Pensions Life Hack by Victoria Jeacock

Alternatives To Buy-in and Buyout for Transferring the Risks Associated With Defined Benefit Pension Schemes (DB Schemes)

What Is the Issue?

Many DB Schemes are well funded but may have insufficient assets for the trustees to buy-in or buyout the pension liabilities in full with an insurer, or the trustees may be prevented from doing this in the near term for investment or operational reasons. Trustees and/or sponsoring employers of DB Schemes may prefer to "run-on" the scheme rather than aiming for buyout due to various reasons, but may be concerned about the downside risks.

Over the last few years, there has been an increase in the number of alternative options available for transferring the risks associated with DB Schemes to third parties that may better suit the circumstances of some DB Schemes, their trustees and sponsoring employers.

What Are the Alternative Options?

Alternative options to a traditional insurance company buy-in and buyout include the use of:

- A capital-backed DB commercial consolidator or "superfund", to which the DB Scheme's assets and liabilities are transferred, and the link to the sponsoring employer is severed
- A capital-backed funding arrangement, under which a particular investment return or financial outcome for the DB Scheme is underwritten for a defined period by third-party capital
- An employer-owned captive insurance vehicle that can enter into a bulk annuity contract with the scheme trustees
- Buy-in style insurance products that offer more limited protection against certain downside risks than a buy-in policy
- A longevity swap to hedge the longevity risk for a proportion of the DB Scheme's liabilities, typically for pensioners

The appropriateness of a particular option will depend on factors such as the endgame objective and associated timescales for the DB Scheme, the level of scheme funding, the strength of the employer covenant and the size of the scheme. Employer appetite to support the strategy is also important to ensure that it can pay any additional monies required to implement the project.

Lessons Learned

It is useful for trustees and sponsoring employers to have an awareness of these alternative options, which can be complex and expensive. Given that most of the options are relatively new, it will be important that thorough due diligence is undertaken on the provider and the arrangement is considered in detail with professional advice.

Top Tips

1. Engage with the scheme's sponsoring employer early to understand its long-term strategy and risk appetite in relation to the scheme.
2. Ensure that the investment strategy is aligned with the endgame objective.
3. Discuss the de-risking options with your risk transfer consultants and lawyers.
4. Consider having a training session to explore the advantages and disadvantages of the various de-risking options.
5. Take time to scope out the project, assess the costs and seek approval from the sponsoring employer.

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