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Superfund vs buy-out

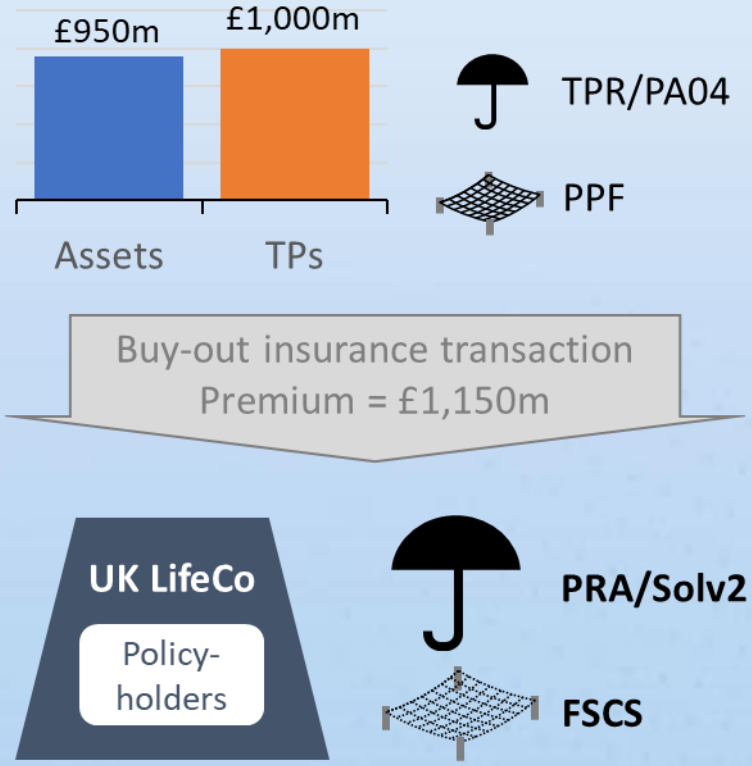
John Hodgson - Isio

4 February 2021

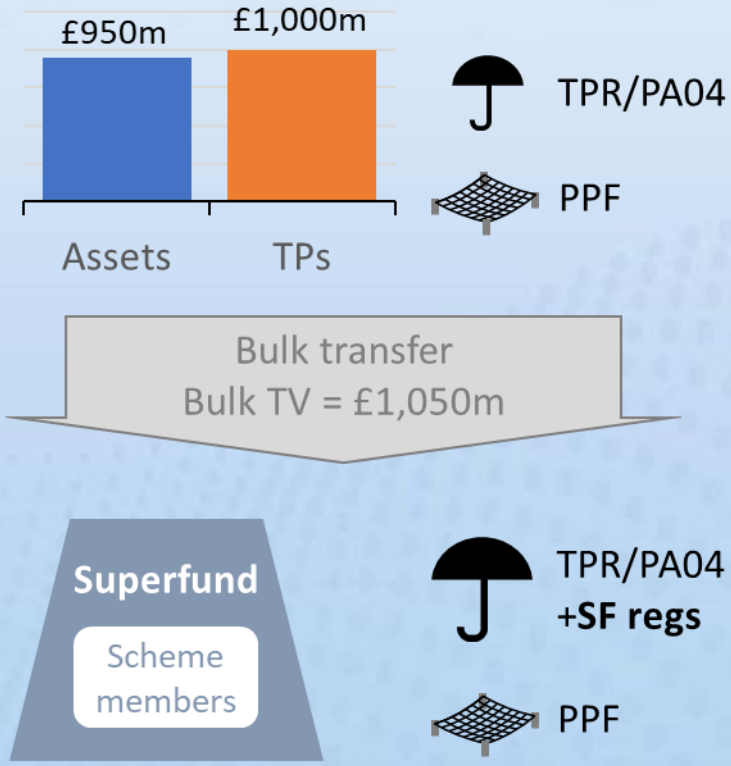
isio.

Today's options

Buy-out



Superfund



Current market

Pension SuperFund	• Occupational pension scheme • Target price in region of 90% of buy-out • No traditional covenant *(like buy-out)* • Downside risk capital provided *(like buy-out)* • Providers expect to make profits/returns on that capital *(like buy-out)*	• Fully pooled arrangement • Intended as long term run-off vehicle • Potential member benefit upside
Clara Pensions		• Segregated arrangement • Intended as bridge to buy-out • No member benefit upside

Both models still going through TPR assessment

Other potential providers considering market entry

Q1: “Superfund or Buy-out”?

1. PPF+ case in assessment	✓	Higher or full benefits via superfund
2. Low chance of buy-out in next 10-15 yrs	✗	Buy-out likely unattainable
3. Decent chance of buy-out in next 5-10 yrs	✓	Superfund or buy-out possible Might plan buy-out, switch to superfund if off track
4. Highly likely to achieve buy-out	✗	Almost certainly buy-out
A. Corporate activity	✓	May accelerate decisions if part of deal

For Group 3 – trade off between:

1. The risks of waiting for buy-out to become affordable *(funding, covenant, future pricing)*
2. Settling sooner but with a different product *(diligence of superfund structure & regulation)*

Q2: “Superfund or Status Quo”?

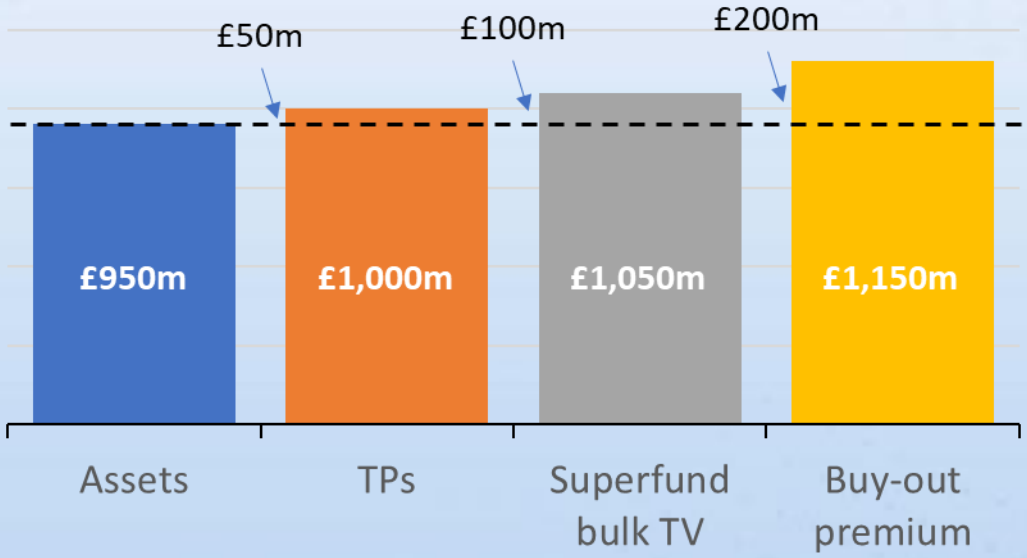
	Q1?	Q2?	
1. PPF+ case in assessment	✓	✗	No realistic “status quo”
2. Low chance of buy-out in next 10-15 yrs	✗	✓	Perhaps only viable settlement target
3. Decent chance of buy-out in next 5-10 yrs	✓	✓	Need to compare if considering superfund Might plan run-off, with superfund option
4. Highly likely to achieve buy-out	✗	✗	Superfund an unlikely option
A. Corporate activity	✓	✓	Have to compare if part of deal

Expected member outcomes are key *(allowing for funding, covenant, investment risks)*

Maybe consider: 1. If already in a superfund, would you give that up for the current covenant etc?

2. Approach for a normal bulk TV, scheme merger etc?

Example corporate proposal for superfund



Funding	•	£50m deficit; £7m p.a. for 8 years
Investments	•	Well hedged; 50% growth
Covenant	•	Limited UK employer affordability
	•	Medium rating today; unclear beyond 5 years
Fees & levies	•	£1m p.a.
Buy-out modelling	•	Best estimate of buy-out late 2030
	•	25% chance of buy-out by 2026
	•	25% chance can't buy-out before 2036

- Parent company looking to sell UK business pensions-free
- It offers up £100m cash today conditional on bulk transfer to a superfund
- Trustees asked to consider quickly, so TPR clearance can be sought

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Superfund vs Buyout

Scheme Actuary perspective

Leanne Johnston FIA

MERCER

“End game” options

MERCER

Duty of care	Pay member benefits
Levers	Contributions and cost
	Investment Risk
	Security and covenant
End Game Options?	Run off
	PPF
	Buyout / buy in

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“End game” options…

Duty of care	Pay member benefits
Levers	Contributions and cost
	Investment Risk
	Security and covenant
	Flexibility
End Game Options?	DB Master Trust
	Superfunds
	Assured Payment Policy
	Insured Self sufficiency
	Captive buy-in
	Run off
	Surety bonds
	Asset backed contributions

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Challenge is how do you choose which option?

Buy-out	Still a preferred route for many – BUT not always affordable or achievable
Covenant is key	Understand covenant now, longer term and the outcome in the event of failure
Downside Protection	What contingency plans are there?
Cash vs Risk	What cash is affordable/available and how much investment risk is needed?

Corporate activity could ACCELERATE the position

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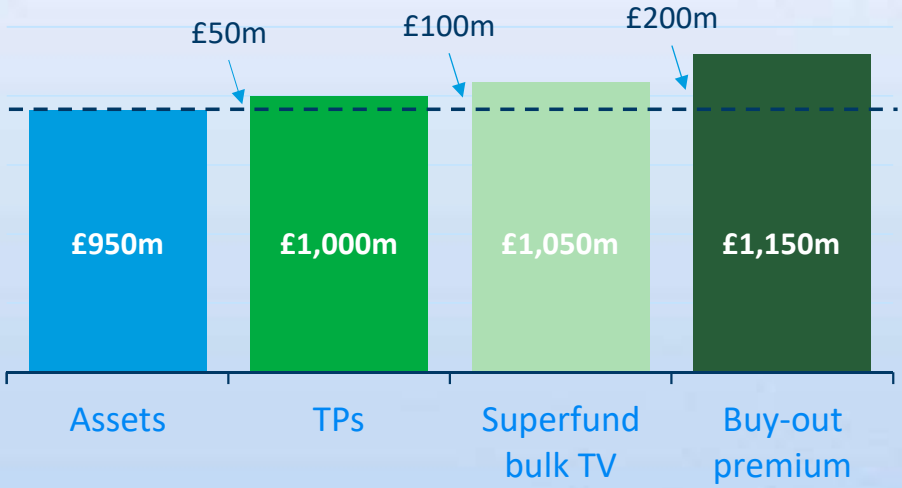
Coming back to our scheme example



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Superfund option - Gateway principles

1	2	3
Scheme cannot afford to buy out now	Scheme cannot afford to buy-out in the foreseeable future	The transfer improves the likelihood of members receiving full benefits
Objective	**Subjective**	**Complex**
Still £100m shortfall	**Modelling with upfront extra £100m?**	**Requires deeper thinking**

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Member outcomes

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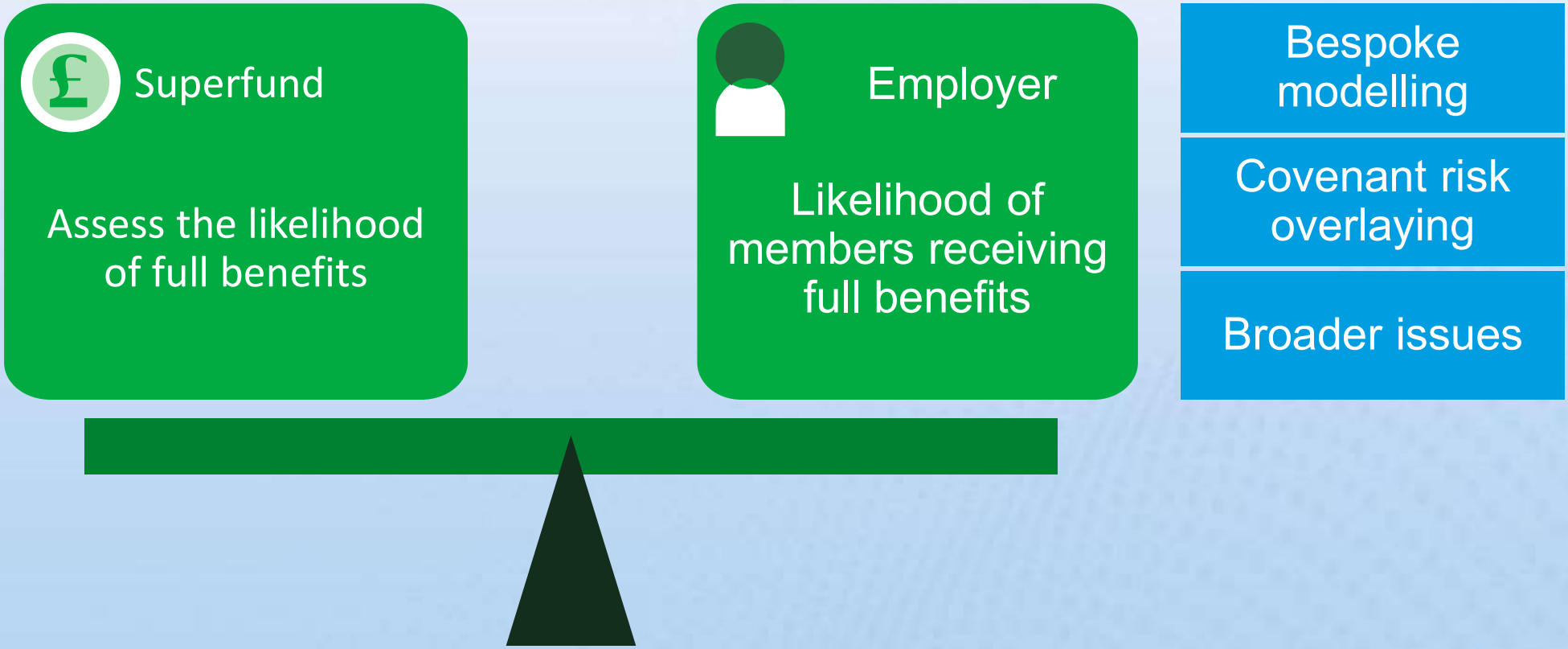

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Factors to consider to support a trustee decision?

Superfund	Own due diligence – clear on what is being offered and risks
Other options	Considered/tested other options?
Negotiation	Challenged/negotiated the best outcome?
Corporate activity	Advice on historical activity – value extraction

Focus on the member – is the transfer right for members?

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Superfund vs Buy-out - some conclusions

Have a Plan	Regardless of buyout or superfund – have a plan
Agree your Plan	Agree it with all stakeholders
Contingency	Have a back up and/or be prepared to divert your plan
Focus on the Member	Move to focusing on member outcomes

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Superfund vs Buyout: a covenant perspective

Atul del Tasso-Dhupelia, PwC

pwc

Contact details

Atul del Tasso-Dhupelia

PwC Pensions Employer Covenant & Restructuring

atul.dtd@pwc.com

Superfund vs Buyout: Which has the stronger covenant?

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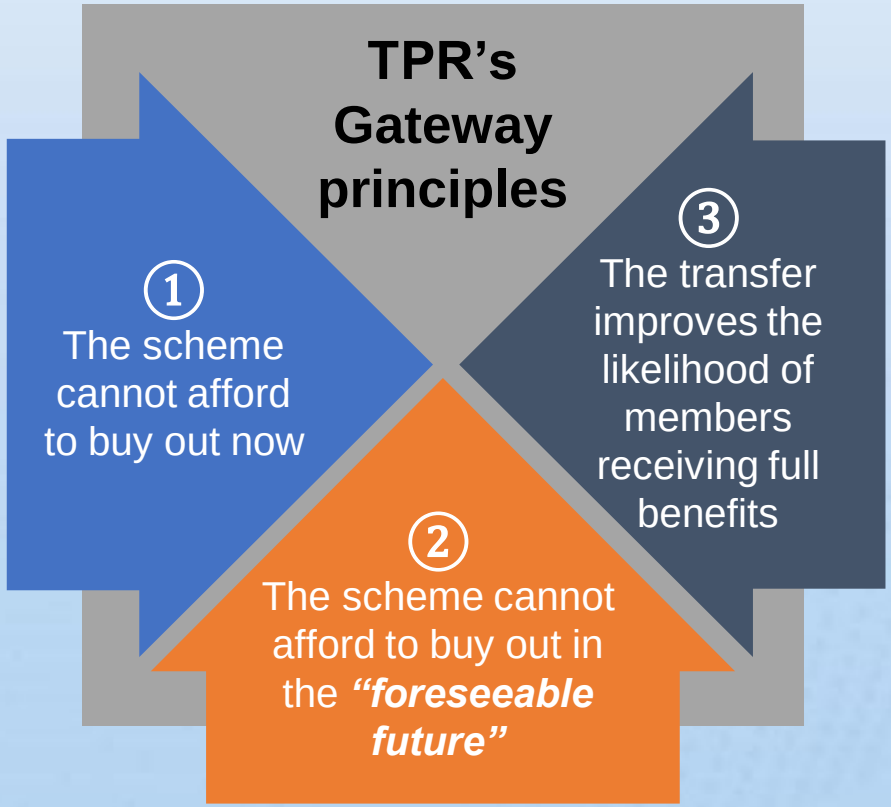
Covenant is core to TPR's Superfunds guidance

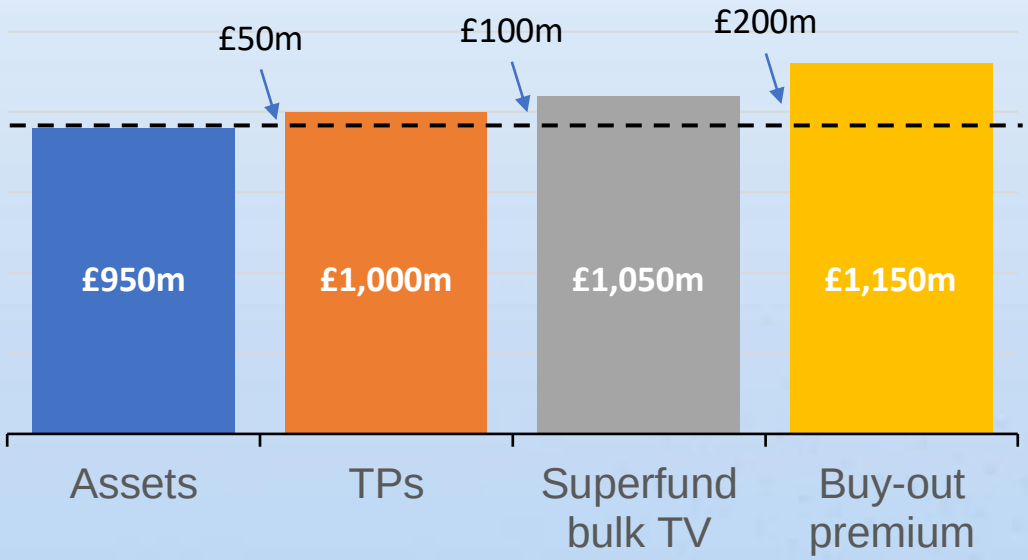


Material detriment assessment: Assessment of any prior potential material detriment

Example covenant considerations of the employer

Past	Today	"Foreseeable future"	Longer term
• Transactions • Refinancings and restructurings • Dividends • Intergroup and Transfer Pricing	• Financial performance • Short term forecasts and liquidity • Covid-19 • Brexit • Insolvency analysis	• Covenant visibility and reliability • Markets and strategy • Forecasts, business plans and capital funding • Affordability • Downside risks • Scenario analysis • Contingency planning • Insolvency analysis	

Recap of Case Study



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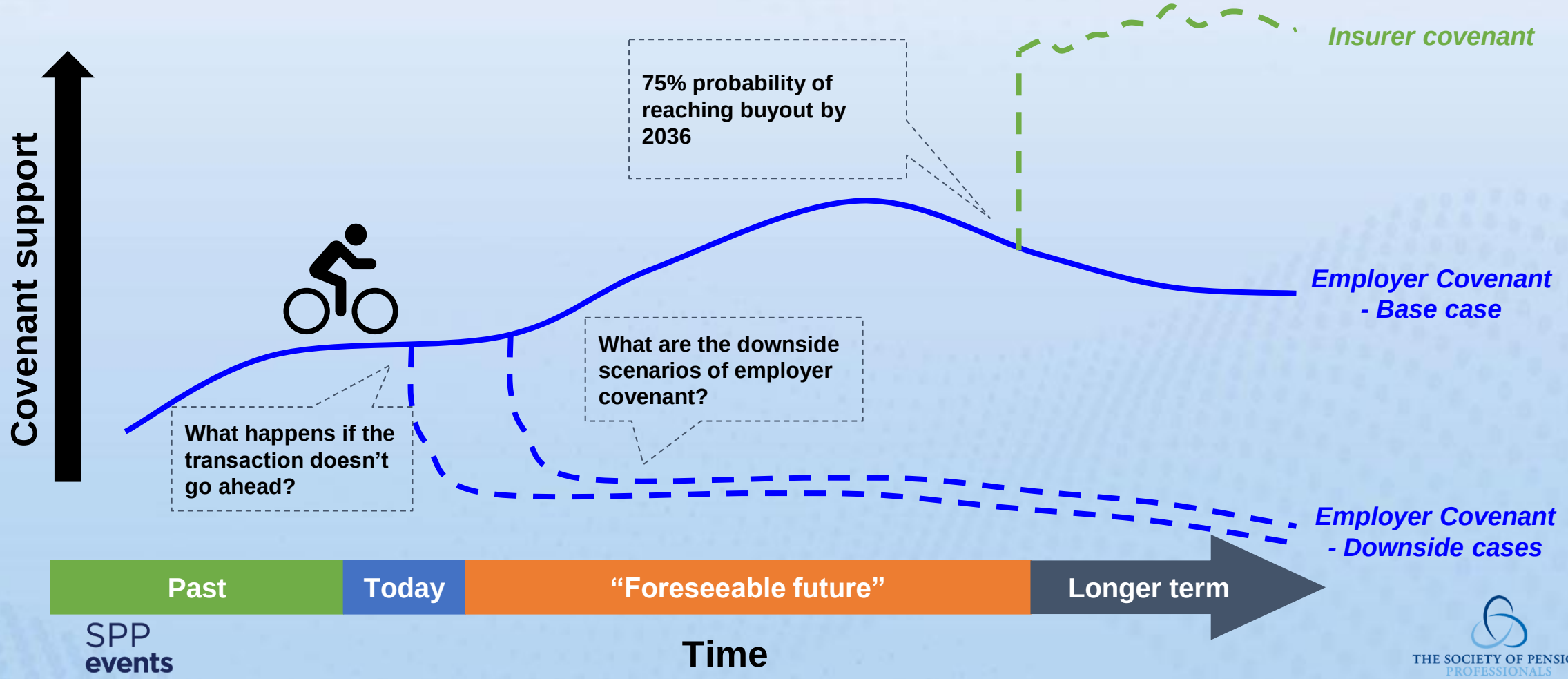
What is your status quo employer covenant?



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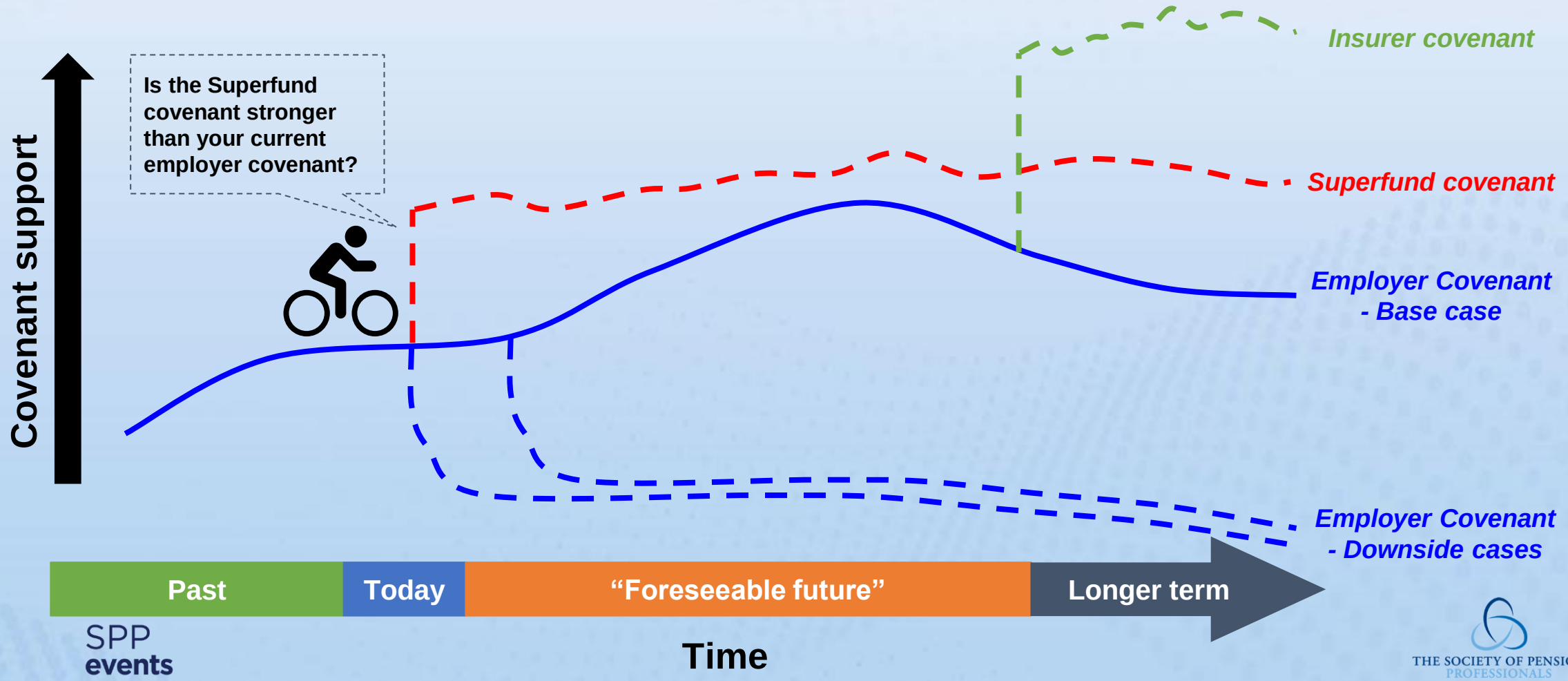
What is the Superfund covenant and is it stronger than your status quo?



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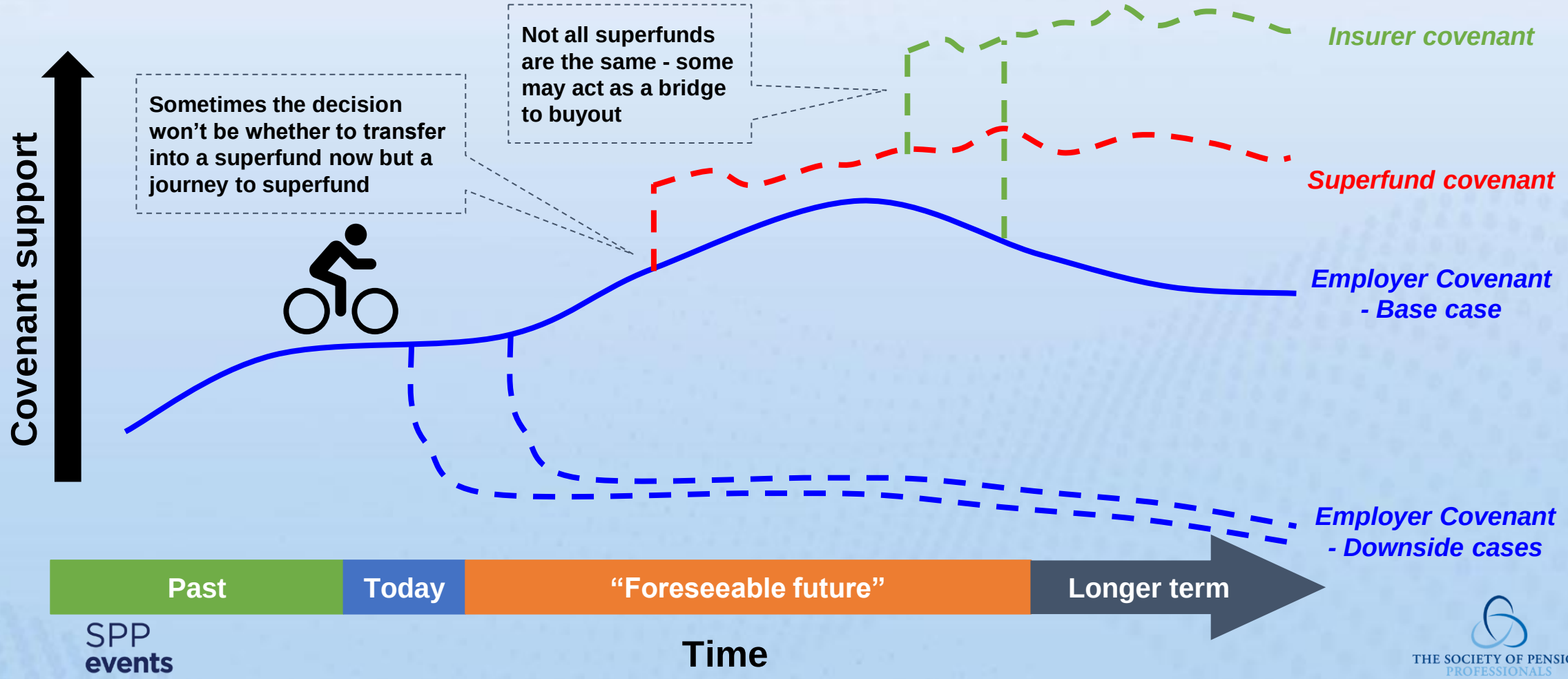
Could a LTFT target a Superfund rather than Buyout?



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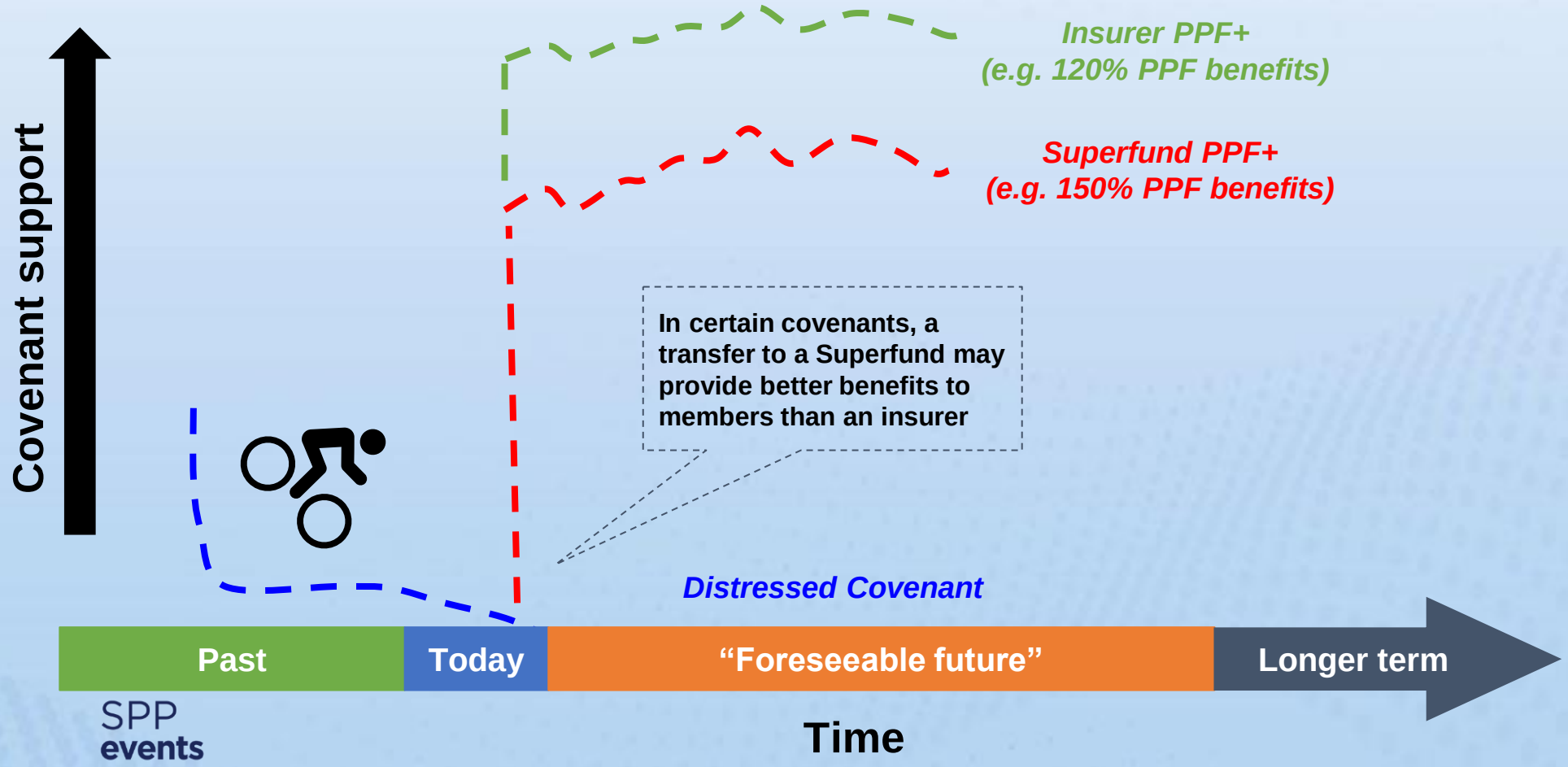
Could Superfunds give better PPF+ outcomes in distressed covenants?



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