Drops in the ocean

DB superfunds are finally making a splash, with the first transfer into one having taken place in November. But what will the role of these funds be in the wider de-risking market?

It took some time, but November saw the UK's first transfer of a defined benefit (DB) scheme into a DB superfund.

The transfer in question resulted in 9,600 members of the Sears Retail Pension Scheme having their retirement savings shift to Clara Pensions. The scheme, at the time, had assets of £590 million. To aid its completion, Clara agreed to provide an additional £30 million in funding *[see page 18 for more information]*

This first DB superfund deal came six years after its launch and two years after Clara had completed The Pensions Regulator's (TPR) assessment process and received permission to onboard schemes.

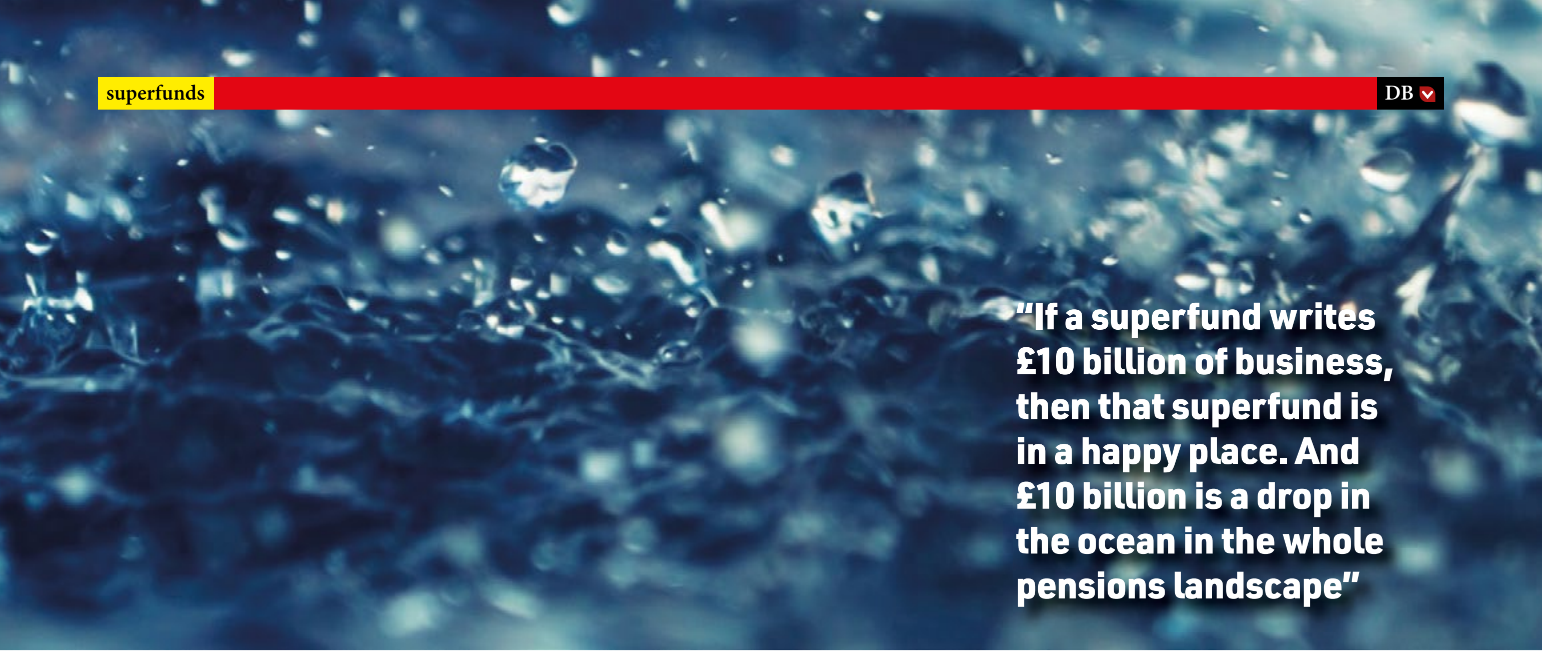
Summary
- Clara Pensions has just completed the first transfer in the UK to a DB superfund.
- However, the Pension SuperFund has been 'mothballed', citing an opacity around regulations.
- Superfunds have a role to play in the DB de-risking market but it may still be of minor interest.

Such a move might herald a bright and broader future for de-risking DB schemes looking for options. A recent survey conducted by WTW said that 90 per cent of respondents felt a superfund could be a viable option for schemes in the right circumstances.

But there is no escape that uptake has been slow, and there is now only one pension superfund in operation. Another superfund that launched at a similar time as Clara, the Pension SuperFund (PSF), has yet to receive regulator permission to onboard schemes and has been 'mothballed' for now, citing issues with some of TPR's positions.

Still, there are some that take the view that any development is a welcome one. And that the first such transaction being so large bodes well.

"It's helpful that the first transaction was significant," says Hymans Robertson head of alternative risk transfer solutions, Iain Pearce. "The £590 million is smaller than Clara would like it to be, but it



demonstrates a decent seed asset pool to cover ongoing running costs. A couple of transactions of that size will put them over the £1 billion mark. If the transaction had been for £10 million, that would have been subscale. The size of this transaction is evidence that the superfund is resilient and stable in its current shape."

Likewise, there was little concern over the glacial speed at which the transaction had taken place, with the lag between Clara receiving permission and transferring over the assets from Sears.

WTW senior director, Suzanne Vaughan, who worked on the transaction, says that such a long period is not unusual, particularly when it is a new development.

"This is the first time that this type of thing has been done in the market," she explains, "and there's always an element of caution when there's something new. When these things happen, advisers and trustees want to make sure that it's the right thing to do."

Vaughan referred to the LDI crisis of 2022 and the impact it had on improving many DB schemes' funding levels. "That's the other big part," she said. "If we look back to before the Liz Truss Budget, there would've been a pipeline for Clara of similar schemes, all of which could have been the first to transfer. But that vanished overnight."

For its part, Clara says that this first transaction is early days. Its CEO, Simon True, tells *Pensions Age* that there is a 'healthy pipeline' of interested schemes, which had increased following the Sears' transfer. This, he says, has led to Clara progressing on its next moves.

Potential impact

The question remains as to what impact the advent of superfunds will have on the de-risking landscape. The criteria for a scheme, says TPR, to qualify for such a transfer is infamously narrow: It must not be able to afford a buyout, that this position will remain for the foreseeable future, and any transfer must improve the likelihood of members receiving full benefits. These characteristics mean that few DB schemes may even qualify.

There have been three routes down that a DB scheme approaching its end game could go: A buyout with an insurance company, self-sufficiency, or approaching the Pension Protection Fund (PPF). DB superfunds now offer a fourth option.

Barnett Waddingham partner, Richard Gibson, says that there were many schemes in the UK that could be consolidated.

He says: "If a superfund writes £10 billion of business, then that superfund is in a happy place. And £10 billion is a drop in the ocean in the whole pensions landscape. It's a happy medium between a set of assets that's big enough to operate on the scale needed but still possible to be put together."

Barnett Waddingham, Gibson says, has done research on this. Fifteen per cent of the FTSE 350, the company calculated, were in the window for consolidation.

"There are a lot of assets out there," he explains, "that are suitable for this. But it's entirely plausible for a superfund to have £10 billion of assets. And they'd be very happy with that."

Vaughan takes a slightly different view. "It won't get to the scale of insurers conducting buyouts," she says, "but it is incredibly valuable to the wider de-risking landscape. For the schemes who find themselves not able to go to buyout and who don't have the covenant support to afford them the time to get there, this gives them the mechanism to enhance security and benefits for members."

Clouds on the horizon may also provide some kind of boon for this nascent part of the sector. State Street Global Advisor head of LDI, Jeremy Rideau, points to darkening economic clouds. Figures from the Office for National Statistics released in November showed that Britain's GDP neither grew nor shrunk between July and September. The same week saw the Flash UK PMI composite output index rise to 50.1, just above the mark indicating stagflation.

"When you start looking 12-18 months ahead, we're expecting a slowdown in the UK economy. When

that happens, we may see some scheme sponsors feeling the pinch or even going under. The scheme now has a different solution that is not buyout or going to the PPF. They've got another option for someone to take on that risk," Rideau states.

True, meanwhile, states that there were a number of places Clara could next turn to.

He says: "We are seeing interest from DB schemes with varying circumstances and requirements, from well-funded schemes with a weak corporate sponsor, to PPF+ cases, to schemes which have a sponsor involved in corporate activity such as M&A or restructuring.

"Trustees are increasingly viewing consolidation as an option, and while Clara won't be right for every scheme, it is encouraging that trustees and sponsors are considering ways to improve the security of their members' benefits."

Friction

There is still some friction in the market though, as evidenced by the PSF being 'mothballed' in September. At the time, its co-founder, Ed Truell, placed blame around the lack of guidance over profit extraction.

TPR was non-committal over the comments, saying in September: "We're now considering how best to go forward on profit extraction, but our primary focus has to be ensuring that savers' interests are protected."

A lack of clarity rarely bodes well. And TPR seems no closer to producing guidance. Vaughn sees this as unfortunate.

"I've got sympathy with the PSF over it being mothballed in the way it has," she says. "It's going to be challenging for other superfunds to enter the market until we see further clarification on issues such as profit extraction."

A surge?

With news that a permanent regime for superfunds is on the horizon, the future could bring a slight surge of superfunds entering the market. Gibson claims that there are several parties already interested in entering the space but have been held back by the current uncertainty and other hurdles.

"The one major thing," he says, "that TPR needs to tackle, if there are to be new entrants and better innovation, are the provisions around returning capital to investors. It has said that it will return to the topic but they are limiting the solutions put forward until they do."

Whether new entrants to the market will be beaten to the punch is yet to be seen, as Chancellor of the Exchequer, Jeremy Hunt, announced that the government would explore how the PPF itself could act as a consolidator of DB schemes, also confirming that the current administration would look to "open the PPF as an investment vehicle for smaller DB schemes".

However, True is sceptical at the idea of the PPF taking on the role of a DB consolidator.

"We don't believe there is a need for a public consolidator at this moment," he says, "with commercial consolidation already an option and beginning to provide secure, more affordable alternatives to buyout for members."

He adds: "We will need to see the details of the consultation on the government's proposals, but if the government does decide to proceed, we believe the PPF should only have a role to play for very small schemes that won't be able to reach either a buyout or a transaction with a commercial consolidator."

Gibson says that there would be many sceptical at the idea of the PPF taking on this role, but he remains hopeful. The PPF, he says "is doing a great job and is already the biggest consolidator in the country. They've got great streamlined processes and administration. If it's done and managed in the right way, acting as a DB consolidator could work."

It may still early days, but there are still some drops that can be heard falling. But is this going to be a light rain or are we about to see a storm of activity?

Written by Pete Carvill, a freelance journalist