Burges Salmon Pensions Law Summary

Buy-in / buy-out

Scope and Summary

This note provides a practical summary of some key aspects relating to de-risking in connection with bulk annuity policies as at June 2021.

Takeaway points include:

- A decision to enter into a bulk annuity contract is an investment decision by Trustees;
- It is important to ensure a scheme is “ready” for a transaction;
- Establishing a “joint working group” to encourage sponsors and trustees to work together is attractive for insurers;
- Resolve scheme issues at an early stage to avoid them disrupting the project.

Summary of legal position

The main legal issues for bulk annuity contracts are:

- A decision to enter into a bulk annuity contract is an investment decision by Trustees and therefore Trustees should ensure that their scheme’s investment powers permit the investment (including whether there are any restrictions in the rules). Trustees should also ensure that the investment decision is consistent with the scheme’s statement of investment principles (which should be updated as necessary in consultation with the sponsor);
- A bulk annuity policy (in almost all relevant cases) is not capable of being surrendered once signed and therefore Trustees should be comfortable they are content with the policy terms;
- The policies will contain important provisions including how GMP equalisation can be addressed, Trustee liability, the ability to challenge calculations and what happens if a scheme falls into the Pension Protection Fund. Trustees should also be comfortable with the data protection and cyber-security provisions under the contract given a material amount of data is likely to be passed to the relevant insurer.

Relevance for Trustees/Employers in greater detail

There has been a trend in the last few years for many trustees (including those with smaller to mid-sized schemes) to opt to buy-in and/or buy-out benefits for various reasons, including:

- securing scheme members’ benefits;
- seizing the opportunity to reduce risk in their scheme or even working with the sponsor to remove the scheme’s liability from the sponsor balance sheet altogether;
- transferring some (or all) of the scheme’s longevity, investment and inflation risk to a third party;

- reducing the overall risk of volatility for the sponsor in terms of contribution levels;
- providing a solution where the trustee and/or sponsor are looking to wind-up a scheme.

Improved affordability, driven by a tailing off in life expectancy, good asset performance and attractive insurer pricing has meant that a full buy-out is an achievable target for many more schemes and their sponsors.

What can you do to prepare for a buy-in or buy-out?

In a booming market, insurers can afford to be more selective regarding the schemes to which they will offer a quotation. Therefore, if you want to maximise the potential for a competitive tender process, you need to ensure your scheme is in good shape to make it attractive to as wide a range of insurers as possible. To achieve this, you should:

- Reconcile your data: Dig out those old paper files or microfiche records, liaise with former administrators and write out to members to fill in any gaps or address any inconsistencies in your data;
- Prepare a benefit specification for your scheme: We recommend that you get your lawyer to review it as early as possible;
- Practice may not comply with the rules. Undertaking this work now avoids issues arising later in the process which can de-rail or delay a project. Being aware of matters sooner rather than later also increases the range of potential solutions available to trustees;
- Consider GMPs: If your scheme holds GMPs, sponsors may wish to speak to their advisers about addressing GMP equalisation through statutory conversion and conducting a pension increase exchange exercise at the same time. The Lloyds judgments could offer trustees and sponsors a real opportunity to re-shape benefits in a way that could maximise insurer interest; and
- Form a "joint working group": Most importantly, sponsors and trustees should work together (using a "joint working group") so that they can show the insurance market there is a real commitment (from a time and a financial perspective) to get the transaction done.

Please contact us if you would like further information or advice on anything in this note. We complete buy-ins and buy-outs both for ongoing clients and as one-off projects for new clients and we have successfully negotiated buy-in/buy-out deals with all of the key insurers in the market. Some transactions may require a bespoke service but for others we have a streamlined buy-in service with pre-negotiated contract terms with all of the key insurers. This means transactions can be dealt with smoothly and efficiently.

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