The Pension
SuperFund
Taking care of pension promises

Rt. Hon. Frank Field, MP
Chairman, Work and Pensions Committee
House of Commons
London
SW1A 0AA

27 April 2018

Dear Frank,

Both on behalf of The Pension SuperFund and in a personal capacity I welcome this opportunity to submit evidence to the Committee's Inquiry into the Government's White Paper on Protecting Defined Benefits Pension Schemes.

The Pension SuperFund

The Pension SuperFund was created earlier this year with the aim of consolidating UK occupational pension schemes, through the mechanism of accepting bulk transfers of defined benefit pension assets and liabilities from other UK occupational pension schemes. No change is envisaged to scheme benefits and as a result consolidation can take place under existing legislation. The principal change is that the sponsoring employer's covenant is replaced by financial security, with initial assets in the pension scheme equal to 100% of the liabilities (valued on a prudent 'self sufficiency' basis) and with an additional level of security provided by an asset backed contribution arrangement containing assets equal to a further 15% of the liabilities, giving overall protection equal to 115% of the liabilities.

This, together with a low risk asset strategy, supported by full liability hedging, means that members can expect their full benefits to be delivered in an overwhelming majority of cases. Although low risk, our investment strategy will nevertheless allow the fund to reap the benefits of consolidation and to invest in asset classes such as infrastructure, which are a good match for pension liabilities but are difficult for smaller schemes to invest in economically. For a typical scheme sponsor this will create the ability to close out their legacy defined benefit liabilities at a substantially lower cost than the often unaffordable insurance alternative and importantly provide members with access to the benefits of

consolidation, improved security and (in contrast to other arrangements) participation, through a profit sharing arrangement, in the success of the SuperFund.

Consolidation

The White Paper sets out clearly the case for consolidation, which we support. In brief the benefits of consolidation can be summarised as:

i) Lower costs per member due to economies of scale in procurement
ii) Improved investment returns and lower relative risk due to the ability to invest in asset classes such as infrastructure, which can provide both an improved match for cash flows and yield an 'illiquidity premium'
iii) Better governance and resourcing

Partly as a consequence of the above factors, the cost of transferring liabilities to a pensions consolidation vehicle will be significantly lower than the cost of insurance 'buy-outs', allowing those responsible British businesses who are eager to transfer responsibility for their legacy defined benefit pension schemes to a third party, but could never contemplate an insurance 'buy-out' because of high cost involved, to find a more appropriate and pension fund based solution to their problem. We believe the reduction in cost will depend on both the split of liabilities between pensioners and deferred members and the scheme's level of funding; however as a guide, we believe the value of liabilities on a conservative pension fund 'consolidation basis' could be between 85-90% of the value an insurer would place on such liabilities.

As the White Paper notes, in any new arrangement it is important that there are adequate safeguards in place to protect members. We believe there are two principal areas which will require consideration; governance and funding (including protection of the PPF).

a) Governance

We believe that it is sensible to ensure consistency where possible with the supervisory regime for Master Trusts. We would therefore expect the Government's proposed consultation to cover such items as 'Fit and Proper' tests for the Trustees (and others with significant influence) of all pension schemes (not just commercial consolidators) and the quality of systems and controls, as well as the proposed annual statement by the Chair of the Pension Fund Trustees.

b) Funding

We believe that the Regulatory framework will need tested as proposed in the White Paper. However we believe any standard applied to commercial consolidators will also need to apply to other schemes without a substantive sponsor – arguably more so, since while commercial consolidators may be able to raise additional capital if their funding level drops below 100%, as the investors may be willing to commit fresh capital in the hope of securing further future transfers, it is unclear where

other schemes without a substantive sponsor would look for support if their funding level falls below a threshold set by TPR or the PPF.

We believe that it will be important that the protection offered by the PPF should extend to commercial consolidation vehicles, as it does to schemes without a substantive sponsor, such as the new British Steel Pension Scheme. While the Government's proposed consultation will no doubt examine this issue, we believe that although, as noted in the White Paper, required funding standards may be such that it is extremely unlikely that there will be calls on the PPF, nevertheless it is an important reassurance for members and thus it is important that it be maintained. We note that the PPF already has an option based pricing arrangement for schemes without a substantive sponsor to supplement the standard method of calculating a PPF levy for all schemes and we believe that such an approach is also appropriate for consolidation schemes.

We also consider that it is important that any new funding regime introduced for consolidation schemes is not excessively stringent. The UK Government took a strong stand against the proposals made by EIOPA in 2012 which would have enshrined a Solvency 2 type approach to occupational pensions in IORP II, arguing successfully that UK pensions were not funded on an insurance model and to do so would add a further £1 trillion of liabilities to the balance sheets of British business, which would be unsupportable. Although we believe that an end game of insurance 'buy-out' may be a sensible objective for some funds, we believe that 'self sufficiency' is, or will be, the ambition of the majority of funds. A funding regime which is strong enough to provide confidence that the scheme can deliver such an outcome for members but which does not force sponsors and members down an insurance route as the only means of transferring their legacy defined benefits is therefore necessary if scheme consolidation is to flourish.

We do however believe that more regular assurance on funding would be welcomed both by Trustees and TPR – it is possible therefore that TPR may consider annual valuations as opposed to the standard triennial valuations more appropriate for consolidation schemes, a position we would support.

Broader White Paper Proposals
In addition to commenting on the consolidation proposals in the White Paper, in view of my previous experience I hope it will be helpful to the Committee if I also comment briefly on some of the other areas covered in the White Paper.

I am pleased to see the proposal to give the Regulator powers to punish those who deliberately put their pension scheme at risk by introducing punitive fines has been included in the White Paper. I would hope the Regulator seldom if ever needs to use such powers,

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but their existence should serve as a powerful deterrent to those who are contemplating actions which would put members' benefits at risk.

I also believe that in conjunction with such powers (and the proposal to increase the Regulator's powers to require information) it is right to continue with a regime of voluntary clearance, rather than introduce a mandatory clearance regime which could stifle or significantly slow corporate activity in the UK and thus have the unintended impact of potentially damaging the economy.

Finally, one area not directly addressed in the White Paper but which the Committee may wish to reflect on is the approach to Recovery Plans. Annex A of the White Paper notes that around 80% of schemes were underfunded on a Scheme Funding Objective as at March 2017. Although the average recovery plan period remains around 8 years (essentially unchanged since the implementation of the 2004 Pensions Act), 22% of schemes in the White Paper analysis still have recovery plans in excess of 10 years. It is therefore worth considering a requirement for schemes or sponsors to adopt an 'comply or explain' approach in their annual accounts , such that any recovery plan in excess of 10 years should be accompanied by an explanation of why such an extended term is required.

I hope the above comments are of help to the Committee and look forward to discussing them with you.

Yours sincerely,

Alan Rubenstein
Chief Executive, The Pension SuperFund

Appendix

Alan Rubenstein
Alan Rubenstein is the Chief Executive of The Pension SuperFund. Prior to joining The Pension SuperFund he was, from April 2009 until January 2018, Chief Executive of the Pension Protection Fund.

Alan is a non-executive Director of esure plc and a Trustee (and Chair of the Investment Sub-Committee) of the British Coal Staff Superannuation Scheme. He is a former Chair of the National Association of Pension Funds Investment Committee, a former member of the Council and of the Management Board of the Institute and Faculty of Actuaries and a former member of the Takeover Panel.

Luke Webster
Luke Webster is the Chief Investment Officer of the The Pension SuperFund.

Luke is Chief Investment Officer of the Greater London Authority. He was formerly Chief Finance and Risk Officer of the London Pension Fund Authority and was instrumental in the creation of the Local Pension Partnership between the London Pensions Fund Authority and Lancashire County Council, which was the first Local Government Pension Scheme pooling arrangement. He is a non-executive Partner in Disruptive Capital LLP, one of the major capital providers for the Pension SuperFund, is a member of the Chartered Institute of Public Finance and Accountancy's Capital and Treasury Management Panel and of the Bank of England's Money Markets Committee.