Work and Pensions Select Committee – Defined benefit pensions White Paper
Evidence session (6 June 2018)

Thank you for inviting me to give evidence to the Work and Pensions Select Committee on 6 June. Further to the hearing, I would like to provide additional information in response to Question 118 raised by Steve McCabe MP about the buy-out market versus so-called “Superfunds”, as well as your follow up Question 120, about the ability of insurers to transfer their businesses.

**Question 118 - The buy-out market versus so-called “Superfunds”**

The buy-out market is rapidly growing in the safe and secure insurance environment, which is subject to the stringent regulatory regime set by the Prudential Regulation Authority (PRA). Through buy-outs and buy-ins, trustees and sponsoring employers can effectively de-risk from future uncertainties, deliver on their promise, and secure full benefits to their members.

Insurers already look after the DB benefits of around one million citizens, and £80bn of DB benefits, having consolidated 1200 schemes. Over the last four to five years, insurers have taken on over £10bn worth of defined benefit liabilities annually and in 2018, the volume is estimated to be £15bn. As suggested by advisory firm Lane Clark & Peacock “insurers have continued to work hard and innovate and optimise investment strategies to stay ahead of their competitors”; this has seen the pricing of buy-outs become more competitive. Similarly, advisory firm Willis Towers Watson said in May 2018 that “Insurers’ pricing is becoming more competitive (...) Mortality trends are one contributor. In addition, insurers’ investment strategies are getting more sophisticated”. Advisory firm Hymans Robertson agree that the “strong competition for buy-ins and buy-outs means opportunities for DB schemes”.

---

The end of 2017 saw the highest level of affordability for full buy-outs since the banking crisis. 1 in 5 FTSE 100 companies are now over 80% funded on buy-out (up from 1 in 8 in 2016). As LCP point out, "at this level, the pension plans should have a clear end game plan with some sponsors likely to conclude their plan is within cheque-writing distance of full insurance". DWP's proposal in the White Paper to require trustees of DB schemes to appoint a Chair, and for that Chair to report to TPR in the form of a chair's statement, are critical to ensure trustees have a clear objective (including buy-out where appropriate), and to avoid drift.

The insurance industry remains the undisputed ‘gold standard’ for guaranteeing member benefits in DB schemes. Rather than entrusting new so-called "Superfunds" with members' benefits and allowing them to cherry-pick schemes which are well-funded and can afford buy-out, TPR should work with trustees to help them prepare for buy-out transactions where appropriate, especially where buy-out is the scheme's stated long-term funding objective.

**Pricing for buy-out transactions**

Currently, the cost of buy-outs/buy-ins from regulated insurers is driven in part by the valuation basis and capital requirements under Solvency II, the robust EU-wide prudential regulatory regime. While robust, there are elements of the regime which are inefficient and disproportionate. The ABI made proposals to the Treasury Select Committee on Solvency II that would help reduce prices but not dilute member protection. These proposals were endorsed by the Committee in a recent report. However, many of the Committee's recommendations have since been rejected by the Bank of England. The ABI will continue to strongly make the case for these changes, which include:

- A more flexible approach from the PRA, particularly when considering the eligibility of assets to back annuity business. This would mean firms could invest in more long-term illiquid assets with higher yields, resulting in a lower price for the customer.
- Fixing a mechanism in the balance called the Risk Margin. This is flawed: It is too large and too sensitive to interest rates. It has also been identified as a financial stability risk. It means that insurance firms must hold disproportionately more capital (compared to the last regime) for long-term business like annuities. This cost gets passed on to customers.

Making these changes will help make buy-out transactions more affordable. However, if it is stressed schemes we want to help, there are other means such as benefit simplification, pooling assets and advisory functions with other schemes that will improve their funding position.

The ABI will explore over the summer what more the insurance sector might be able to do for stressed schemes and their members, and what policy changes would be needed to enable this.

---

5 LCP, ibid.
6 LCP, ibid.
Insurance companies’ ability to transfer their business

You asked (Question 120), whether insurance companies could sell off their business to an entity not under the regulatory system of this country, and whether because of this transaction the status and security of policyholders would change as they would lose the protection they had when they became policyholders. This is not legally possible and I have set out further information below relating to this.

- Insurers can stop taking on new business (and become “closed book” providers). But they must honour their contractual obligations to their customers in full and can only transfer insurance contracts if the High Court approves such a transfer under section 111 of Part VII of the Financial Services and Markets Act 2000. These transfers are referred to as “Part VII transfers”. A typical Part VII transfer will take between 6 months and 2 years from an initial application to the final court hearing, depending on the complexity of the proposed transfer.

- Both the PRA and the Financial Conduct Authority have formal roles in this process. The PRA leads the Part VII transfer process, and the FCA will provide views to the Court on their assessment of the transfer against its statutory objectives. The PRA published guidance to firms on its approach to Part VII transfers in 2017 and the FCA has recently published updated guidance on its approach.

- In advance of a court hearing, an independent expert must be appointed to prepare a report setting out the impact of the proposed transfer on policyholders. The insurance company is also required to communicate the details of the proposed transfer to policyholders in writing, who can object to the proposals as part of the court process.

This demonstrates that, far from being able to extricate themselves from their contractual obligations to policyholders, insurers can only transfer their obligations – typically to another insurance company - after a rigorous assessment by the High Court and with the agreement of regulators. This contrasts with the vague proposals for commercial consolidator vehicles, and the uncertainty about the circumstances where capital investors can extract their investment and leave the vehicle.

I hope this information is helpful, and I would be more than happy to assist if you have any further questions.

Dr. Yvonne Braun
ABI Director of Policy, Long-term Savings and Protection