Technical guide 1: An introduction to Stoneport

STONEPORT
PENSIONS

Forward

Stoneport is a consolidation vehicle for occupational defined benefit pension schemes in the UK with fewer than 1,000 members.

For schemes that join, it will dramatically **improve the security of members' benefits** and deliver substantial improvements in governance, whilst **significantly reducing the running costs** incurred by employers. These enhancements are achieved by operating Stoneport as one large centralised scheme.

This guide is part of a series of technical guides, aimed at pension professionals who advise trustees and/or employers, covering the full range of issues we think a consultant might wish to discuss with a client who is considering joining Stoneport. However, should you have any questions, please do not hesitate to contact the team at enquiries@stoneport.co.uk.

In this first guide in the series you will find a brief explanation of what Stoneport is, who it is aimed at, its conceptual origins and the key benefits it provides.

The other guides in this series are as follows:

- The second guide describes Stoneport's structure, how it will operate before centralisation, the centralisation process and what happens if Stoneport fails to centralise. It also covers the regulation of Stoneport.

- Guide three details the cost savings that Stoneport will bring to the schemes that join. It also considers the potential upside on investment returns that improved governance can bring.

- The fourth guide covers the reduction in risk for employers and members alike, including the improvement in benefit security, the reduction in idiosyncratic risk and the reduction in risk that Stoneport will deliver by adopting higher standards of governance.

- The fifth guide in the series sets out Stoneport's funding and investment strategy, including the flexibilities that exist within them. It also covers the valuation process and the provisions for employers wishing to exit the structure if necessary.

- Guide six describes the allocation of liabilities between employers on centralisation and the tracking of notional asset accounts and notional liabilities thereafter. It also provides some simplified worked examples of the funding mechanism in order to aid understanding.

- Guide seven describes how the member option terms will be set.

- The eighth and final guide covers the entry terms and joining process.

Our technical guides are quite detailed, reflecting their intended audience. Separate guides specifically tailored for trustees and for employers can be found on the Stoneport website at www.stoneport.co.uk.

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1. What is Stoneport?

Stoneport is a purpose-built, innovative new consolidator for Defined Benefit pension schemes; the first to address the growing challenges facing trustees and sponsoring employers of smaller schemes, specifically those with fewer than 1,000 members. By harnessing strength in numbers, Stoneport will help these schemes cut the costs they incur for each member by thousands, boost investment returns, radically reduce risk, and improve benefit security and governance to ensure members receive the retirements they are entitled to.

Stoneport is designed specifically with the needs of the trustees and employers of smaller schemes in mind. It allows the runoff of the pension promises the consolidated arrangements have undertaken to deliver, in a far more secure and cost-effective way, before securing the remaining benefits with an insurance company.

2. The need for change

Defined benefit pension schemes are the gold standard for pension provision in the UK. In the private sector, more than 5,000 defined benefit pension schemes are committed to provide a guaranteed retirement income for life to in excess of 10 million people. Over £1.6 trillion of assets have been set aside to meet those obligations.

Running a larger scheme can be a test for both trustees and employers alike, even with the scale and resources to run efficiently and effectively. For smaller schemes, the challenge can be far more severe.

Smaller DB schemes, those with fewer than 1,000 members each, are responsible for providing the retirement benefits of almost one million members, but these individuals are split across some 4,350 different schemes, nearly all separately administered. Along with increased legislative pressures and a lack of scale to run efficiently, schemes end up shouldering very significant running costs, the smallest more than £1,000 per member, per year.

Despite the best intentions of regulation to protect members' retirements, this alone cannot address the fundamental issues with the defined benefit market. For many schemes, the cost of simply meeting red tape restricts them from being able to run as well as they should do or want to. Consultants have done their best to look after clients and trustees, but the panacea to the problems requires a wider solution to address the inherent structural issue of too many sub-scale schemes.

Lack of scale is not the only problem facing smaller schemes. Running a pension scheme is complex and challenging with good governance being the bedrock of a well-run scheme. When risk is managed effectively it can be minimised, and opportunities for the scheme and members can be maximised. Often though, smaller schemes struggle to access the range of investments available to larger schemes. They fail to achieve the same level of investment returns or provide a comparable level of support to their members, not for want of trying.

Even the strongest schemes face a risk that their members pensions will have to be reduced. Research by the PLSA indicated that schemes with the strongest employers still had a 6% chance of members' benefits being cut back during their lifetimes. Effective and conclusive action is required to protect member benefits, improve governance and alongside that, save costs.

3. Who is Stoneport for?

Stoneport is aimed at the trustees and employers of all schemes with fewer than 1,000 members wishing to radically improve benefit security and reduce running costs, whilst maintaining the link between the scheme and the employer.

We expect Stoneport to appeal to the trustees and employers of smaller schemes which, like Punter Southall, want to run off their liabilities over time, but are looking to tap into the significant benefits that Stoneport can bring today.

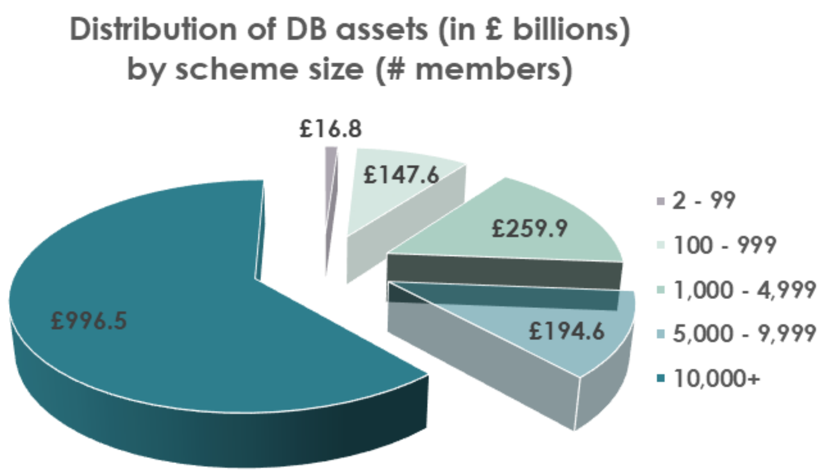
We do not expect Stoneport to be appropriate for schemes that have a desire to discharge their liabilities in full in the short-term, either with an insurance company buy-out or a transfer to a superfund.

Moreover, to protect members and the other employers that join, schemes will have to meet our entry criteria. In particular, each employer joining Stoneport must meet the Covenant Test, which requires each employer to be strong enough to support its own liabilities as well as cope with a degree of adverse deviation. The Covenant Test is described the eighth and final guide in this series.

We want to find around 100 other schemes to join Stoneport, allowing us all to share in the benefits Stoneport will generate and enhance the pension proposition for our members.

3.1 The DB market

The £1.6 trillion of assets in DB schemes can be subdivided by scheme size as follows:



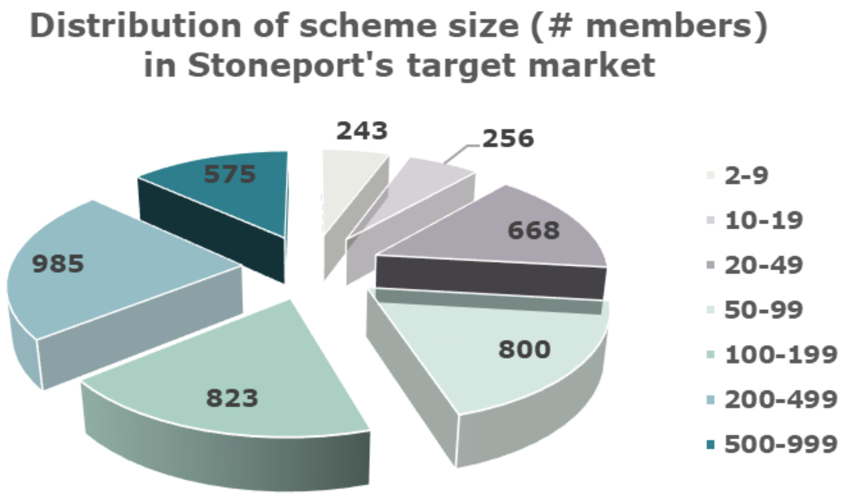
Source: *The 2019 edition of The Purple Book, published by the PPF.*

What this shows is that most of that money - more than 60% - is sat in the very large schemes with 10,000 or more members, which make up fewer than 4% of schemes by number. Those schemes, as well as many schemes with more than 1,000 lives, have the size and resources to run efficiently and effectively.

3.2 The market for Stoneport

Stoneport is designed to help the smaller schemes that would benefit the most from consolidation.

It is open to the two smallest groups shown in the chart in the previous section, those with fewer than 1,000 members, which have only 10% of the money between them. These schemes can be further sub-divided by size as follows:



Source: *The 2019 edition of The Purple Book, published by the PPF.*

4. Stoneport's origins

Stoneport was conceived and developed by Punter Southall Group Limited ("Punter Southall").

The team at Punter Southall is backed by over 30 years of history operating in the defined benefit market, with long-standing pensions professionals at the helm.

Punter Southall has operated a small defined benefit pension scheme of its own since 2002. It was expensive to operate, and struggling to run as well as it could or should, given the significant costs of simply meeting the compliance burden. Stoneport was developed to address this very problem – to cut costs and deliver better governance outcomes.

When presented with the Stoneport proposition, the Trustees of Punter Southall's scheme very quickly appreciated the value to members of being part of Stoneport, both in terms of improved benefit security and enhanced governance and were extremely supportive of its development.

We worked closely with the Trustees of Punter Southall's scheme and with Punter Southall during the design and development of Stoneport. As such, Stoneport was built specifically to meet the needs of both employers and scheme members (and by extension their trustees) of smaller schemes. Moreover, much care was taken in the construction of Stoneport to ensure both the fair and equitable treatment of employers and the fair and consistent treatment of members.

The Trustees of Punter Southall's scheme and Punter Southall have in effect become Stoneport's first "customers" by agreeing to amend and rename Punter Southall's scheme so that it could become Stoneport.

Punter Southall is proud to be the first employer to join Stoneport, demonstrating our commitment to changing the landscape for members, trustees, and their employers and our belief in the Stoneport proposition.

The trustees too are pleased to be the first to join Stoneport, recognising the transformative impact Stoneport has for scheme members.

5. Why Stoneport?

Stoneport addresses both the benefit security and employer cost issues faced by smaller schemes, providing buy-out like security for members, whilst slashing running cost. Furthermore, operating at scale will allow the development of a strong governance framework and a first-rate member experience.

On costs: The average DB pension is around £5,000 a year, but the smallest schemes shoulder average running costs of well over £1,000 per member per year, compared to £100 for the largest schemes. Stoneport is able to radically reduce running costs for smaller schemes, by as much as 80% a year on average for those with fewer than 100 members.

On security: The risk of benefit loss for members is virtually eliminated – within Stoneport the chance of members receiving their pension benefits in full is increased to more than 99%. By way of comparison, even the strongest schemes face a risk that their members' pensions will have to be reduced; more than 1 in 20 (6%) on the PLSA's analysis.

On governance: Stoneport scale and resources enables it to ensure all issues are considered in appropriate depth, ensuring the highest levels of expertise underpin its operation with three professional independent trustees, a level of service not usually be available to smaller schemes. Stoneport's robust governance framework will also be expected to translate into higher investment returns.

Other advantages include reduced investment risk and the diversification of idiosyncratic risk, such as mortality risk.

For employers, joining Stoneport will free also up a significant amount of management time, allowing them to return their focus to running their businesses, safe in the knowledge that their members are being well looked after.

6. Stoneport's objectives

Stoneport's objective is to run off the liabilities of the consolidated schemes over the next 25 years in a secure and efficient way, before securing the remaining benefits with an insurance company.

Stoneport's aim is to be fully funded on a buy-out basis by 31 December 2045, such that a buy-out can be completed in 2046.

If the buy-out funding target is achieved before 31 December 2045 and all benefits can be secured with an insurance company, without the need for any further contributions from the employers, the Trustees have the power, with the consent of the principal employer, to implement a buy-out and wind-up the structure early. Conversely, if the buy-out funding target becomes too onerous for the employers, it will be possible for the Trustees to defer the point at which full buy-out funding is targeted.

7. Who is Stoneport run by?

Stoneport will be run by three professional independent trustees, all chosen from the Pension Regulator's trustee register.

The Trustees are advised by Barnett Waddingham and by SPML.

Barnett Waddingham are the administers and the actuary and investment consultant to Stoneport. SPML provide the Trustees with covenant review services and act as the interface between the employers and the Trustees, allowing the Trustees to operate Stoneport as if it were a large single employer scheme.

SPML is also responsible for the promotion of Stoneport, engaging with potential customers and their advisers and helping schemes through the joining process.

8. How Stoneport works

Stoneport's unique structure allows it to operate like a single scheme and spread the fixed costs of running a complex DB pension scheme across a much larger number of members.

It works by joining employers together to meet a shared funding target and by pooling the assets and liabilities of all the schemes it brings together.

Stoneport will complete its consolidation and become a centralised scheme on 31 December 2022, when the assets and liabilities fully comingled. Notional assets accounts will be created for each employer, and employers will be allocated (and become responsible for funding) a notional proportion of Stoneport's liabilities as whole.

The date that Stoneport becomes a centralised scheme is defined in the TD&R as the Centralisation Date.

It will be possible to defer centralisation if the number and mix of employers is insufficient for Stoneport to safely and efficiently operate as a centralised scheme. Prior to centralisation, Stoneport will be operated on a fully sectionalised basis, exactly like a DB Master Trust, with each employer responsible for funding its own section.

Stoneport has a system for notionally allocating assets and liabilities to each employer at the point of centralisation and for tracking and adjusting those allocations through time. This process is described in the sixth guide in this series.

Employers will have flexibility as to how they meet the buy-out funding target by 31 December 2045. In particular, employers will, within certain bounds, be able to set:

- the level of investment risk by choosing the allocation between the Investment Fund and the Matching Fund that the Trustees are required to operate; and

- the level of contributions and the length of the period over which they are paid, as well as the profile of those contributions.

Further details of the funding and investment flexibilities afforded to employers are given in the fifth guide in this series.