Sackers

TPR issues superfund guidance for prospective ceding trustees and employers

Alert | 22 October 2020

Introduction

On 21 October 2020, TPR published guidance for trustees and employers contemplating a transfer to a DB consolidator superfund (or other new model). The guidance sets out TPR's approach to regulating such transfers, and its expectations of trustees and employers when considering whether to transact.

This follows the June launch of TPR's interim regime for the regulation of superfunds (see our Alert), pending the DWP's establishment of a full legislative framework for their authorisation and supervision.

Key points

- TPR notes that "[w]ell-run superfunds have the potential to offer good outcomes for pension savers and employers, but they will not be the solution for all schemes".
- Before trustees and their sponsoring employers enter into a transaction with a superfund, TPR expects schemes to demonstrate why they believe it is in the best interest of members, and how the transaction meets three "gateway principles".
- TPR expects transferring ("ceding") employers to apply for clearance and for trustees to demonstrate they have undertaken appropriate due diligence in respect of the transfer. Where a clearance application is not appropriate (for example, as the scheme is in PPF assessment), TPR still expects to be notified of the transaction, and to engage with the ceding scheme and superfund.
- The guidance provides specific information on transferring to superfunds where there is no immediate severance of employer covenant, for schemes in PPF assessment, and on partial transfers.
- Schemes should ensure that they take appropriate advice and that they engage with TPR "at an early stage". In particular, TPR would generally expect professional covenant advisers to be used and suggests trustees consider the appointment of an independent trustee "in view of the complexity of the considerations".

What is a superfund?

According to TPR, a superfund is a model that allows for the severance of an employer's liability towards a DB scheme, where one of the following conditions applies:

- the scheme employer is replaced by a special purpose vehicle employer (a shell employer, usually put in

place to preserve the scheme's PPF eligibility)

- the liability of the scheme employer to fund the scheme's liabilities is replaced by an employer backed by a capital buffer (generally created by investor capital and contributions from the original employers).

TPR believes DB superfunds offer "a secure destination for schemes and members". Its interim assessment and supervision regime, "setting clear standards for how superfunds should operate, the level of capital they should hold, and through ongoing supervision of these areas", aims to "substantially reduce" the potential risks associated with them. Schemes should only consider using a superfund named on the TPR website.

Guidance

The "gateway principles"

Before trustees and their sponsoring employers enter into any transaction with a superfund, TPR expects them to be able to demonstrate why they believe the transaction is in the best interest of members, and how the transaction meets three "gateway principles":

1. A transfer to a superfund should only be considered if the scheme cannot afford to buy out now (based on the transferring scheme actuary's estimated buy-out funding level at a date no more than one month before the date of the clearance application).

2. The transfer should only be considered if a scheme has no realistic prospect of buy-out in the foreseeable future, given potential employer cash contributions and the insolvency risk of the employer.

   "The foreseeable future" is specific to the employer's circumstances. In general, TPR expects this to be a period of up to five years, but acknowledges that there may be greater certainty around employer covenant over three years. Longer periods are "unlikely to provide the clarity trustees need to inform their assessment of this principle". Trustees should provide a rationale for the timeframe they choose.

3. A transfer to the chosen superfund must improve the likelihood of members receiving full benefits. Again, trustees and their advisers must consider the issues carefully based on their experience, supported by "appropriate and proportionate quantitative analysis". The guidance sets out a range of factors trustees should take into account. These include the trustees' current view of their employer's short- to medium-term covenant, emerging trends in their employer's sector, and future potential risks (such as legislative changes or significant debt refinancing).

The role of the employer

In many cases, the employer will be providing any additional capital necessary to facilitate the transfer to the superfund. It will also have a key role in making the clearance application and providing and coordinating the information needed.

As the trustees ultimately take the decision to transfer, TPR expects any sponsoring employer to ensure their trustees "have all they need – including the necessary time, resources and information" to consider a transfer. It also expects employers to pay for the professional advice the trustees need to inform their consideration of the proposed transfer.

Trustee due diligence

While trustees "can take some comfort" from TPR's interim assessment of a superfund, and are not expected to replicate this, they must carry out their own due diligence, and demonstrate that thorough consideration

has been given to their decision.

The approach to due diligence should be proportionate to the scheme's circumstances. But, amongst other things, TPR would expect it to include:

- consideration of other available options to improve the scheme's position
- consideration of the superfund's offering, their associated fees (including all transaction and transition costs), their funding and investment objectives, their methods for implementing and achieving those objectives (including their investment management proposal) and the risks to achieving them.

Clearance

TPR considers a transfer to a superfund to be a new category of Type A clearance event. Except in limited circumstances, TPR therefore expects transferring employers to apply for clearance in relation to a transfer from their scheme to a superfund. A clearance statement gives assurance that, based on the information provided in the application, TPR would not consider it reasonable to use its anti-avoidance powers to issue a contribution notice or financial support direction against the applicants in relation to the transfer.

The clearance process involves TPR assessing whether any potential detriment to the scheme caused by the transfer (in this case the removal of the ceding employer's covenant) has been adequately mitigated.

As part of the clearance application, TPR will expect to see evidence of the trustees' due diligence and of their consideration of the gateway principles. The superfund will be expected to demonstrate that, once the transaction has taken place, it will continue to meet TPR's expectations regarding capital adequacy.

No clearance statements will be issued before TPR has assessed a superfund against the requirements in its guidance. Once a clearance application and accompanying evidence have been submitted, applicants should generally allow at least three months for a decision to be made. However, if a superfund has yet to be assessed, it could take "significantly longer".

Where a transaction then proceeds, it should normally take place within three months of TPR issuing a clearance statement.

Next steps

This is, as TPR notes, a rapidly developing area, and it intends to provide further guidance as the market evolves. The list of superfunds it has assessed is expected to be published "shortly". Trustees are advised to recheck the website at regular intervals to ensure they have the most up-to-date information.

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