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Commentary

THE BUFFIN FOUNDATION SOCIAL AND ECONOMIC DEVELOPMENT ISSUES

Proposed Consolidation of UK Defined Benefit Pension Plans

The December 2004 edition of *Commentary,* under the headline "Missa Solemnis for Pensions" described the decline of defined benefit pension plans and the various factors that had contributed to their demise. Since then, many pension plans have been terminated or closed to new entrants. What remains of the defined benefit pension system is perceived to be inefficient and costly to administer, particularly in the United Kingdom (UK) and the United States. To address the challenges facing the remaining pension plans in the UK, a taskforce of the Pensions and Lifetime Savings Association (PLSA) has issued an interim report *The Case for Consolidation* that identifies certain areas that policymakers should address to resolve the problematic situation, including consolidation of the plans into a Superfund. The PLSA report develops proposals for consolidation at four different levels. The first level (model #1) focuses on shared services such as plan administration, data management, accounting, pension payments, technical support and communications. The second level (model #2) focuses on asset consolidation, including asset pools that are managed centrally, and utilization of a common fiduciary manager. The third level (model #3) focuses on governance merger to add further integration in such areas as trusteeship, and administrative functions. However, the key recommendation of the PLSA report is contained in its fourth level (model #4) that explores a much more ambitious plan for complete consolidation into a Superfund. Under this model a Superfund would be created to absorb and replace existing pension plans so that employer-sponsors and trustees would be discharged from their obligations in respect of benefits that are paid from the Superfund.

It is clear that greater consolidation of defined benefit pension plans, under any of the four proposed models, would greatly improve the plans' ability to benefit from economies of scale, and mitigate the effects of duplication of costs and intermediation. While each model would deliver marginal improvements, the report states that more radical measures are necessary in order to address the risks of plans not meeting obligations to pay expected benefits in full to participants. The Superfund model is intended to address this issue by consolidating both the assets and liabilities of participating pension plans and discharging solvent employers from their pensions obligations. Under the arrangements for transfer into the Superfund, employers would pay a fee, either upfront or in the form of secured debt, to offset any funding deficiency and obtain discharge from future plan obligations. Participants' benefits would be aligned so as to conform with a uniform Superfund structure on an actuarially equivalent basis. The Superfund would operate with the highest standards of governance and be managed to and maintained at a funding level to provide participants with greatly enhanced prospects of actually receiving their respective expected benefits. The report acknowledges that many employers with poorly funded plans might be unable to meet their pension plan obligations without raising capital from markets or creditors to enable a transfer to the Superfund. However, the Superfund would reduce the existing risks posed by poorly funded plans to the viability of the employers' business and provide a more secure outcome for employees.

The Superfund concept, as proposed by PLSA, merits further study. In order to be viable, the Superfund will need to be in a position to specify the terms of entry for each plan and obtain full and accurate disclosure of the assets, liabilities and commitments of transferring plans. A plan that is in a deficit position in relation to its obligations will require a negotiated commitment from the plan sponsor in order to reach the appropriate entry level, either by means of a cash settlement or through the delivery of a tradable capital instrument adequately secured. With respect to ongoing payment obligations for funding the plan, it will be necessary to reach a separate agreement for the sponsor to re-categorize the payments as commercial debt so that the downside risk to the Superfund and the plan participants may be mitigated to a greater extent. It is important that the Superfund is sufficiently robust to withstand severe economic shocks, or has appropriate defensive capacity to permit an orderly recovery. If a Superfund becomes faced with the prospect of likely failure to meet its obligations, it is important to provide some degree of protection for participants' expected benefits. The PLSA report mentions the need to undertake further study to research the possibility of making the Superfund eligible for coverage by the UK Pension Protection Fund (PPF). If the PLSA Superfund proposals are implemented, there would be a positive impact on the UK economy in terms of enabling greater investment in jobs, wages and corporate growth. Capital raised for entry to the Superfund would be more efficiently allocated by operating at scale with high levels of investment management skill.

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