Defined Benefit Consolidation Regulation Round Table

The Pensions Policy Institute (PPI) held a round table on 17 June 2019 to discuss the design of regulation for Defined Benefit (DB) pension consolidation proposals which was hosted by Willis Towers Watson.

The event was attended by 22 people representing a broad range of interests from Government, regulators and the pensions industry.

Mark Duke, Managing Director of Retirement at Willis Towers Watson chaired the discussion, welcomed attendees and made introductions. **Chris Curry, PPI Director** presented the challenges and opportunities for DB consolidation in the context of regulatory uncertainty. He discussed the purpose of DB consolidation and types of schemes that would be suitable, as well as what regulatory framework may be appropriate for the target market.

Discussion and Q&A

The following points were raised during the round table discussion session held under the Chatham House rule, chaired by Mark Duke. They do not necessarily reflect the views of the Pensions Policy Institute.

Four key themes emerged which were underpinned by the sub-themes of risk, member benefits, efficiency and covenant strength.

Constructing the framework for a consolidation regime

Participants discussed the extent to which existing insurance and /or pensions regulation can be applied to authorisation and oversight of consolidators.

- Multiple policy, industry and scheme objectives should be balanced in order for regulation to be effective
- Authorisation and regulation regimes should ensure that super funds are safe, affordable and offer a suitable level of member security
- Views were mixed as to whether a regime should be based on the existing pensions system but with greater restrictions ("Pensions Plus"), or on the existing insurance system but with greater flexibility ("Insurance Minus")
- Many participants view a potential regulatory system as a stronger version of the existing pension regime. Additional requirements could be derived from underlying details and principles of the robust, readily available insurance framework that would reflect the specific nature of the consolidation proposition
- Regime design should focus on the objectives of consolidation (both financial and operational). Potential principles include:

- Assessing risks as well as opportunities of existing regimes
- An underlying framework that is well-understood by trustees
- Compatible statistics and benchmarks that enable comparison between consolidated and non-consolidated pension schemes
- Clear delineation between consolidators and insurers
- Strict risk and regulatory frameworks that place controls on the conflict of interest between members and shareholders

Squaring the circle: determining the right level of funding

The level at which the consolidation proposition can be both affordable and allow consolidators to raise capital is key to the design of regulation.

- The DB consolidation space can be quantified by the gap between minimum pricing for insurer bulk annuities (upper bound) and pricing for consolidator transfers (lower bound)
- Funding requirements will influence price and ultimately determine the size of the potential consolidation market. Requirements which are too high may limit the ability of consolidators to de-risk the system whilst improving member outcomes
- An appropriate definition of "safe" which aims to prevent superfund failure through prescribed funding requirements is political in nature
- Eligibility requirements for consolidation and insurance solutions should be mutually exclusive to discourage regulatory arbitrage, through which schemes could prioritise price over member security
- A solvency based regime may limit assets required to attract investment and also risks conflating buy-out and consolidation markets
- Limitations of using funding levels as a single measure of eligibility include scheme diversity and decision complexity, particularly around scale of impact in the event that either consolidators or existing schemes fail
- Alternative options to increase transparency and robustness of the authorisation process include structuring strict procedural frameworks. PPF assumptions and / or technical provisions could also be used to determine viability and shape a consolidator 'PPF+' funding level test.

Measuring the benefits, the authorisation process

- Interest from Covenant Grade 2 and 3 schemes has exceeded expectations, indicating the size of the gap between insurance and PPF grade schemes
- Market fragmentation coupled with situational and financial drivers will make it difficult to predict which schemes will require help
- Trustee decisions will be driven by the catalyst for consolidation and potential improvements for members. They will need:

PENSIONS POLICY INSTITUTE
PPI

    - To be able to compare the viability of existing schemes with projected outcomes in a consolidated environment
    - Clear regulatory and operational frameworks presented in consistent language with comparable statistics and benchmarks that address financial, operational and conduct risk
    - All transactions to be approved by the regulator, with consolidators supported by the government, regulator and PPF

- Wide-ranging benefits of consolidation include swapping risk and covenant uncertainty for fixed financial obligations with capital injections from employers and external investors, improved funding, administration, governance and diversification, economies of scale and lower investment risk
- To support decision making, it may be valuable for trustees to invert the consolidation proposition by considering circumstances under which a consolidated scheme may want to return to its standalone status

Measuring the benefits, the monitoring process

- Assessing ongoing consolidator viability may require different measures of scrutiny to authorisation processes
- Rules should be defined and measured in a comparable way across the sector
- Relative risk measures would enable unbiased forward-looking projections to be applied both before and after transactions
- Stress tests may be preferable to projections
- Penal regimes which prescribe or limit investment are unlikely to be compatible with consolidator objectives
- Measures of ongoing consolidator viability may require different valuation methods to those used in existing pension and insurance regimes

Questions for future discussion

- What protections could be added that would allow consolidators to operate successfully within the pensions regime?
- Given that member security will be a significant factor in pricing, how can consolidators price the likelihood of members receiving full benefits?
- What is the appropriate gap between pricing levels in the insurance market and pricing levels by consolidators?