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CRC Superfund response to 2019/20 Pension Protection Levy Consultation Document

To be received by 5pm 25 October, 2018

With reference to Section 3 and Section 8 of The 2019/20 Pension Protection Levy Consultation Document.

The CRC Superfund is a proposed new Superfund defined benefit scheme consolidator with long-term capital provided by Christofferson Robb & Company ("CRC"), acting on behalf of one or more of its funds or other investment vehicles managed and/or co-managed by CRC or its affiliates.

CRC offers the following responses:

General issues raised

- From the standpoint of potential consolidators, a holistic understanding of any proposed regulatory approach is important. In particular, the combination of capital adequacy requirements and the proposed PPF levy ("Levy") may have a material impact on Superfund economics. We expect the pension regulatory entities (DWP, PPF and tPR) to work with one another so that the regulatory framework for Superfunds is "joined up". This will avoid uncertainties which could hamper the Superfund initiative.

- Superfunds would draw considerable additional funding from employers, as well as investors, to support entering schemes. Consequently, the Superfund policy initiative is capable of materially reducing the PPF's risk exposure, particularly if entering schemes are underfunded and their employers relatively weak. This will be "measurable" by the elimination of S179 deficits on consolidation.

- The total PPF Levy estimate for 2019/20 is approximately £500 million. CRC's preliminary calculations for applying a SWOSS levy to a £7.5 billion asset Superfund (modelled as a single scheme), with a more prudent investment policy than the PPF itself, could easily result in a levy as low as £50 million per annum, despite the Superfund having a funding level in excess of S179. As a sense-check on the PPF's proposed Levy approach to consolidators, we would suggest that the PPF provide projected calculations for the overall Levy impact of DB consolidation if, say, £50 billion or £100 billion of individual scheme assets are consolidated. Successful DB consolidation should significantly enhance scheme funding levels and eliminate S179 deficits, but might also quickly result in the PPF doubling its Levy estimate notwithstanding the elimination of the risk of S179 claims. In such instance, further justification for the PPF's levy approach to consolidators would seem both appropriate and necessary.

- The SWOSS levy construct may not adequately reflect the Superfund structure and mission and was not designed to apply to Superfunds; it was "borrowed" for this purpose. The Superfund construct comprises a substantial injection of new scheme funding from the pre-entry employer, facilitating an investment policy likely to be at least as safe as the PPF strategic asset allocation, with a capital "buffer" of available liquid assets ready to draw down to repair adverse outcomes. The Superfund construct should offer a very high level of safety to members without the need for support by a substantial investment-grade corporate sponsor. It would not, in principle, appear correct to penalise Superfunds for presenting a different mix of ingredients – covenant, investment policy and funding level - if they together provide a high level of benefit security. This is especially so where reliance on the weakest and least tangible element for many individual schemes, covenant, is first substantially reduced and then replaced by a certain capital buffer provided by long-term investors.

Potential framework for regulation of Superfund "wind-up"

The key question for regulation of Superfunds is at what point responsibility for managing Superfunds would be handed over to the PPF (a "Failure Event"). CRC considers that a transfer to the PPF would only arise when the following conditions (the "Conditions") are met:

(i) the relevant supporting Superfund capital buffer has been used up; and
(ii) investors providing the relevant capital buffer don't wish to replenish it; and
(iii) the Executive team of the Superfund have failed, within a reasonable timeframe, to secure alternative means to fund a replacement capital buffer.

This would be the type of "wind-up trigger" which the CRC Superfund would propose to protect the PPF and other Levy payers.

Further, if Superfund capital buffers are deployed to defend the S179 funding level, then it follows that if the Conditions are subsequently met, then the Superfund will only transfer to the PPF at or close to the S179 funding level. If this is the case, then in a Failure Event there can be no risk, or very limited risk, to other levy payers or taxpayers. With reference to 3.1.5 of the Levy Consultation, there could be no "claim on the PPF". Using the PPF's own reasoning, so long as capital buffers are deployed to defend the S179 funding level for each segregated Superfund scheme and a Failure Event is defined as above, then Superfunds pose very limited risk to the system and only a flat rate levy can be economically justified to reserve for monitoring and associated oversight charges.

In terms of ongoing monitoring, we would suggest the PPF needs to know, for each segregated scheme that has successfully entered the Superfund, the safety margin between its funding level and the S179 funding level, supplemented with an actuarial annual audit independently assessing its baseline and its resilience to pre-defined stress cases. We would suggest this ought probably to be reported on a quarterly basis. In terms of assessing the potential for remedial actions, further detailed information would be required from a Superfund as segregated schemes approach the S179 funding level. This would be commensurate with proposed remedies from the Superfund Executives in their efforts to address Conditions (ii) and (iii) above.

If the PPF were to operate in relation to Superfunds by focusing on the above Conditions and proposed definition of Failure Event, then the PPF's direct involvement in Superfunds would be efficient, streamlined and directed at ensuring that Superfunds do not expose the PPF to S179 claims. However, if the Failure Event is defined in relation to the S179 funding level, we would have concerns over adverse changes by the regulator to the definition of and/or basis for, calculating S179 funding and the impact this would have on investors making longer-term commitments to Superfunds' capital buffers.

Section 8 -Consultation Questions

i. Do you think the proposed definition will adequately identify those schemes that ought to be levied as a consolidation vehicle?

The proposed definition will correctly identify the CRC Superfund as a consolidation vehicle.

ii. To incentivise consolidators to have appropriate wind-up-triggers, do you think it better to adjust the strike price or set a higher scheme-based levy?

A wind-up trigger set at the S179 funding level should adequately protect against claims on the PPF given a fixed income dominated investment strategy. Triggers set below the S179 funding level will expose the PPF to claims and this should indeed be reflected in higher levies. Superfunds with triggers set at S179 funding should not be penalised by higher levies.

If the margins of Superfund sections' funding levels in excess of S179 funding are reported to the PPF through quarterly returns, with an obligation on the Superfund to comply with certain stress metrics and also inform the PPF of material adjustments such as transfers in or out as well as dividends paid to investors, the PPF should be in a position to monitor the risk of claims on the PPF in a timely manner.

iii. Do you agree that we should make prudent assumptions in the event information is not forthcoming?

We would presume that timely reporting of margins to the PPF would be a condition of continuing authorisation. Failure to report a negative margin that could trigger a Failure Event would be a serious matter for which even prudent assumptions would not necessarily compensate.

iv. Do you have comments on the approach proposed in relation to buffer funds?

The buffer should be recognised as part of the assets when calculating the Levy, regardless of whether or not it is invested in the scheme. In practise, buffers will relate to segregated sections, if these comprise the Superfund structure.

v. Do you have comments on the adjustments we are making to the SWOSS methodology (and which will also apply in the commercial consolidator methodology)?

This allows the PPF to set the threshold of how small the difference must be between the iterations before deemed. Small changes year on year allows the PPF to determine how many schemes no longer converge and therefore have to pay the large capped version on scheme assets. We are unclear as to the merits and practicalities of potentially heavily penalising any sections of a Superfund that are doing badly, potentially increasing the probability of a Failure Event.

In other contexts, regulators might be expected to work closely to remedy the situation, not compound it.

vi. Are the information requirements that we propose ones that consolidators can reasonably comply with?

If consolidators comprise multiple individual sections each with S179 liabilities below £1.5 billion, the PPF should consider carefully what information requirements are proportionate for the purpose of monitoring the risk of PPF claims.

The PPF should be cognisant that the post-consolidation risk of PPF claims by individual sections (previously schemes) will be substantially reduced within a Superfund structure. Imposing much stricter and tighter standards of reporting than might apply to individual schemes, needs justification.

We note there are references to concentration risk in the Consultation Document. Where a Superfund adopts primarily a fixed income-based investment strategy, we consider that the concentration risk is relatively mitigated, as it would be in relation to growth assets with high volatilities and correlations. We agree that if a Superfund were to become very large and the growth assets remaining in each section were essentially the same, then measures should sensibly be taken to manage concentration risk by e.g splitting the management of growth assets.

vii. If not are there simplifying assumptions that we should use?

We would suggest that the primary focus is on regular reporting of Superfund section margins over S179 funding.

Please contact Laurie Sudwarts (lsudwarts@christoffersonrobb.com) for any further information.