First Briefing, February 2019
Superfunds: Defined Benefit consolidators

DB consolidation encompasses a wide range of potential solutions, such as DB master trusts, mergers, benefit simplification and the use of investment platforms. One of the more interesting solutions is the emergence of the new DB financial consolidators, commonly known as "superfunds".

Essentially superfunds involve a third party providing additional capital to replace the covenant of the sponsoring employer. This allows the sponsor to make a clean break from the pension scheme at a lower cost than buying-out with an insurance company.

How do Superfunds work?

Under the superfunds model, all the existing assets and liabilities of a DB pension scheme plus a cash top up from the sponsoring employer are transferred into the superfund.

In some ways, the superfund then works like any other DB pension scheme with a board of trustees responsible for governance. The key difference is that there will no longer be any support provided by an ongoing sponsor. The covenant is replaced by additional capital provided by external investors, who expect a return on their investment.

Before transferring to a superfund, the trustees of a scheme will have to be satisfied that the security provided by the superfund offers members a better expected outcome than continuing to rely on the covenant of the original sponsor.

It seems the initial superfunds will be subject to the same regulatory framework as any other DB pension scheme. The Pensions Regulator (TPR) will be the primary regulator and they are expected to retain eligibility to the Pension Protection Fund (PPF). However, the DWP are still considering how a future legislative framework for authorising and regulating superfunds might work and therefore this may change in the future.

To add to the complexity, there is no such thing as a standard superfund. It is not like buying an annuity where all the providers are essentially offering the same product.

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The first two superfunds launched, Clara-Pensions and The Pension SuperFund are very different in their approach.

	Clara-Pensions	The Pension SuperFund
Aims	Bridge to buy-out To buy-out each transferred pension scheme over the medium term (5 to 10 years)	Run-off vehicle Run-off transferred pension schemes until the final member dies
Structure	Each pension scheme is transferred into its own segregated section	Non-sectionalised
Cost	Around 90% of buy-out depending on the liability profile	105% of the self-sufficiency liabilities
Capital requirements	External investors will provide capital equivalent to 10% of the buy-out liabilities 100% of buy-out liabilities covered from day one	External investors will provide capital equivalent to 10% of self-sufficiency liabilities 115% of self-sufficiency liabilities covered from day one
Return to investors	Capital is only returned to investors once each pension scheme is fully bought out with an insurer Returns to investors are the profit generated against the buy-out cost	A self-sufficiency funding test is carried out annually. If funding level exceeds 115% excess assets are returned: • 1/3rd to a separate member trust • 2/3rds to investors
Member benefits	Mirror existing benefits – no potential for any upside	Member trust funds can be held as future security, or distributed as a bonus to members

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Who should be considering Superfunds?

Some sponsoring employers are likely to find the idea of superfunds attractive, with the potential to make a clean break from their DB pension promises at a cost that is lower than buying out with an insurance company. However, the DWP consultation suggests that schemes already close to being able to afford to buy-out may not be eligible to join a superfund.

Trustees of pension schemes with relatively weak employer covenants or uncertain outlooks may also be interested, although the stumbling block here is whether the employer can afford the cash injection required in order to be able to transfer to a superfund.

Given these points and concerns about security relative to buying-out with an insurance company, the new superfunds may therefore only likely to be suitable for a minority of pension schemes.

However, both Clara-Pensions and The Pension SuperFund are talking to several different schemes and so it is possible that the first deals will take place in 2019. It will also be interesting to see whether other providers come into the market once it becomes clearer how superfunds will be regulated.

Please contact your usual First Actuarial consultant, or First Actuarial's specialist buy-out team on enquire.buyout@firstactuarial.co.uk if you would like to discuss anything contained in this Briefing or any other issues to do with buy-out.