XPS Pensions Group

XPS Insights
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Pensions Regulator issues guidance for defined benefit superfunds

What you **need to know**

- The Pensions Regulator (TPR) issued guidance on 18 June 2020 for approval of defined benefit (DB) superfunds. This guidance is expected to allow transactions to now happen.
- TPR defines superfunds as a model that removes an employer's liability and replaces it with a corporate entity such as a special purpose vehicle employer backed by capital that supports a consolidator pension scheme. It is an alternative to insurance for settling pension liabilities.
- TPR has set out the standards it expects to be met by superfunds for capital reserves, the superfund pension scheme funding level, investment strategy, people involved, governance and systems and processes. TPR's guidance applies ahead of any longer-term legislation being put in place.
- Clearance is required from TPR for every scheme transaction. TPR does not expect a superfund to accept a scheme that can buy-out or is on course to do so within five years.

Actions you can take

- **Include superfunds as a possible endgame option** in setting pension strategy and journey plans.
- **Understand** the circumstances in which superfunds can help protect members' benefits.
- **Prepare to transact** if superfunds now present an opportunity to improve member outcomes, including understanding the strength of employer covenant being giving up.

Comparing superfunds and insurers

Area	Superfund	Insurer
Employer link	Removed	Removed on buyout
Benefit vehicle	Occupational pension scheme	Individual's insurance policy if a buyout
Pensioner cost	Possibly more expensive	Possibly cheaper
Deferred cost	Cheaper	More expensive
Regulator	The Pensions Regulator	Bank of England (PRA)
Transaction approval needed	Every transaction needs TPR clearance	Individual transactions do not need clearance
Capital security[1]	1 in 100 over 5 years	1 in 200 each year
Member protection	PPF[2] – covers a proportion of benefits	FSCS[3] – covers full benefits

[1] The measure of liabilities covered by capital differs.
[2] Pension Protection Fund.
[3] Financial Services Compensation Scheme.

The finer detail: Guidance on DB superfunds

DB superfund	A DB superfund allows for a clean break of an employer's liability towards a DB scheme. Once the pension scheme liabilities are transferred, the security of members' benefits depends on the assets held in the new scheme, together with the capital buffer held by the superfund. To make a clean break the ceding employer must provide scheme assets equal to the technical provisions, plus a contribution towards a capital buffer.
Scheme funding level	TPR requires a superfund to fund its consolidator scheme using technical provisions based on 'gilts plus 0.5%' or stronger and has set out guidance on financial and demographic assumptions, which include a 1.5% p.a. long-term rate of mortality improvement. A reserve for all future expenses must be held.
Capital requirements	A capital buffer must be held, which can be outside of the superfund's scheme: • When added to the scheme's assets, there should be a 99% probability of still being funded on the technical provisions basis in five years' time. • A longevity reserve should be included at least equivalent to the increase in liabilities caused by changing the assumption for the long-term rate of improvement in mortality to 2.0% p.a.
Investments	TPR sets out a number of principles that the investment strategy of the consolidator scheme and the capital buffer must meet. The aim of these is to reduce risk ensuring the strategy is appropriate and aimed at protecting members' benefits. TPR see it as key that capital assets are invested consistently with scheme assets as these may ultimately fall under the consolidator scheme trustees' control.
Triggers that must be in a superfund's legal documents	TPR sets out two triggers to protect members if funding levels worsen. 1) If the total assets of the superfund's scheme plus the capital buffer falls below 100% on the technical provisions basis, then all funds in the capital buffer must be paid into the superfund's scheme. 2) The superfund's scheme must have a winding up trigger if its funding level falls below 105% on a S179 PPF basis.
Trustees' role	TPR expects to be notified by trustees well in advance of an intended transfer, for example 3 months. As part of the clearance application TPR expects to see evidence that trustees have done some due diligence of their own (and are not relying purely on TPR).
Type A clearance	Removing the ceding employer is a type A event and ceding employers are expected to apply for clearance. The path is now clear for TPR to issue the necessary clearance to allow a transfer of responsibility for DB scheme liabilities from the existing sponsor to the superfund.
Gateway check	TPR does not anticipate a superfund accepting a transfer from a scheme that has the ability to buy-out in full, or is on course to do so in the foreseeable future (here TPR gives an example of five years).
No value extraction	No surplus should be extracted from the superfund's capital buffer or the superfund scheme until all benefits are bought out in full with an insurer. This is an interim policy and will be reviewed after three years. TPR will oversee and review superfunds charging reasonable expenses.
Governance and the fit and proper test	TPR will review the superfund's stochastic modelling, legal arrangements and governance structures. Key staff will be subject to fit and proper tests.

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