Finance & investment briefing

September 2023

Sackers finance and investment experts take a look at current issues of interest to pension scheme investors

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In this issue

Abbreviations

CDC: Collective Defined Contribution

DB: Defined Benefit

DC: Defined Contribution

DWP: Department for Work and Pensions

ESG: Environmental, social and corporate governance

FSCS: Financial Services Compensation Scheme

GMP: Guaranteed Minimum Pension

HMRC: HM Revenue & Customs

HMT: HM Treasury

IGC: Independent Governance Committee

LDI: Liability-driven investment

OTC: Over the counter

TPR: The Pensions Regulator

WPC: Work and Pensions Select Committee

Finance & investment focus

"In our briefing this time last year I mentioned the "unusually hot and dry couple of months". In contrast, this year, it feels like there has been a deluge of rain over the summer, but hopefully some of you will have made it to sunnier climes.

Not all deluges are unwelcome and, if you have been away, you may have missed the deluge of risk transfer transactions that has continued through 2023, with some schemes reaching the sunny uplands of full buy-out. In this, our third briefing of 2023, we continue our series of articles on moving from buy-in to buy-out and this issue focuses on some of the key processes which need to be completed before issuing a buy-out request. We also catch up on the latest legal developments on page 5, where the deluge theme continues with the Chancellor's wide-ranging Mansion House speech, including an outline of a high-level framework for how a new pensions investments landscape could look.

Time to put my umbrella away and prepare for a busy autumn.

As ever, if you have any questions about any matters covered in this briefing, please speak to your usual Sackers contact."

Ian Cormican
Partner, finance & investment group

ian.cormican@sackers.com

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Navigating your journey from buy-in to buy-out

In our June 2023 briefing, we set out an overview of the legal process involved in moving from a buy-in to a buy-out. In this briefing, we delve further into some of the key issues that arise on the journey to buy out.

By way of a reminder, a buy-in policy is a bulk purchase annuity contract held as an asset of the scheme in the name of the trustees. The trustees have the option, under the terms of the buy-in policy, to progress the buy-in to a full buy-out. A buy-out is where the policy is converted into individual policies written between the insurer and the individual members (and any dependants whose benefits are in payment). Once each member's benefits have been bought out, the scheme is no longer responsible for paying those benefits.

Motivation for moving from buy-in to buy-out

There are many reasons for buying out the benefits in a pension scheme, including:

- reducing the employer's exposure to continuing legislative or regulatory risk that arises from an ongoing DB scheme
- seeking a clean break from the responsibility and cost of running a DB scheme and the removal of some or all DB pension liabilities from the employer's balance sheet
- completing the full transfer of inflation risk, longevity risk and investment risk to a third party, and
- eliminating the possibility that the employer will need to contribute to a DB scheme in the future.

Key issues on moving from buy-in to buy-out

It is important that a project plan is agreed between all parties, to ensure that the pension scheme rules, relevant legislation and the specific requirements in the buy-in policy are complied with on moving to a buy-out. Key issues to be concerned about include:

1 Triggering winding-up

Most buy-in policies are converted to a buy-out once the winding-up of the pension scheme has commenced. This allows the scheme to benefit from legislation confirming the discharge of the scheme from the liability to provide the secured benefits. Different legislative provisions apply depending on whether the pension scheme is "on going" or whether wind-up has been triggered.

The trustees and sponsoring employer should consider the timing and implications of triggering winding-up and ensure that these are understood and a project plan is in place.

2 Adjustments to benefit specification and data

Once a buy-in policy is signed, there will typically be a verification exercise to confirm the accuracy of the data and benefits secured, the "data cleanse". Under a standard buy-in policy, mechanisms will be provided for:

- the trustees and insurer to agree the final benefit specification and data. This would include any necessary adjustments to the these before buy-out to, amongst other things, equalise benefits in the scheme for the effect of unequal GMPs (to the extent not completed before buy-in) – see below, and
- a price adjustment relating to any changes identified in the data cleanse process. The pricing methodology for these changes is usually locked into the initial pricing basis as long as the changes are not "material".

It is in both the trustees' and employer's interests to ensure that the data and benefit specification are as accurate as possible prior to the data cleanse to avoid inconvenient or unexpected subsequent price movements.

3 GMP equalisation

To the extent not completed before buy-in, there will need to be agreement between the trustees and the insurer on the method to equalise benefits in the scheme for the effect of unequal GMPs and implementation of a GMP equalisation exercise.

Navigating your journey from buy-in to buy-out cont.

4 **Identify "in-dispute" beneficiaries**	Typically, if there is a beneficiary in respect of whom there is an outstanding dispute, an insurer will not issue an individual policy to that beneficiary unless it is satisfied that the dispute does not have the potential to affect the type or amounts of policy benefits payable to or in respect of that beneficiary. Trustees should identify disputes and complaints and deal with them as quickly and efficiently as possible to avoid holding up the full buy-out of the scheme.
5 **FSCS and overseas members**	Generally speaking, annuity contracts (including buy-out policies) will be covered by the FSCS. However, the FSCS does not provide universal cover. Under its rules, it requires an "eligible claimant" to have an "eligible claim". Following a buy-out, it is possible that some members may not be covered, particularly if they live overseas. Trustees may wish to consider this and take advice as part of their move from buy-in to buy-out.
6 **Fixed protection**	Fixed protection is a form of tax protection which requires registration with HMRC. There are strict conditions which must be adhered to for members to retain their protection. Fixed protection will be lost if there is a transfer that is not a "permitted transfer". Trustees may wish to consider this and take advice as part of their move from buy-in to buy-out.
7 **Review individual annuity documentation and deed poll**	The individual policies of members created pursuant to the buy-out will need to be reviewed by the trustees' legal advisers to ensure that they satisfy prescribed requirements that allow the trustees to obtain a statutory discharge. There may be instances where, instead of the insurer issuing individual policies direct to individual members, the insurer enters into a "deed poll" under which it assumes obligation to pay the benefits to the individual members in accordance with the terms of the "deed poll" which will append the draft individual policy. There is often a commercial reason for pursuing the deed poll route, typically when the sponsor wants to remove the pension scheme from its balance sheet in quick order if approaching the end of its financial year.
8 **Data warranties**	In order to move to buy-out, the buy-in policy will typically require trustees to provide certain warranties, which include confirming that, to the best of the trustees' knowledge and belief, having made due enquiries of their advisers, the trustees are satisfied that the revised benefit specification and the data file are materially accurate and complete. It is important for trustees to liaise with their advisers early on during the buy out process to ensure that they obtain comfort from their advisers to enable the trustees to provide such warranties.
9 **Residual Risk**	Trustees will need to consider what protections apply to them following buy-out and wind-up of the scheme. We will cover this is in more detail in a subsequent briefing.

Issue buy-out request

Once the necessary preparatory steps have been completed and the conditions required under the buy-in policy have been satisfied, trustees may make a buy-out request. The buy-in policy will set out what such request should contain. Once all of the benefits in the pension scheme have been bought out, the trustees can then move on with completing the wind-up of the scheme.

Legal update

Government announces "Mansion House" reforms

On 10 July 2023, the Chancellor, Jeremy Hunt, delivered his Mansion House speech announcing a package of measures to enable the financial services sector to "increase returns for pensioners, improve outcomes for investors and unlock capital for our growth businesses". He also announced that some of the UK's largest pension providers have entered into a voluntary agreement to commit 5% of their DC scheme default fund investments to private equity and early-stage business by 2030.

Following the speech, on 11 July 2023, a number of pensions-related consultations opened (each of which will close on 5 September 2023):

DWP consultations opened

- a DWP consultation on a policy framework to support individuals in DC decumulation
- a DWP consultation on "ending the proliferation of deferred small pots" proposing establishing a system of multiple default consolidators
- a DWP call for evidence on DB scheme surplus, consolidation, asset allocation and incentives around investment strategies, along with a separate response to the DWP's 2018/19 consultation on consolidation of DB schemes, and
- a joint HMT and DWP call for evidence on pension trustee skills, capability and culture.

In addition, the following papers were also published:

- a response to the joint January 2023 consultation on a value for money framework, announcing that the parties intend to move forward with their proposals, and
- a DWP response to the January 2023 consultation on extending opportunities for CDC schemes.

The reforms are "welcomed" by TPR as supporting its "ambition for pension savers to be in large, well-run schemes that deliver good outcomes at every stage of their retirement journey".

Please see our Alert for more details.

WPC publishes report on DB schemes with LDI

The WPC published its report on DB schemes with LDI on 23 June 2023, following its recent inquiry. The report acknowledges actions taken by the DWP and TPR in response to the surge in gilt yields in autumn 2022, and sets out areas for further change. Key recommendations include:

Key recommendations for DWP and TPR

- the DWP and TPR should explain how they intend to deliver the Bank of England's Financial Policy Committee recommendations that TPR should specify minimum levels of resilience for LDI arrangements
- TPR should consider requiring trustees to report regularly on their use of LDI and develop a strategy for engaging more closely with schemes based on the results
- the DWP should publish its consultation on DB consolidation by the end of October 2023 and work with TPR to improve the regulation of trustees and standards of governance, and
- the DWP and TPR should pause the forthcoming new DB funding regime, at least until they have produced a full impact assessment for the proposals, including the impact on open schemes.

The Government's response is due by 23 August 2023.

TPR to publish guidance on alternatives to buy-out

On 8 June 2023, the WPC published TPR's written evidence to its DB inquiry. TPR's evidence covers a wide range of topics, including DB funding, consolidation and the quality of trustee boards. In particular, TPR confirms:

TPR preparing guidance and reviewing Trustee Toolkit

- it will publish guidance for trustees, setting out the issues they should bear in mind when considering alternative models to buy-out, such as DB superfunds
- it is reviewing the Trustee Toolkit, a free online training programme for trustees, to make it "more accessible" and to align it more with TPR's codes and guidance so it acts as a "gateway" to TPR's wider expectations.

No timings have been given in relation to the above.

Sackers

Contact

Sackers is the UK's leading commercial law firm for pension scheme trustees, employers and providers. Over 65 lawyers focus on pensions and its related areas, including Sackers finance and investment group, a team of lawyers who provide cutting-edge advice on all aspects of pension scheme finance and investment.

Paul Phillips
Partner
D +44 20 7615 9523
E paul.phillips@sackers.com

Key areas of expertise include: risk transfer transactions, LDI, longevity transactions, OTC derivatives and repurchase agreements, investment management, transition and custody arrangements.

Ian Cormican
Partner
D +44 20 7615 9501
E ian.cormican@sackers.com

Key areas of expertise include: longevity transactions, funding negotiations, risk transfer transactions, LDI, fiduciary management and governance.

Stuart O'Brien
Partner
D +44 20 7615 9539
E stuart.obrien@sackers.com

Key areas of expertise include: risk transfer transactions, LDI, investment management agreements, ESG issues including fiduciary duties, policy, stewardship, climate change risk, responsible and impact investing.

Jacqui Reid
Partner
D +44 20 7615 9550
E jacqui.reid@sackers.com

Key areas of expertise include: DC investment strategy, regulation and industry best practice for IGCs and providers, member engagement and value for money.

Ralph McClelland
Partner
D +44 20 7615 9532
E ralph.mcclelland@
sackers.com

Key areas of expertise include: risk transfer transactions including buy-ins and buy-outs, fiduciary management, custody arrangements, DB consolidators, all types of pooled investment products and ESG.

Liam Goulding
Senior associate
D +44 20 7615 9564
E liam.goulding@
sackers.com

Key areas of expertise include: risk transfer transactions including buy-ins and buy-outs, longevity transactions, ESG issues and climate change risk, investment management agreements and escrow arrangements to address the concern of trapped surplus.

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Sacker & Partners LLP
20 Gresham Street
London EC2V 7JE
T +44 20 7329 6699
E enquiries@sackers.com
www.sackers.com