DWP identified the main characteristics of a superfund as:

- containing an occupational pension scheme set up for the purpose of effecting consolidation of DB pension scheme labilities;
- a transferring scheme's link to the original employer is severed on the transfer to the superfund;
- the covenant of the original employer is replaced by a capital buffer provided through external investment that sits in the superfund structure; and
- there is a mechanism that enables returns to be payable to investors.

It is expected that once a formal framework is in place, superfunds will need authorisation from TPR to operate. In the meantime, TPR has introduced an interim regulatory regime whilst the industry awaits legislation in this area.

There are currently two superfund providers who have sought approval from TPR under its interim regime. TPR notes that trustees can take some comfort from its assessment of the superfund providers. These two providers offer different superfund models:

Clara

This is a segregated fund where each transferred in scheme is kept separate from all of the other schemes that are transferred into the superfund. The aim of Clara is to act as a bridge to buy-out. The transferred in schemes will be managed until they are at the stage where the member benefits can be bought out in full.

Capital and profit within the superfund are not available to the fund until all members of a segregated scheme have achieved buyout.

The Pension SuperFund

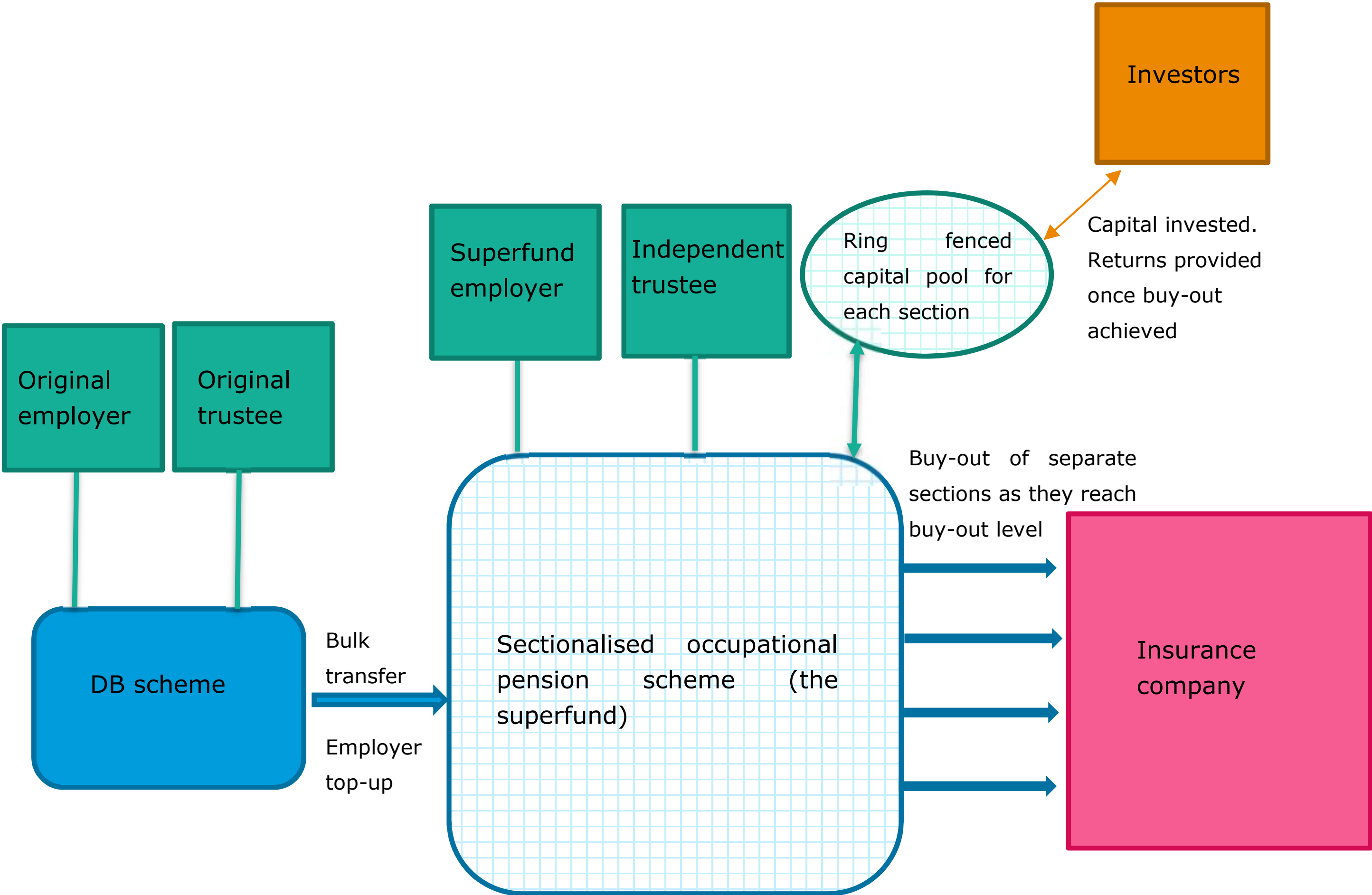
The Pension SuperFund is a non-segregated pension scheme. This means that the transferring schemes are not kept separate from one another after the transfer. Unlike with Clara, the aim is for benefits to be paid to members directly from the superfund, and not for their benefits to ultimately be bought out. Surplus capital is distributed to members by way of periodic defined contribution bonuses.

When certain minimum funding requirements are met, capital can they be released into the fund.

[1] DWP Consolidation of Defined Benefit Pension Schemes public consultation December 2018

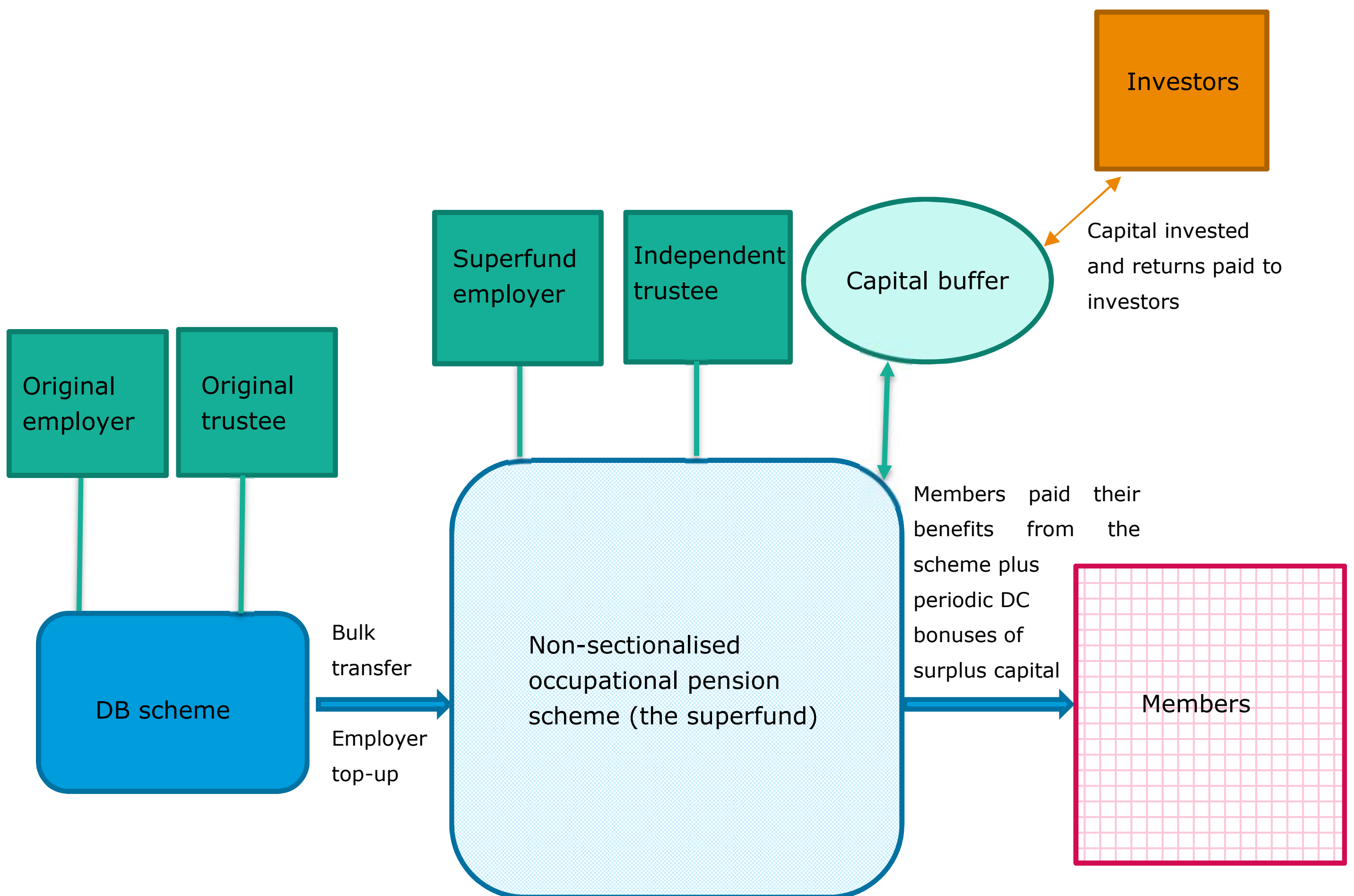
Overview of superfund structures – bridge to buy-out

Below is a high level overview of how a structure such as the Clara superfund may work.



Overview of superfund structures – with profits model

Below is a high level overview of how a structure such as the Pension SuperFund may work.



Can you transfer your scheme to a superfund?

TPR has made clear that before any transfer to a superfund can occur, the employer of the transferring scheme will have to receive clearance from TPR. Clearance will not be forthcoming unless the 'gateway' principles are satisfied.

The gateway principles

A transfer to a superfund is only available if:

The existing pension scheme cannot afford to buy out now
TPR's guidance provides that this should be based on the scheme actuary's estimated buy-out funding level at a date no more than one month before the date of the clearance application.
The existing pension scheme has no realistic prospect of buy-out in the foreseeable future given potential employer cash contributions and the insolvency risk of the employer
TPR states that this would usually mean that the scheme has no realistic prospect of buying out within 5 years. TPR expects an independent covenant assessment conducted by a professional covenant adviser to be a key component of the trustees' considerations here. The covenant advice should cover specific points set out in the guidance.
A transfer to the chosen superfund must improve the likelihood of members receiving full benefits
Trustees will need to compare the likelihood of members receiving full benefits in the superfund with the likelihood of members receiving full benefits if the scheme remains with the employer. TPR notes trustees will need full information from the employer and comprehensive professional advice in making their judgement. TPR lists a number of factors to be considered when assessing this principle.

These gateway principles make clear that a transfer to a superfund will not be available to all employers; in particular those for who a buy out is within reach.

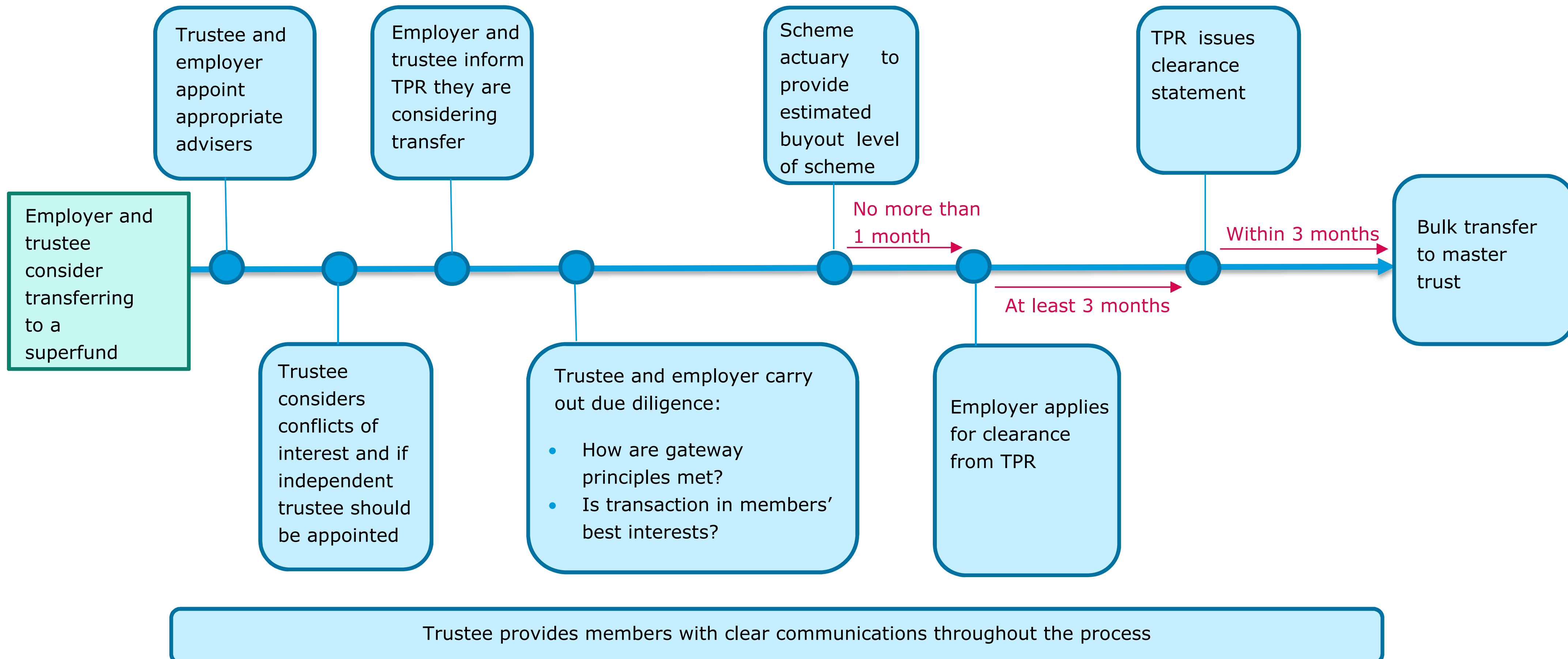
Trustee and employer considerations

In its guidance, TPR sets out the steps it expects trustees and employers to take in reaching the decision of whether the gateway principles have been met. A transfer should only occur if it would be in the best interests of the members. Some of the key steps TPR expects a trustee and employer to take in assessing this can be found in the table below.

Trustee	Employer
Appoint appropriate professional advisers (actuarial, covenant and legal).	Appoint appropriate professional advisers.
Consider conflicts of interest and if an independent trustee should be appointed.	The employer is expected to pay for the professional fees incurred by the trustees in undertaking the project.
Consider whether the gateway principles are satisfied and how the detriment of removing the employer covenant has been mitigated. This should be documented. TPR provides details of what it expects to be considered as part of this process.	Provide trustees with access to management and any information and material needed by the trustees to carry out the due diligence process.
Carry out due diligence. TPR lists a number of areas it expects the trustees' due diligence to cover. This includes (not exclusively): • considering other options available to improve the scheme' position; • considering past value extractions from the employer; • reviewing the superfund, including its offering and TPRs assessment of it (TPR does not expect trustees to duplicate its assessment of the superfunds); • ensuring the transfer is in line with the gateway principles; and • considering the risks attached to any residual liabilities left in the scheme.	Together with the trustees, the employer must have considered why a transfer to a superfund is in the members' best interests and how the transaction meets the gateway principles. It must be able to demonstrate this to TPR.
Following the due diligence, the trustee will need to consider whether to consent to the transfer.	Apply for clearance from TPR. This will involve working closely with the trustee in putting together evidence about how the gateway principles are met and how the detriment of removing the employer covenant is mitigated.
The trustee should provide clear communications to members throughout the process.	Employer is likely to need to provide additional capital to effect the transfer and so must take this into consideration from the outset.

Moving to a superfund – an overview of the process

Before the bulk-transfer process can begin, there are a number of steps to be undertaken which are set out in TPR's guidance



STEPHENSON HARWOOD

pensions law group

CLEAR VIEWS