DWP Consultation on the Consolidation of Defined Benefit Pension Schemes
Institute for Family Business Response

About the Institute for Family Business

The Institute for Family Business (IFB) is the UK's family business organisation, supporting and promoting the UK family-owned business sector through representation, thought leadership, analysis, events and networking.

We work closely with family firms to support them in growing enterprises for generations to come. A central part of our work is to provide educational resources and knowledge-sharing designed to support business owners and those who work in family business. We champion best practice within the family business community and help others to learn from these examples.

About Family Business

Family business is the backbone of our economy, and the bedrock of our communities. In the UK, family firms generate a quarter of GDP and employ over twelve million people. By their very nature family businesses take a long term view, building on long-term stewardship of people and resources. Their commitment to passing a healthy business on to the next generation is locked into their corporate DNA.

The family business sector is extremely diverse. Family businesses come in all sizes and are found in all industries and communities across the UK. Whilst the majority of family firms are small or micro businesses, there are around 17,000 medium and large firms. The tax contribution of family businesses now stands at £149 billion – more than the annual NHS budget.

The UK family business sector continues to grow. In the UK there are 1 million more family businesses than in 2010, and family businesses have created an additional 2.3 million jobs. Family firms now turn over £1.4 trillion annually, up 7.2 per cent since 2010 - family business turnover has grown by more than that of non-family businesses since 2010[1].

Family businesses have a long history of acting as responsible employers, and this includes their provision of pensions to their employees. Many firms now have significant pension scheme obligations, and family business owners are committed to ensuring that their business is able to meet these sustainably whilst also investing in growth for the future. Whilst firms may no longer accept new entrants into final salary schemes, those schemes remain a company liability until all beneficiaries of the scheme have passed away.

Consolidation of Defined Benefit Schemes

Q1. Are these characteristics wide enough to define a superfund? If not, how could superfunds be defined for the purpose of a future regulatory regime?

[1] State of the Nation: The UK Family Business Sector 2017/18, Oxford Economics for the IFB Research Foundation

Q2. Given the differences of superfunds and traditional DB occupational pension schemes, what are the additional risks and challenges associated with TPR regulating superfunds?
Q3. Are the proposed authorisation criteria the right ones for superfund regime?
Q4. Are there any circumstances in which it would be advantageous, or necessary, that the authorisation criteria are not applied to the whole superfund but instead to individual segregated sections when the superfund scheme is sectionalised?
Q5. Are these restrictions the right ones to ensure that superfund corporate structures are transparent and compatible with regulatory supervision? Are there any other measures that would aid TPR's ability to supervise superfunds?
Q6. Should the corporate entities of superfunds be permitted to be established as partnerships or should they be required to be set up as a UK limited company?
Q7. Should TPR have a discretionary power to require evidence that individuals outside the superfund structure meet the fit and proper persons requirement?
Q8. Would these requirements be sufficient to allow TPR to identify those subject to mandatory fit and proper persons requirements?
Q9. Should TPR have the power to interview individuals for the purposes of the fit and proper persons test?
Q10. Are there other areas that should be included as part of the mandatory fit and proper persons requirement?
Q11. Would introducing a set of standards of conduct for the superfund's corporate board be proportionate?
Q12. What in your view should form the basis of any standards of conduct?
Q13. In your view, are there other elements that should form part of a potential integrity test, conduct requirement or competency test?
Q14. Should there be a minimum requirement on the proportion of independent NEDs on the superfund's corporate board or should this be left to TPR discretion? If so, what would be a suitable proportion?
Q15. Should superfund trustee boards consist entirely of independent trustees?
Q16. Should there be a non-affiliation requirement for the appointment of trustees to a superfund's trustee board?
Q17. Should superfund trustee boards be subject to the MNT/MND requirement?
Q18. Should superfunds be required to establish member panels? Would such panels be an effective and proportionate way of ensuring that members' views are represented?
Q19. In your view, would the areas outlined in this section enable TPR to assess the effectiveness of a superfund's systems and processes? If not, what alternatives would you propose?
Q20. Are there other areas that should be included as part of the systems and processes requirement for superfunds?

In our response to the Department for Work and Pensions consultation on the 'Security and Sustainability of Defined Benefit Pension Schemes' in May 2017 we stated the following about the consolidation of schemes:

"Consolidation may be desirable for some schemes, particularly smaller schemes, as a means of reducing the costs and charges associated with running a defined benefit scheme. However, consolidation should not be mandatory as it may not be suitable for all.

Our conversations with family business owners indicate that there is a lack of awareness and understanding of the consolidation options available. Guidance should provide more information on consolidation, so that those schemes which might benefit from this option are able to find out more about whether it is suitable for the circumstances and how practically to go about consolidating."

We support measures to increase consolidation options for family businesses. Although it is essential to ensure that members have sufficient protections, it is important to balance this against the need to ensure that regulation does not act as a disincentive either to legitimate providers establishing superfunds, or to make consolidation inaccessible to smaller schemes.

It is important for proportionate regulation to be introduced, but this needs to be mindful of the policy intention to secure benefits for members. Over regulation could increase the costs of running and entering superfunds to such a level that their use would be disincentivised, particularly for smaller schemes. This would hamper the overall growth of the market and options available. This must be avoided.

Regulation must also be balanced against the fact that you would expect businesses and pension trustees to also undertake their own due diligence for any provider they expected to do business with. This provides an extra level of scrutiny and security.

Q21. Should superfund financial adequacy be regulated through a pensions based funding requirement approach with an added test of probability of success or an insurance based approach using Solvency II type balance sheet?
Q22. Which of the suggested models would best ensure appropriate financial adequacy, and balance the interests of the various parties? Are there elements of other options that you think should be combined with your preferred option?
Q28. Are the additional minimum standards in (iii) needed, in order to ensure a high level of protection for member benefits? In particular, are the additional minimum standards (that the superfund scheme itself is funded to 87.5% on the authorisation basis) required for every scheme entering a superfund?
Q29. Should superfunds be required to publish an annual balance sheet using market valuations and including liabilities valued on a buyout basis together with a buffer fund based on the Solvency II approach?
Q31. Should superfunds be required to maintain a minimum level of scheme funding regardless of approach to financial adequacy? This could include a separate long term objective for the superfund scheme itself to reach a buyout level of funding but to a lower level of probability than the superfund as a whole?

Superfund financial adequacy should be regulated through a pensions-based funding approach, not an insurance-based approach using Solvency II type balance sheet. If an insurance approach is used, you are likely to end up with only insurance-based options – options which are already available elsewhere for those who are interested. A Solvency II approach could also make superfunds unaffordable for smaller schemes.

For the same reasons our preferred model option is a stochastic modelling approach; we do not think superfunds should be required to publish an annual balance sheet using market valuations and including liabilities valued on a buyout basis together with a buffer fund based on the Solvency II approach; and we do not think superfunds should be required to maintain a minimum level of scheme funding regardless of approach to financial adequacy. These could all make superfunds unaffordable for smaller schemes, undermining the policy objective for consolidation.

Q23. Does a 99% probability of paying or securing members' benefits over the lifetime of the scheme adequately protect members' benefits, and effectively balance the competing priorities of employer affordability and member security? If not, what would an appropriate probability be, and why?

Institute for Family Business

Yes, a 99% probability of paying or securing members' benefits adequately protects and balances interests. The Department should consider whether a lower probability of benefits – but higher than if members stayed in the employer scheme – should be available, particularly for smaller schemes.

Q24. Should a superfund have a long term objective to secure benefits with an insurance company?
Q30. Should superfunds be required to secure benefits with an insurance company as soon as practicable, once the scheme assets reach the buyout level of liabilities?

This should be a decision for commercial bodies, not regulators. Superfunds must have the ability to make models which adapt to their own needs.

Q32. Is the failure test in relation to the PPF funding level proportionate and what probability of failure is acceptable?
Q34. At what level above fully funded on the S179 basis should the winding up trigger be set?
Q35. Is three months an appropriate period of grace to allow for any volatility in investments to recover before triggering a wind up?
Q36. Is this minimum funding level trigger sufficient to provide adequate protection for the PPF while mitigating the risk that short-term volatility might force a superfund into the PPF when it still might have a very good chance of meeting the long term objective?
Q37. Do you agree that there should be a Tier 1 funding level trigger to protect members' benefits at this level?
Q38. What would be the best way of expressing this trigger?
Q39. Is three months an appropriate period of grace to allow for any volatility in investments to recover before allowing trustees access to the capital buffer?
Q40. Should TPR have the power to intervene and require wind up or transfer if they believe the trigger has not been acted on in the best interests of members?
Q41. Is this a reasonable basis on which to prevent new business being written, or should this be left to the discretion of the superfund trustees on the basis they should not be accepting new business if it would have a detrimental effect on existing superfund members?
Q42. Is it reasonable to only allow investors to take a profit after they exceed the requirements for authorisation and if so on what basis?
Q43. Is it reasonable to retain investor profits for a period to mitigate against profits being taken from market volatility rather than genuine outperformance?
Q44. Should superfunds be restricted from taking profit until the funding level is above that required to secure a buyout?
Q45. Is it reasonable to allow a sectionalised superfund to take profit or write new business if one or more sections are inadequately funded?
Q46. In relation to the criteria for financial adequacy and funding level triggers discussed above, should each segregated section within a sectionalised scheme:

a) *Be considered separately for financial adequacy purposes and also considered separately for the funding level triggers;*
b) *Be aggregated together (along with the capital buffer) for assessing financial adequacy but each section is considered separately in relation to funding level triggers*
c) *Be consider separately for assessing financial adequacy but be considered together as a whole when assessing whether the collective scheme funding position meets any of the funding level triggers; or be aggregated together (along with the capital buffer) for assessing financial adequacy and considered together (along with the capital buffer) for assessing financial adequacy and considered*

together as a whole when assessing whether the collective scheme funding position meets any of the funding level triggers?

Q50. Is it reasonable and proportionate to require superfunds to provide detailed fund guidelines, and does this provide the regulator with sufficient information?
Q51. Should superfunds be required to submit their modelling for TPR to review, or should TPR develop a model against which they can assess all superfund proposals?
Q52. Should TPR have a 'fall back' model for cases when the modelling provided by superfunds is not adequate?

We do not have specific views on how to address these issues, we think that the tests and protections need to balance the need to have a sufficient market with the need to protect the PPF, as well as making sure that there are no significant failures of superfunds which would place extra costs on DB schemes paying in to the PPF.

Q33. What powers should TPR have to intervene should a funding level trigger be breached?

The model described in Diagram 4 is reasonable.

Q47. Does this approach provide adequate protection for members, while effectively balancing the interests of investors?

Keeping in line with how occupational schemes work is a proportionate approach, in our view.

Q48. What are the minimum requirements on a buffer fund in order for the scheme to be able to rely upon the assets being available in the event they are needed?
Q49. Should there be minimum standards on the capital buffer to ensure it can be relied upon in stressed situations?

Effectively allowing ring fencing then transferring into a scheme seems a reasonable approach, given all the other protections outlined in the regulatory approach.

Q53. Should there be any other reporting requirements of either the corporate entity or pension scheme to ensure effective supervision?
Q54. Should the corporate entity and pension scheme have to disclose their strategic asset allocation and investment risk limits so that TPR can effectively supervise the investment strategy?
Q55. Should superfunds be required to regularly publish publicly available material on their financial position and operations?
Q56. Would the proposed events outlined in Table 1 to meet the aims of the significant events framework?
Q57. How could we define 'significant deterioration' in relation to investment performance and funding level?
Q58. Should TPR's executive arm have the power to unilaterally commission a skilled persons report in relation to superfunds with TPR acting as the end user?
Q59. Would an enforceable Code of Practice be sufficient to allow TPR to respond quickly and proactively to emerging market risks and supervise effectively?
Q60. In your view, what areas of a future code should be enforceable?
Q61. Would the proposals outlined in Chapter 4 allow for the effective regulation of superfunds? Are there any other powers needed for TPR to intervene where necessary to effectively regulate superfunds?
Q62. Should superfunds be subject to a bespoke levy to fund their ongoing regulation?

We do not have specific views on how to address these issues, but believe the standards should not disincentivise growth in the market, while balancing the needs and protections for scheme members.

Q63: Do these principles achieve the policy aims?

We believe the principles outlined are reasonable. We would support, in addition, the introduction of a principle of proportionality. This could allow for a simpler approach for smaller schemes where appropriate (as highlighted in response to question 23 above).

Q64. Is five years a reasonable timeframe to assess a scheme's potential to reach buyout in the foreseeable future?

We have concerns about the proposed policy to exclude schemes that are assessed as having the ability to buyout at the point of transfer, or in the 'foreseeable future' (up to five years).

The time frame for 'foreseeable future' should be reduced, or this should be judged on a case by case basis. Five year modelling is not appropriate for many businesses, particularly for smaller firms, and would not provide accurate predictions. It would also incur unreasonable levels of cost, and may act as a disincentive to uptake and growth in the consolidation market.

Q66. Should a scheme looking to join a superfund be required to meet a specific minimum funding level at the point of transfer, for example 87.5% funded on the authorisation basis?
Q67. If you think there should be a minimum scheme funding level for entry to a superfund, should it be based on the authorisation basis or a buyout basis? What percentage minimum funding threshold do you think would be appropriate?

These should be decisions for consolidators, not regulators. Given the safeguards already in place, introducing these extra measures wouldn't improve the overall safety but would add an additional barrier to individual companies entering. Extra levels of administration and cost would particularly disincentivise smaller schemes.

Q68. Should external covenant advice be a mandatory requirement of the superfund transaction process? In what circumstances would covenant advice not be required?

This should not be mandatory. It should not be required if disproportionate or the decision is very straightforward.

Q69. Should it be a requirement for those providing covenant advice to be regulated be either the Financial Conduct Authority or the Financial Reporting Council?

It should not be a requirement to be FCA or FRC regulated. Businesses and trustees may prefer to use an accountant or adviser who understands their circumstances, rather than spending significant resources on bringing them up to speed. This should not be discouraged, because doing so may put up an additional barrier to deciding to enter a consolidated scheme.

Q71. Should TPR decide whether each scheme transfer to a superfund can proceed or only have the power to prevent a scheme entering a superfund if they judge that the principles set out in the gateways are not being met.
Q72. What checks should TPR do on a proportionate and objective basis to satisfy itself a transfer to a superfund is likely to be in the best interests of members?

Family businesses do need certainty about whether a transfer is acceptable. Rather than mandatory checks, TPR should offer a voluntary pre-clearance process for schemes, to give them the certainty they desire.

Submissions should all be reviewed on a case by case basis. TPR should provide clear guidance up front on the information they are looking for from schemes, to ensure that they know what is expected of them. Clear guidance at the start will go some way to reducing back-and-forth correspondence for additional information, reducing the time and resource involved for schemes and for TPR.

Q73. What further powers should TPR be given to allow it to regulate effectively both superfunds and transfers to superfunds? Please provide reasons for any additional powers suggested.

TPR does not require any additional powers to achieve its objectives in this area.

For further information contact Fiona Graham, Institute for Family Business on 0207 630 6250 or at fiona.graham@ifb.org.uk.