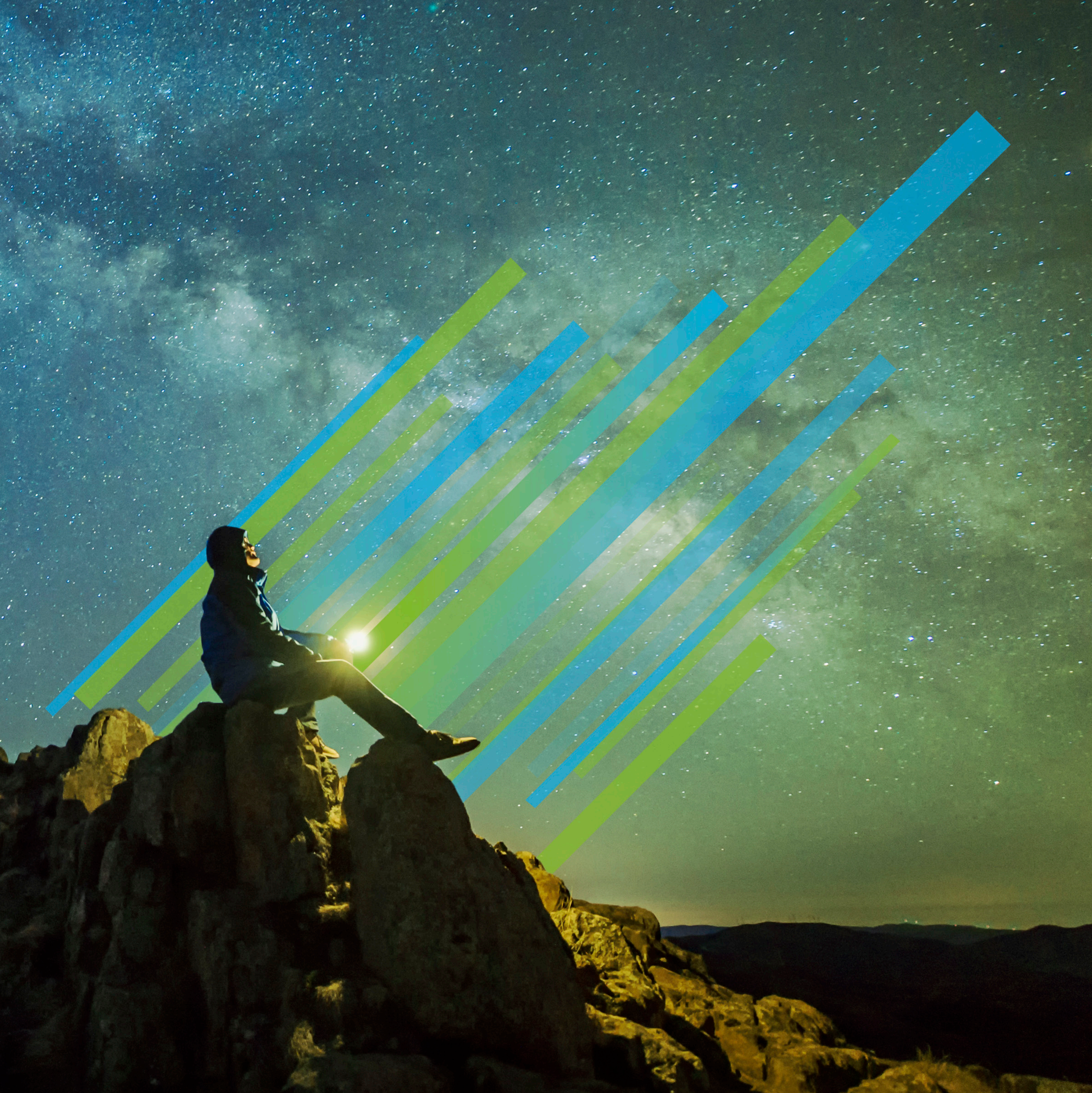
HYMANS ROBERTSON

A closer look at Citrus

Exploring DB Scheme Consolidation

July 2020



A closer look at Citrus

We continue our series with a closer look at one of several DB master trusts in the market – Citrus Pensions. Master trusts have existed for decades and are one of the many forms of consolidation. While they've not received as much hype as the new commercial consolidators, such as Clara-Pensions and The Pension SuperFund, master trusts have many cost, governance and operational benefits which shouldn't be overlooked.

This is the third of our 'closer look' consolidation series, where we take an in-depth look at each consolidation vehicle in turn. In this issue, we shine a light on the Citrus DB master trust, looking at:

1. what is Citrus and how does it work?
2. what are the benefits of Citrus for employers and members?
3. when might Citrus be an appropriate option to consider?
4. what does the future hold?

If you would like us to take a 'closer look' at your own consolidation solution - whether you are a master trust, insurer, commercial consolidator, sole trustee or investment platform - please get in touch.

Alistair Russell-Smith
Head of Corporate DB Consulting
T: 0207 082 6222
Alistair.Russell-Smith@hymans.co.uk

1. What is Citrus and how does it work?

Citrus governance structure

Citrus operates on a not-for-profit basis and is run by a board of Trustees who are nominated by sponsoring employers and members, chaired by a Professional Independent Trustee.

Citrus is one of several well-established DB master trusts in the market. Master trusts are single trusts in which each employer has its own section. Employers transfer their scheme's assets and liabilities into a new section of a larger trust, then close their old scheme. This consolidates the running and governance of the scheme into the DB master trust alongside other schemes and employers, but with no risk of cross subsidy.

Each section within Citrus is fully ringfenced, so each employer can agree their own funding and investment strategy as appropriate to their circumstances and covenant strength.

The success or failure of each section has no impact on any other section within the trust. In other words, there is no exposure to *"orphan liabilities"* or *"last man standing risk"* in the way there is with non-sectionalised multi-employer schemes.

The key difference between DB master trusts like Citrus, and commercial consolidators, is that the link with the employer covenant is retained with a DB master trust. On the one hand this means there is no clean break for the employer from their DB liabilities. However, on the other hand it also means that employers can transfer their schemes into Citrus without needing a large upfront cash injection – or regulatory clearance. Instead they continue to fund the deficit over time in the same way that they would in their own scheme.

Our role with Citrus

Since 2018 we have been appointed as third-party administrators to Citrus and provide actuarial, investment and scheme secretarial services.

2. What are the benefits of Citrus for employers and members?

Lower running costs

One of the key benefits of transferring to Citrus is the significant reduction in running costs. Through cost-sharing with other employers and economies of scale, the average running costs for a scheme within Citrus are over 30% lower than that of a standalone scheme.

The biggest cost savings are achieved for schemes with 100 members or more.

There is an upfront transition cost, but the payback period is short due to the lower running costs. Payback periods are usually under 2 years.

Free up management time

With the governance structure outsourced to the Citrus Trustee board, the burden of finding and training suitable trustees is removed from the employer. The amount of employer time needed to run the scheme and engage with the trustees is also reduced. For employers concerned about a lack of access to the trustee board, they may appoint their own trustee to the board, when there is a vacancy. The Trustee board also seeks to engage and collaborate with employers.

Efficient investment strategy to reach your funding target sooner

Through economies of scale, a greater mix of assets can be accessed in Citrus than is typically available to smaller schemes. Citrus's investment strategy is capital efficient, with a 25% improvement in expected return for each unit of risk taken, compared to a typical strategy in a smaller scheme.

This capital efficiency can be used to either increase overall returns, or reduce the risk being taken, depending on the requirements of the individual section. This means your funding target can be reached sooner or with more certainty.

Better risk transfer pricing

Citrus can be a stepping stone to buy-out, or a commercial consolidator, and the efficient investment strategy enables schemes to reach their long-term objective sooner or with more certainty.

However, Citrus can also group sections together to approach the buy-out market. This provides insurers with a more attractive proposition, potentially leading to better pricing and access to the buy-out market than may have been available for smaller schemes on a standalone basis.

Outcomes within Citrus vs example standalone scheme:

The table below shows the benefits for an example scheme with 300 members, assets of £50m and a funding level of 95% on IAS19.

Citrus has developed a calculator to allow you to see the potential outcomes for your scheme's specific circumstances. Visit https://citruspensions.hymans.co.uk/ to try the calculator.

	Example standalone scheme	Scheme within Citrus
Annual running costs – advisers and admin	£120k	£85k p.a.
Scheme lifetime costs (1)	£1.5m	£0.9m
Annual running costs – internal management time	10 days per year	2 days per year
Time to reach buy-out	7 years	6 years
Downside risk (2)	£5.3m	£3.7m

(1) This includes total running costs over the expected time period to buy-out and advisory costs of a buy-out through Citrus.

(2) A measure of how much worse the deficit of the scheme could be in 1 year's time in the worst 1 in 20 potential outcomes.

3. When might Citrus be an appropriate option to consider?

Transferring your DB scheme to Citrus is likely to benefit employers with small to medium sized DB schemes, particularly those who:

- Want to reduce the running costs of their scheme, while retaining a quality service for members
- Want to outsource the governance of the scheme to save management time
- Want to access a wider range of capital efficient asset classes to boost returns and/or reduce risk
- Want to shorten the timeframe for reaching their Long-Term Objective

A concern for employers transferring to a DB master trust can be the loss of control. Citrus mitigates this risk by taking a collaborative approach to setting funding and investment strategy and letting employers appoint a trustee to the Citrus board. The Trustee regularly communicates with employers and tailors funding and investment strategies to meet mutually agreeable objectives rather than one-size fits all.

Our analysis suggests 14% of companies in the FTSE350 have at least one scheme which could benefit from moving to a master trust arrangement and predict that around 1 million members will be consolidated into a DB master trust by 2042[1]. Additionally, 35% of DB trustees would consider moving to a DB Master Trust.[2]

[1] Source: Hymans Robertson, DB consolidation: when, not if, 2018

[2] Source: Hymans Robertson, research amongst 100 Trustees of DB schemes with assets over £100m, 2020

4. What does the future hold?

Despite the hype around consolidation, the take-off in the DB master trust market has been gradual. However, we expect that more schemes will start switching to DB master trusts. In part this is because as funding improves and investment risk is taken off, focus turns to reducing running costs. In addition, recent regulatory initiatives such as the new funding regime and trustee effectiveness requirements increase the governance burden on trustees, meaning more employers may look to outsource the trusteeship of their schemes.

An informal accreditation regime for DB master trusts is expected to be introduced and should help give employers and trustees confidence that their scheme will be well managed and meet defined standards after transfer. Helping stakeholders make a clear comparison of costs and benefits between master trusts and their stand-alone scheme is vital.

"It's encouraging to see DWP's enthusiasm for DB master trusts. An accreditation regime can provide transparency on issues like costs and investment performance, allowing employers and trustees to conduct more accurate comparison exercises. For Citrus, we want the future to start with building a solid understanding of a DB master trust, and how it can achieve significantly better member outcomes."

Lindsay Davies, Trustee Secretary at Citrus Pensions

Want to find out more?

If you would like to discuss this analysis in more detail or explore whether transferring to a DB master trust is right for your scheme, please don't hesitate to get in touch with one of our experts.

Alistair Russell-Smith
Head of Corporate DB Consulting
T: 0207 082 6222
Alistair.Russell-Smith@hymans.co.uk

Susan McIlvogue
Head of Trustee DB Consulting
T: 0141 566 7672
Susan.Mcilvogue@hymans.co.uk

Lindsay Davies
Trustee Secretary
T: 0207 082 6371
Enquiries@citruspensions.co.uk