Association of Consulting Actuaries

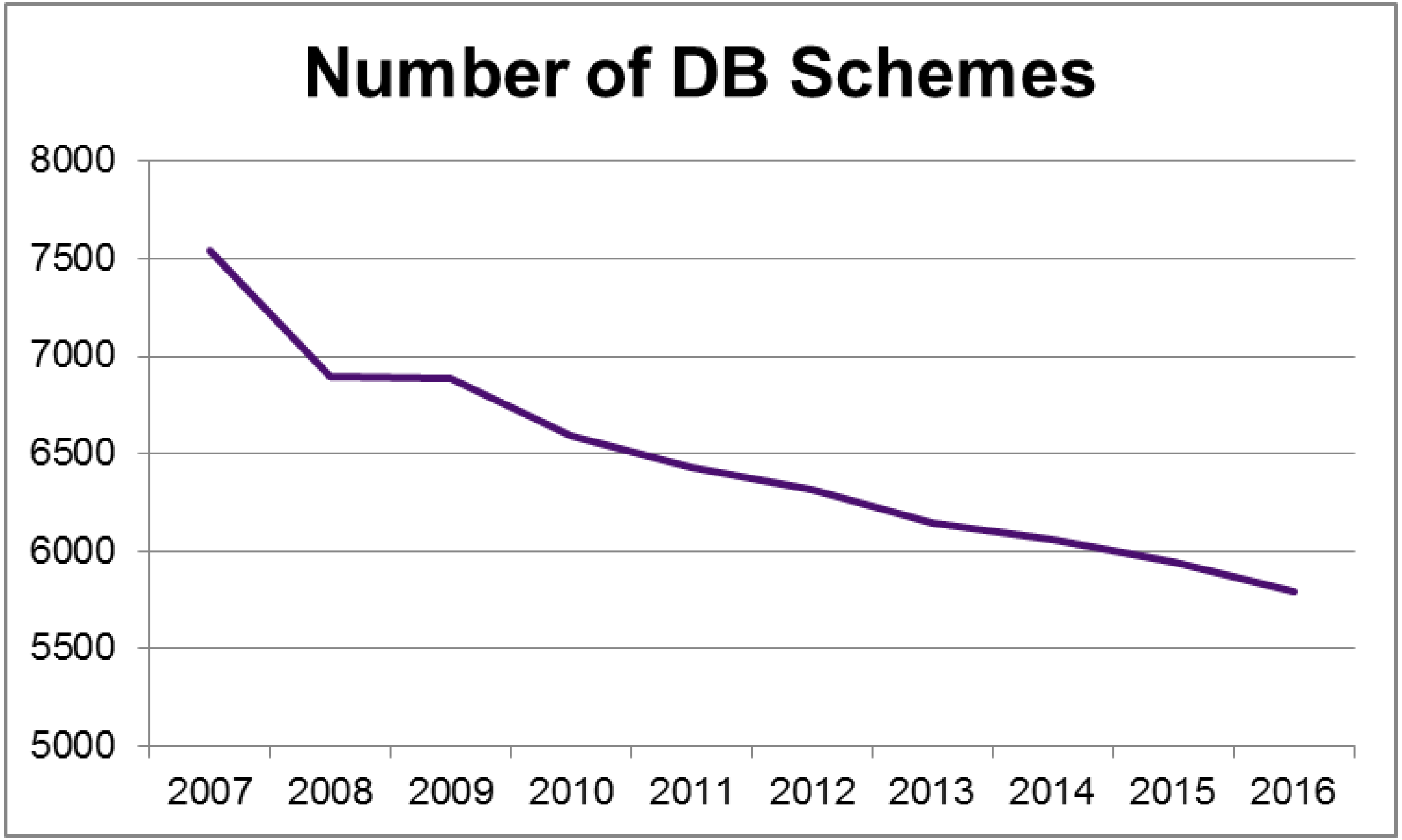
Consolidation through Superfunds

Duncan Buchanan – December 2017

Agenda

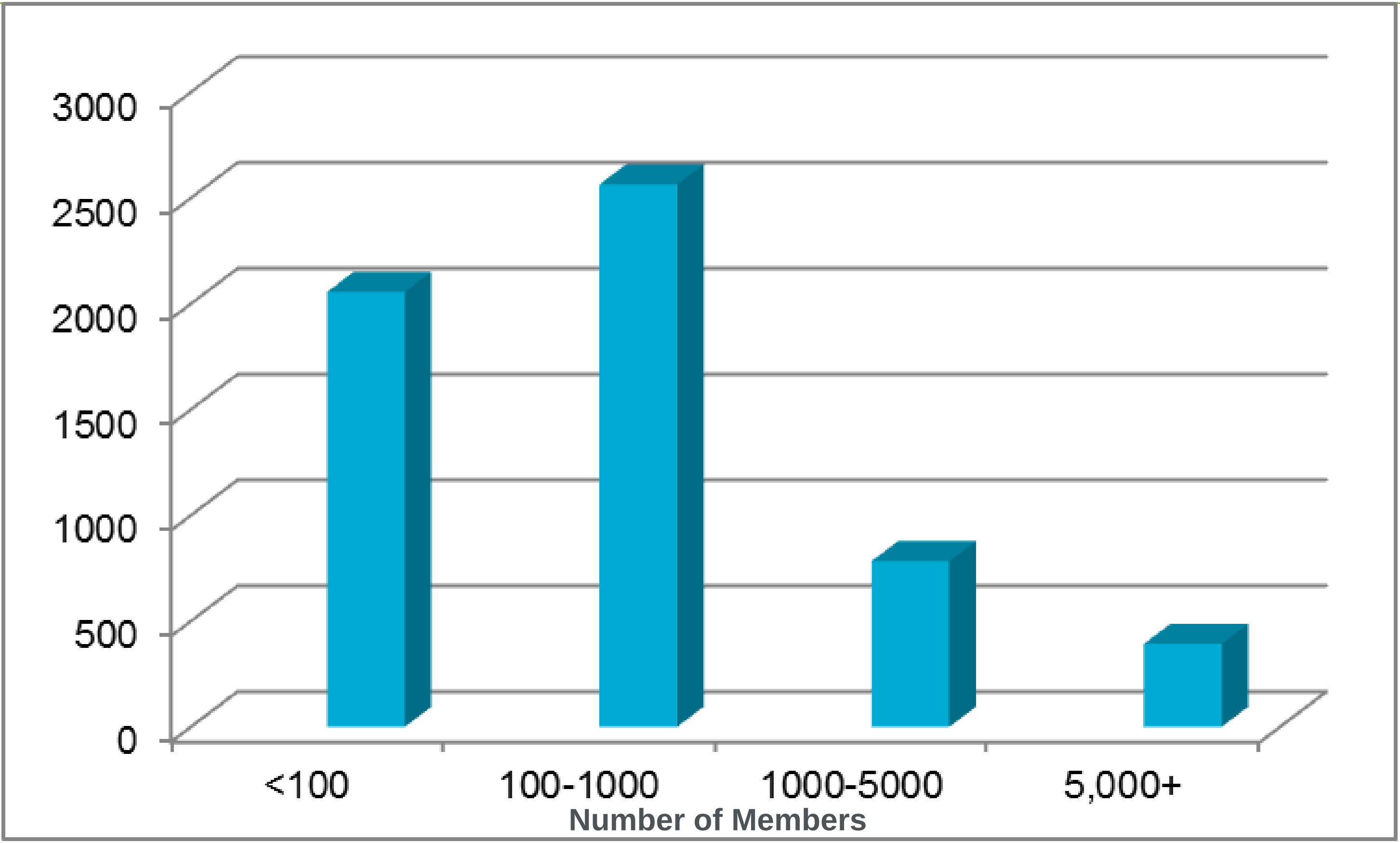
- The defined benefit 'universe‘
- Some recent reports on defined benefit schemes
- The case for consolidation
- Methods of consolidation to date
- Superfunds – how might they be structured
- Transfers to Superfunds
  - Standard transfers
  - Distressed transfers
- The future

The DB "Universe" in 2017



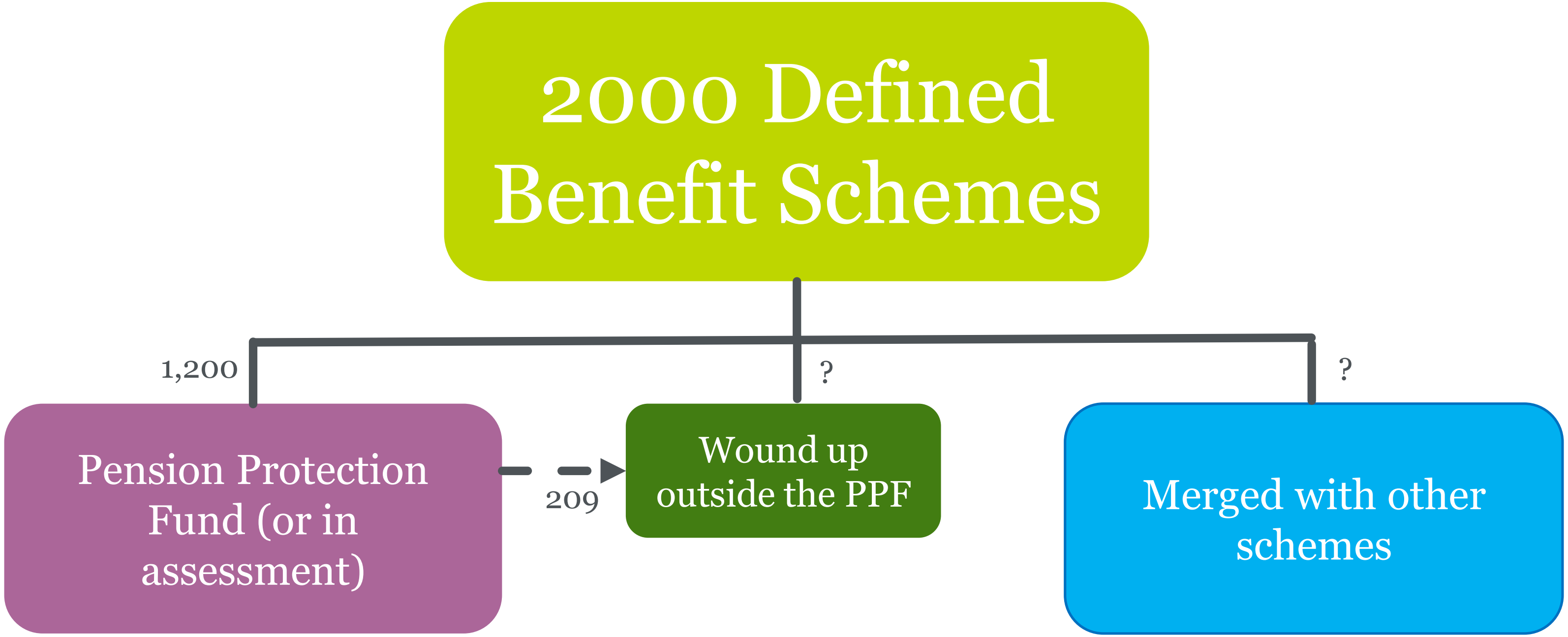
Source PPF Purple Book 2016

Distribution of Schemes

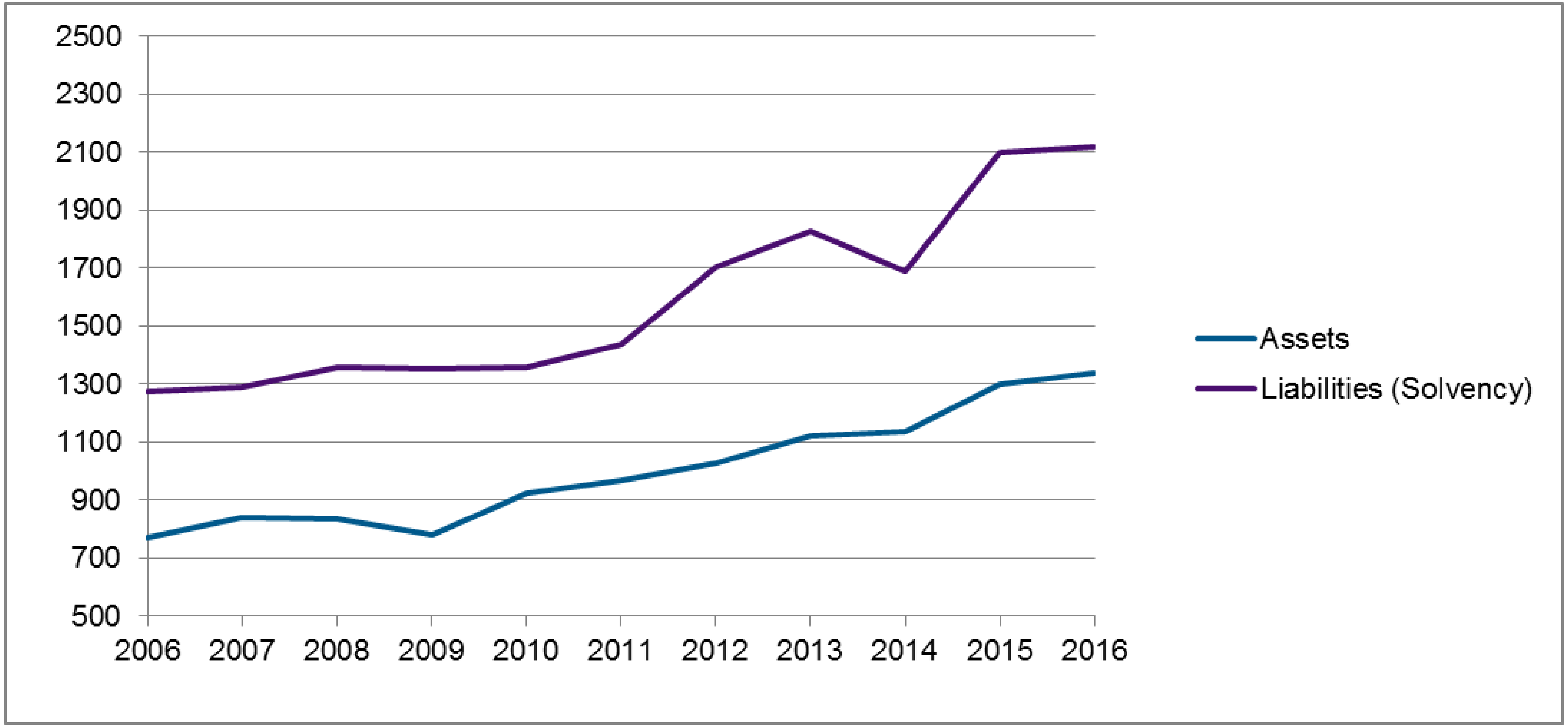


Source PPF Purple Book 2016

Where have the schemes gone?



Funding Levels



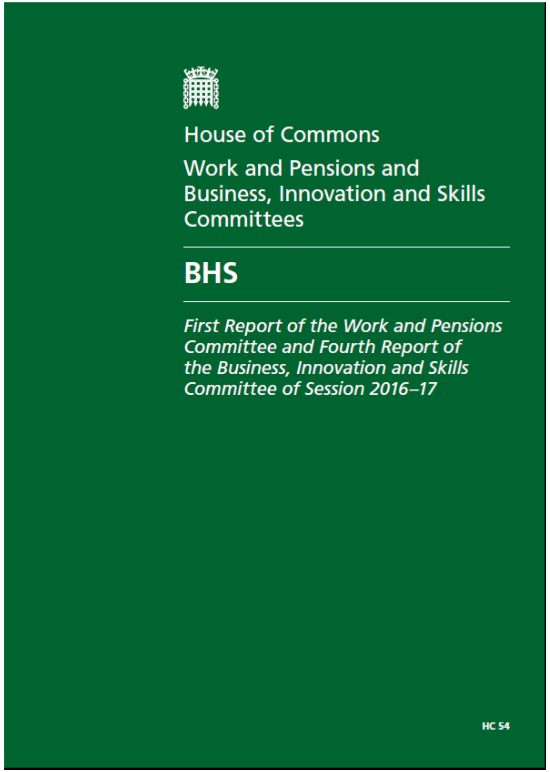
The average DB scheme is less than 2/3rds funded on a solvency basis

Source PPF Purple Book 2016

Recent reports into DB pensions

December 2015

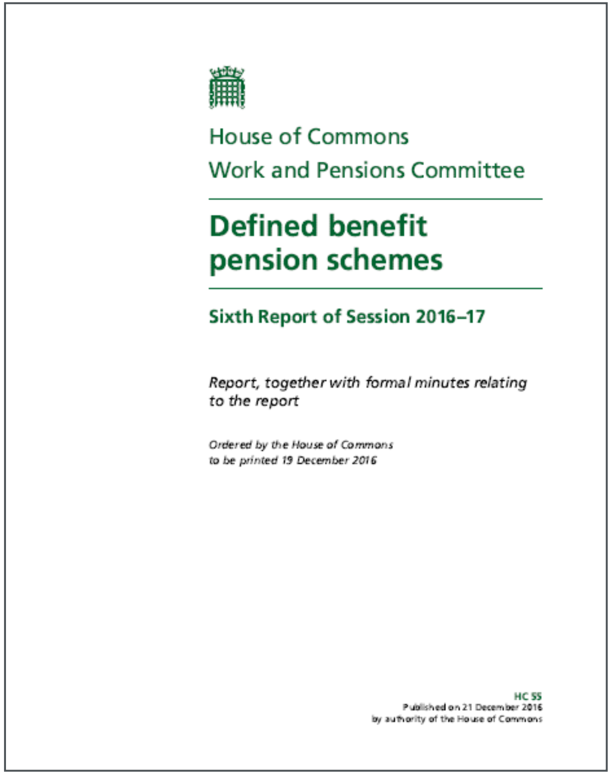
July 2016



October 2016

Recent reports (2)

December 2016



House of Commons
Work and Pensions Committee

Defined benefit pension schemes

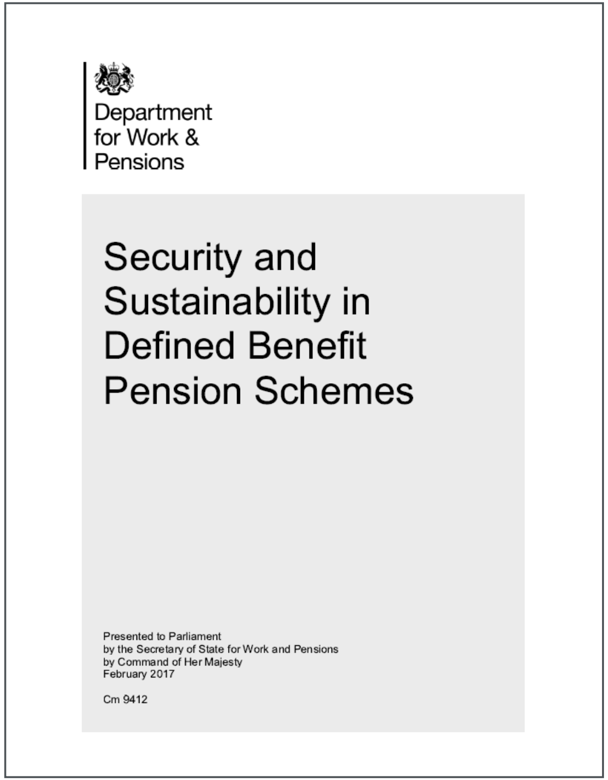
Sixth Report of Session 2016–17

Report, together with formal minutes relating to the report

Ordered by the House of Commons to be printed 19 December 2016

HC 55
Published on 21 December 2016
by authority of the House of Commons

February 2017



Department for Work & Pensions

Security and Sustainability in Defined Benefit Pension Schemes

Presented to Parliament
by the Secretary of State for Work and Pensions
by Command of Her Majesty
February 2017

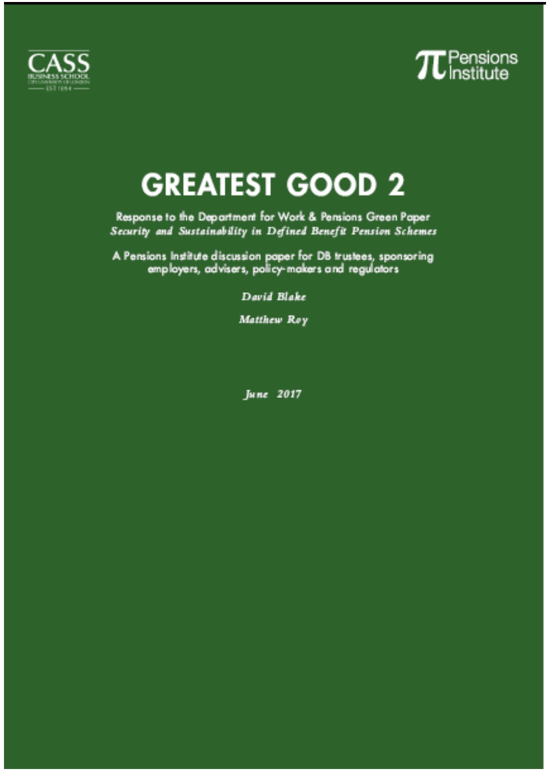
Cm 9412

March 2017

Recent reports (3)

June 2017

July 2017



September 2017

Support for consolidation of smaller DB schemes

- Covenant Risk
- Economies of Scale
- Investment Options
- Stronger governance
- Easier to Regulate
- Negotiating Powers
- Benefit simplification

Leads to better member outcomes…

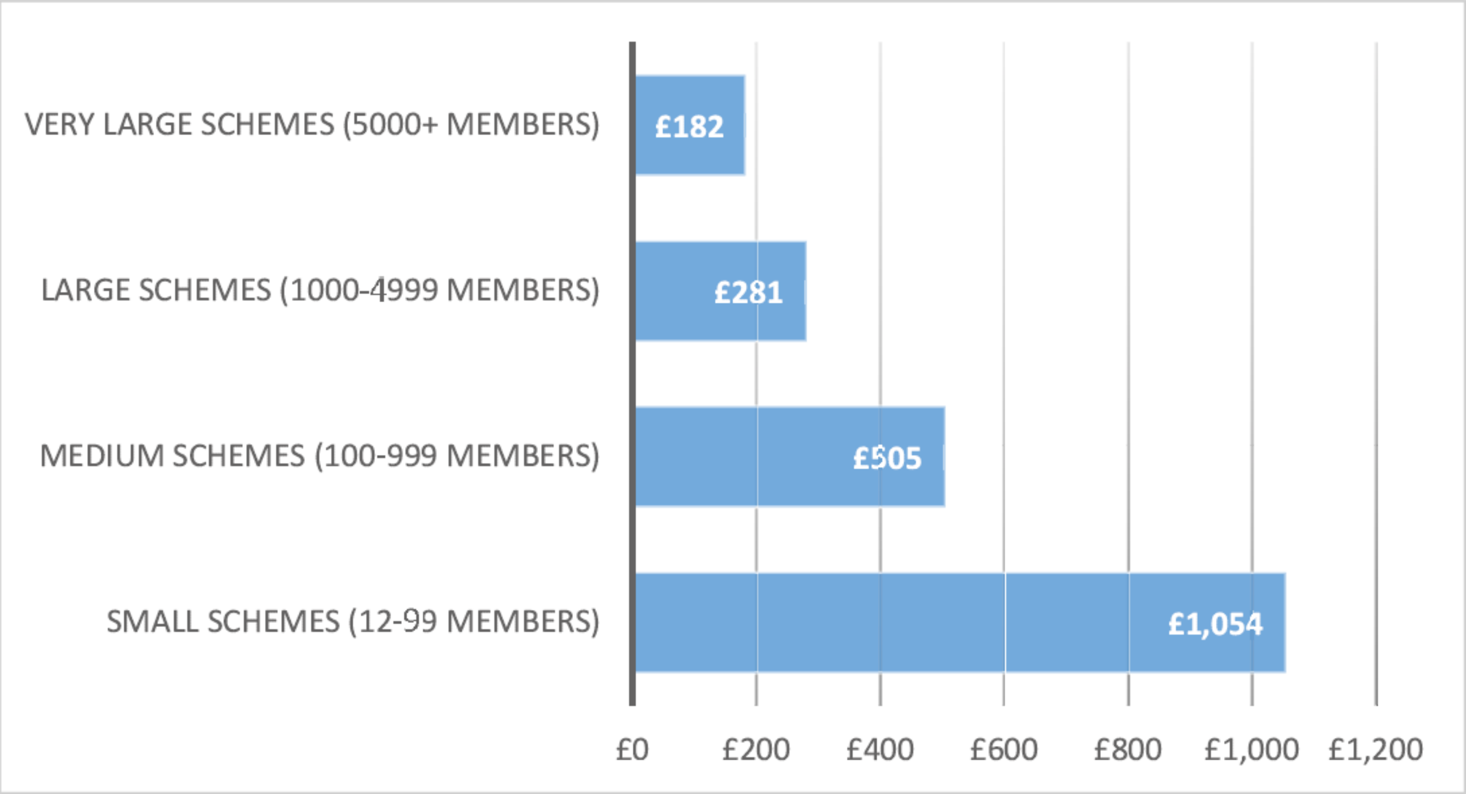
Covenant risk

- Long term obligations and reliance on sponsor
- Existing system designed for binary outcome – full benefits or PPF compensation
- There is risk for DB members but how prevalent:
  - PPF estimate c 600 schemes
  - Greatest Good c 1000 schemes (25 with assets over £1 billion each)
  - DB Task Force –

	CG1 STRONG	CG2 TENDING TO STRONG	CG3 TENDING TO WEAK	CG4 WEAK
WITHIN 30 YEARS	*Base case investment policy*			
Estimated benefit losses on default	11%	14%	16%	19%
Probability of default	6%	20%	40%	65%

- Punter Southall "Risk of Ruin" – one in three DB Schemes will fail to deliver
- Members have no control over risk (except to transfer out)
- PPF compensation is not as generous as it first appears

Efficiencies - Running costs per member



Source Pension Regulator DB Scheme Running costs 2014

Running costs – lawyer maths!

- There are about 1 million members of small/mid schemes @ say£560 pa
- Cost of running those schemes is £560,000,000 pa
- If those members were combined into a very large scheme the cost would be £182,000,000 pa
- Administration cost saving £378,000,000 pa

Savings through better governance

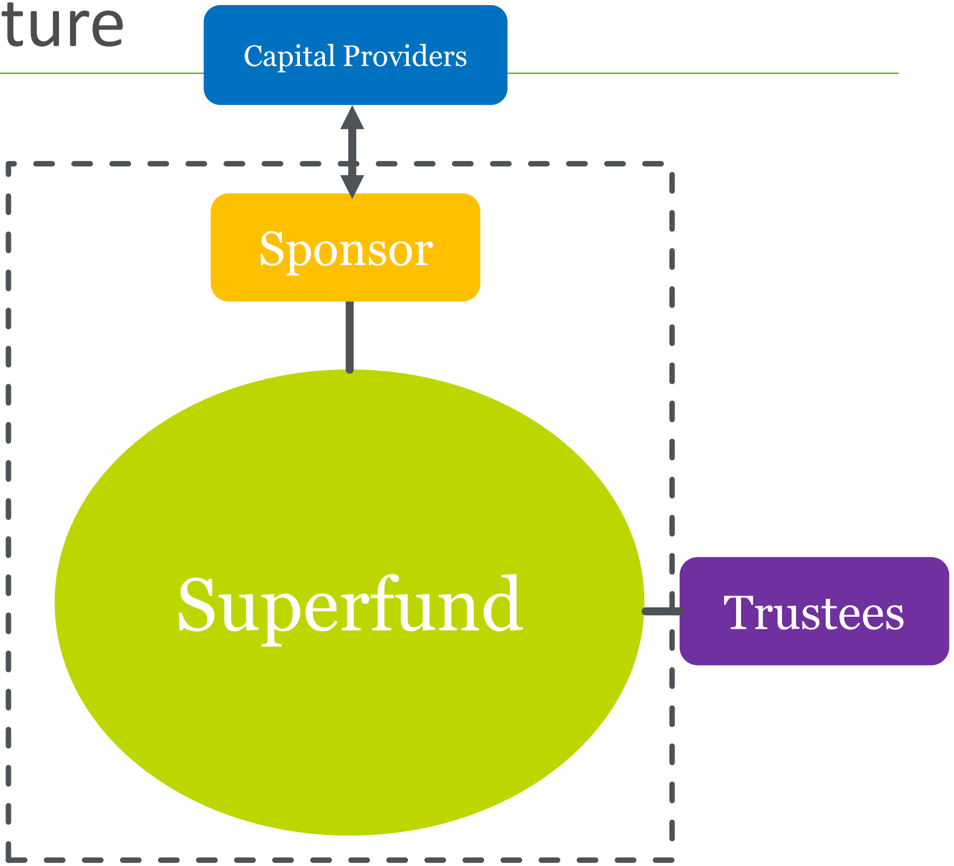
- Governance bonus – estimated at 1% of assets each year
- Small schemes (less than 1000 members) account for £130bn of assets
- Adopting good governance would result in a bonus of £1,300 million pa
- But good governance requires skill, time commitment and has a cost

Consolidation to date

- Group scheme mergers:
  - Unsegregated
  - Segregated
- Common advisers and administrators
- Common investment funds for schemes in larger groups and LGPS
- Little appetite for moves to existing segregated DB master trusts
- No appetite for old fashioned multi employer DB pooled schemes
- If the savings are to be achieved need a new structure…

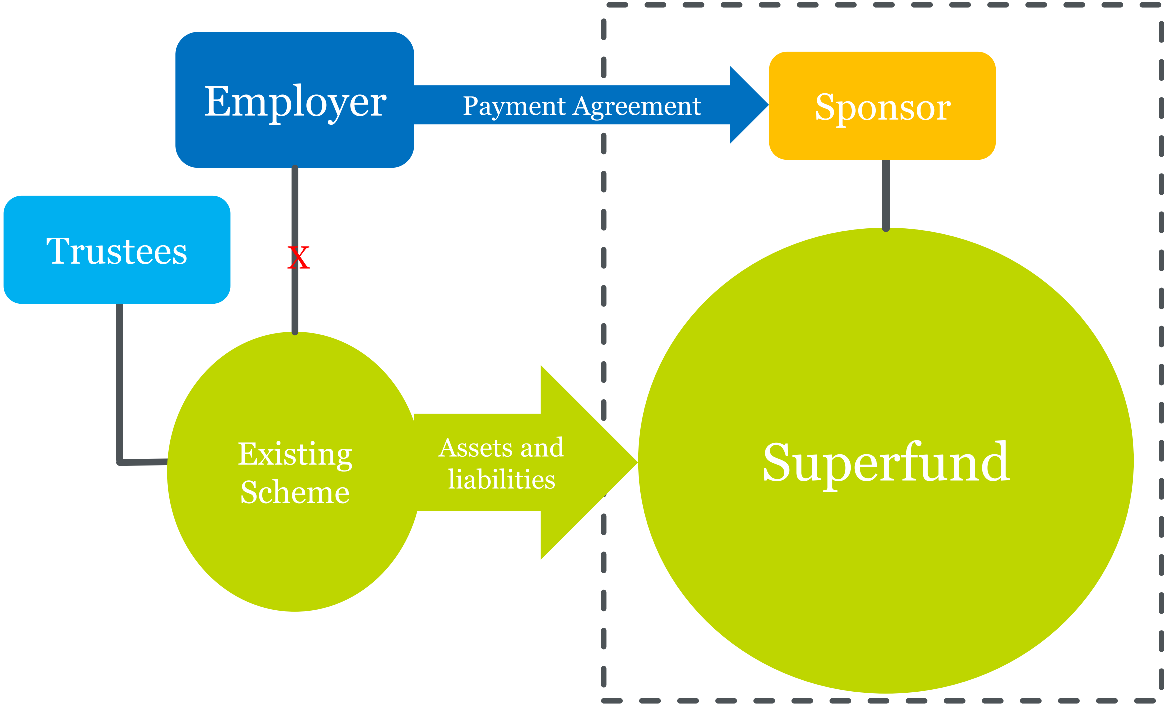
Introducing a Superfund structure

- Occupational pension scheme
- Sponsor sole employer (SPV)
- Independent trustees
- TPR supervised (codes of practice)
- Approved business plan
- SIP needs sponsor agreement
- Eligible for PPF
- Annual valuation (inc covenant)
- Funding triggers assessed annually
- Capital providers return from excess



A “standard” transfer process

- Payment terms agreed
- Bulk transfer no consent
- Actuarial certificate
- Benefits “sausage machined”
- Existing scheme wound up
- Sponsor assumes responsibility
- Transfer cannot reduce funding below set %



The standard transfer - sausage machine

Existing Scheme Benefits

- Deferred pension £5000pa @ 65
- GMP and Barber window
- 5% RPI revaluation
- 5% LPI post 97 – 5% fixed pre
- 66% spouse pension
- Fixed commutation factors

Actuarial Value
£350,000

Sausage machine

Superfund Benefits

- Deferred pension **£6800**pa @65
- ~~GMP and Barber window~~
- **Statutory CPI** revaluation
- **2.5%** CPI ~~post 97 – 5% fixed pre~~
- **50%** spouse pension
- ~~Fixed~~ **Neutral** factors

Actuarial Value
£350,000

- Need amendment to tax rules (AA and LTA)
- How to protect PPF from abuse

Distressed schemes – the level of risk

- Scheme employer has weak covenant and is in decline
- Scheme has 15 year recovery plan
- High risk of entry to the PPF at some point
- High level of PPF priority drift
- Investment VaR is high

<u>Existing Scheme Benefits</u>

- Deferred pension £5000pa @ 65
- GMP and Barber window
- 5% RPI revaluation
- 5% LPI post 97 – 5% fixed pre
- 66% spouse pension
- Fixed commutation factors

Actuarial Value
£350,000

Move to PPF

<u>PPF Compensation</u>

- Deferred pension £4,500pa @65
- ~~GMP and~~ **Barber window**
- **Statutory CPI** revaluation
- **2.5%** CPI **post 97** ~~– 5% fixed pre~~
- **50%** spouse pension
- ~~Fixed~~ **Favourable** factors

Actuarial Value
£260,000

Distressed transfer to a Superfund

- Regulator and PPF "nudge" employer
- Employer can raise funds/grant security to exit DB scheme
- Regulator approves a distressed transfer
- Superfund assumes reduced benefits
- Sponsor assumes risk on employer
- Subsequent move to PPF (no worse off)
- Potential for conditional indexation
- Anti embarrassment provision

Superfund Reduced Benefits

- Deferred pension £**5000**pa @65
- ~~GMP and Barber window~~
- **Statutory CPI** revaluation
- **2.5%** **CPI** ~~post 97 – 5% fixed pre~~
- **50%** spouse pension
- ~~Fixed~~ **Neutral** factors

Actuarial Value
£300,000

The future

- Expect a White Paper – late winter
- Will it include provisions for:
  - Superfunds
  - Easier reshaping of benefits on actuarially neutral terms
  - DB Chair's statement
- Needs significant political and Regulator support
- Will we see a revival of Collective Defined Contribution too?
- How would the press react?