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Publications

UK Pension Regulator Issues New Guidance to Employers and Trustees for Pension Risk Transfers to "Superfunds"

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For some time, the UK has been working to implement the concept of "superfunds" to consolidate defined benefit ("DB") plans. We wrote about this early on here. In essence, a superfund would be akin to a collective defined benefit plan, and a plan transferring assets and liabilities to superfund would relieve the employer of the pension liabilities, at a cost expected to be less than that of a "buyout" or transfer to an insurance company. For that reason, once up and running – no transfers have taken place yet – such pension risk transfers may be of interest to multinational companies with UK pension liabilities. The pension plan members would have less security under a superfund than under an insurance contract from a buy-out, but would benefit from a capital buffer in the superfund and economies of scale for expenses and investing, and superfunds are expected to be closely regulated by the Pensions Regulator ("TPR"), as well as to be insured by the Pension Protection Fund (the "PPF", similar to the US PBGC).

Though not all pieces of the superfund regulatory framework have been put in place yet by TPR or by legislation, on October 21, 2020, TPR issued guidance on how employers and pension fund trustees evaluate a potential transfer to a superfund. This should be of interest to companies and trustees considering making such a move in the future. (It is important to recognize that in the UK pension system, trustees are similar to plan fiduciaries in the US.) Contemporaneous with this guidance for employers and trustees, TPR also issued guidance on the assessment process for qualifying as a superfund. Previously in June, TPR had issued guidance is for those setting up a DB superfund.

The new guidance provides that, before trustees and their sponsoring employers enter into any transaction with a superfund, the TPR expects them to demonstrate to it (1) why they believe the transaction is in the best interest of members, and (2) how the transaction meets the "gateway principles".

The Gateway Principles for Employers and Trustees

These gateway principles are as follows:

1. A transfer to a superfund should only be considered if the scheme cannot afford to buy-out now. If a pension scheme can access buy-out with an insurer, TPR states that they expect the trustees to choose this option rather than transferring to a superfund.
2. A transfer to a superfund should only be considered if a plan or scheme has no realistic prospect of a buy-out in the foreseeable future, given potential employer cash contributions and the insolvency risk of the employer.
3. A transfer to the chosen superfund must improve the likelihood of members receiving full benefits. This may involve a top-up payment or other mitigation. Note that this requirement could make it difficult for insolvent employers to make such transfers.

The Clearance (Approval) Process and Employer and Trustee Duties

Employers are expected to apply to the TPR for clearance to transfer from their scheme to a superfund, and for trustees to demonstrate they have done their due diligence in respect of the transfer. Notably, the pension fund trustees are obligated to carry out their own due diligence on the superfund, and the guidance suggests that trustees consider appointing an independent trustee if additional expertise is necessary, as well as professional advice.

The guidance indicates that the nature and level of such due diligence will clearly vary depending on the resources available to their scheme and their employer, and the potential benefit to members and the sponsoring employer. However, some key considerations would include:

- That the trustees have considered other options, include whether related employers are able and willing to contribute more;
- The destination superfund is right for the members, given the members' experience and the scheme's circumstances;
- Consideration of what the superfund is offering, including associated fees, their funding and investment objectives, their methods for implementing and achieving those objectives (including investment management) and risks;
- The trustees have reviewed with their advisers any modelling outcomes that the superfund produces for their scheme; and
- Consideration of risks attached to any residual liabilities left in the scheme.

In addition, trustees need to demonstrate they have considered past significant corporate activity for any material detriment, for example mergers and acquisitions or bank refinances, that might require some action.

The guidance also permits partial transfers – for example, transfers of those retirees in pay status, which may be useful to ongoing pension plans.

Conclusion

The new guidelines put more structure around how DB plans will be able to be transferred to superfunds and give employers some relief on the liabilities. Though there is no current deadline for TPR to complete its work, once superfunds are actually available, multinational companies with pension liabilities in the UK may wish to consider them as an option.

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