Sackers

DWP consults on DB consolidation vehicles

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Introduction

On 7 December 2018, the DWP published its latest consultation promised by this year's White Paper (see our Alert), setting out its proposals for a new legislative framework for authorising and regulating DB "superfund" consolidation vehicles.

Key points

- The proposed regulatory regime is intended to ensure that members of superfunds "benefit from equally effective protections" as members of other DB pension schemes, that the risks specific to superfunds are proactively regulated, and that TPR has the right tools and powers to intervene when necessary.
- Until the new regime is in place, the DWP would expect employers considering a transfer of their DB scheme into a superfund to seek voluntary clearance from TPR.
- In light of the recent Lloyds decision, the consultation also highlights the DWP's ongoing work in relation to GMPs, including investigating possible changes to tax legislation with HMRC for those potentially negatively affected by GMP conversion and corresponding LTA and/or AA requirements. The DWP is "hoping to be able to provide schemes with some guidance on how they can equalise pensions for the effect of inequalities caused by GMPs". Although there is no indication as to the likely timing of this guidance, the DWP is "confident of finalising [its work] in the near future".
- The consultation closes on 1 February 2019.

Background

With more DB schemes approaching maturity, and their sponsoring employers seeking to secure members' benefits or to transfer risk, the Government made clear in its March 2018 White Paper that it is persuaded that there is "a space that new commercial consolidators could fill". The consultation notes that consolidation already happens across the pensions market to varying degrees, with options including sharing and outsourcing administrative services, pooling assets and liabilities through common vehicles such as a DB master trust, and securing benefits through insurance buy-ins and buy-outs.

The Government considers that "encouraging a well regulated superfund sector may offer a more effective way of managing liabilities for some schemes".

What is a superfund?

The consultation notes that a basic superfund structure includes a corporate entity, a statutory employer, a DB pension scheme, a capital buffer and, potentially, in-house service providers (such as scheme administrators). While individual models may differ, based on its "extensive and ongoing consultation with the industry" and the emerging examples it has seen, the DWP's initial view is that the main characteristics of a superfund are as follows:

- a superfund is, or contains, an occupational pension scheme set up for the purposes of effecting consolidation of DB pension schemes' liabilities
- a transferring scheme's link to the sponsoring employer(s) is severed on transfer to the superfund
- the "covenant" is a capital buffer provided through external investment that sits within the superfund structure, and
- there is a mechanism to enable returns to be payable to persons other than members or service providers.

Keen to ensure that any definition of a superfund captures both current and future vehicles, whilst avoiding placing inappropriate constraints on innovation, the DWP welcomes views on whether the above characteristics are the right ones.

Proposed legislative framework

Although the current legislative framework does not prevent the establishment and/or marketing of superfunds, in the absence of a suitable regulatory framework, the Government is concerned that members of such arrangements may not be appropriately protected. It therefore proposes making DB superfunds subject to an authorisation and supervision regime similar to the one now in force for DC master trusts (see our Alert).

Authorisation

A superfund will be required to seek authorisation from TPR. For a superfund to obtain authorisation, TPR will have to be satisfied that it meets certain criteria. In broad terms, the proposed criteria are that the superfund:

- can be effectively supervised
- is run by fit and proper persons – ie individuals that are competent (on an individual or collective basis) and "act with honesty, integrity and propriety". This test will not only capture the corporate entity and the scheme, but also "those who are in a position to exert influence over entities within the superfund"
- has effective administration, governance and investment arrangements
- is financially sustainable – as the existing DB legislative framework was not set up to deal with the particular risks posed by superfunds, the DWP is proposing to add "a further stochastic modelling requirement" for authorisation and ongoing supervision, possibly requiring superfunds to demonstrate "at least a 99% probability of paying or securing all members' benefits in full", and
- has contingency plans in place to protect members.

“Gateway” proposals

A key issue for the DWP is ensuring that superfund consolidation is not seen as, and cannot be used as, an alternative to buying out benefits with an insurer. It is therefore considering strengthening the current scheme transfer process by introducing a regulatory gateway to ensure that the decision to enter a superfund is in members’ best interests. The gateway would be based on the following principles:

- excluding schemes that are assessed by the trustees as having the ability to buy-out at the point of transfer
- excluding schemes assessed by the trustees as being able to afford buy-out in the “foreseeable future” (defined as a period of up to five years), and
- for any other scheme looking to transfer, a move to a superfund would need to be based on evidence that it enhances the likelihood of members receiving full benefits.

In addition, when considering a move to a superfund, trustees would be required to take the following factors into account:

- the scheme’s current funding position on a solvency basis
- any deficit reduction contributions
- professional covenant advice with a clear conclusion on the employer’s ability to support the scheme for the foreseeable future
- actuarial advice regarding the future funding of the scheme, and
- the funding position and the long-term objective of the superfund.

New notifiable event

To ensure that TPR can take action if it has reason to believe that a move to a superfund is not in members’ best interests, trustees will be required to:

- notify TPR at the earliest opportunity (eg at least three months before) of their intention to transfer scheme benefits to a superfund
- make a declaration to TPR outlining their rationale and evidence as to why the transfer will enhance member security, and
- if professional covenant advice has not been taken, explain to TPR why it is not appropriate in their particular circumstances.

TPR will provide trustees with practical guidance on the above duty in a new Code of Practice.

Protecting members and the PPF

A series of underpinning trigger points that describe what must happen if a superfund’s funding levels fall below certain prescribed limits will be put in place to ensure members and PPF levy payers are adequately protected. TPR will have the power to intervene if the triggering level is not acted upon.

In addition, while the PPF has already consulted on new levy methodology for superfunds (see our Alert), the DWP intends to amend the legislative requirements for the PPF levy to provide more flexibility and, in particular, to allow the amount superfunds and other schemes pay to be considered separately.

Next steps

Many of the DWP's proposals will require primary legislation which will be introduced "when Parliamentary time allows". In the meantime, it expects any superfund considering entering the market to engage with TPR and the PPF before doing so.

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