

Understanding the real risks in defined benefit pension schemes

➤ BPA insurance is intrinsically different to other types of insurance, delivering a consistent, risk-mitigated solution for trustees and, ultimately, members



Inurance is a fairly well understood concept – you pay an insurer a premium, and in exchange, when things go wrong – your car is in an accident, your partner is ill, your house is damaged in a storm – the insurer steps up and pays your costs or some additional amount to smooth things going forward.

The insurance solution that a bulk annuity purchase (BPA) provider offers to defined benefit (DB) pension schemes is, however, intrinsically different. Our role is not to support the scheme only when things go wrong, but rather, to

remove the risk completely to create a seamless, guaranteed process for paying all the members all the benefits they're entitled to. If we were a car insurer, we'd take over ensuring you can get wherever you need to be, whenever you need to be there, 100 per cent guaranteed – you wouldn't even need your own car.

This is more than risk transfer. It's risk elimination.

Looking under the bonnet of a DB scheme's risks

There's absolutely no doubt that any trustee or sponsor of a DB pension

scheme is focusing on understanding and mitigating the risks the scheme faces. Nonetheless, the full breadth and severity of these risks can be difficult to fully prepare for or manage. Advisors play a crucial role in supporting trustees here, but nonetheless it's a meaningful challenge with many moving parts, and risks that are constantly evolving. The common thread, however, is that these risks might be on radars, but they're unpredictable, interconnected, and increasingly expensive to manage in house, particularly if these risks need to be considered day by day or in very stressed scenarios (e.g. the impact of the LDI crisis a few years ago).

Market volatility and investment risk

Even the best-funded schemes remain exposed to sudden shifts in market conditions. Over the past few years we've seen how quickly stability can unravel. Covid needs no discussion, while the gilt shock of 2022 saw that what many trustees thought were low-risk, well-hedged portfolios became a source of acute stress overnight. The lesson is clear: Market events can erode (or indeed improve) funding positions faster than schemes can react.

Insurers, by contrast, are built to withstand extreme scenarios, holding capital well above regulatory requirements and managing liquidity, collateral, and reinvestment risk as part of everyday practice. That means when volatility hits, members' benefits remain fully protected and payments continue

without interruption. The BPA model isn't just about transferring assets; it's about transferring uncertainty in the investment portfolio.

Longevity and demographic shifts

We're all benefiting from longer lives and improved healthcare. But the reality is that longevity management impacts DB schemes and must be prepared for. For larger schemes there are more options for longevity hedging, but these simply aren't available to many smaller schemes. Removing this risk, confident that a scheme can continue to pay out members' benefits even as they live longer, is the sort of insurance other sectors can only dream of.

Data integrity and cyber resilience

Protecting data and managing cyber risk is a growing concern for anyone holding data on their business or their stakeholders. And while it can't be removed completely, the more focus there is on this, and the greater the ability to understand, assess and mitigate the risk or, at worst, remediate any breaches, the better. Managing and preparing for these risks are now embedded in an insurers' risk management protocols, with dedicated teams and robust governance, offering additional peace of mind for trustees.

Operational drag and rising costs

In any business, the risk of increased costs is always a concern. But the operational and administration costs for a pension scheme are impacted by more than just standard cost pressures such as inflation or labour. Changing standards for service delivery, increased data needs and evolving regulation are examples of factors that can shift the fundamental administrative needs of a scheme, with a

corresponding impact on costs.

They also bring increased operational burdens and more

complexity, which, in turn, drive a higher level of operational risk.

Sponsor risk and a weakened employer covenant

DB pension schemes are closely tied to the fate of their sponsor, even years after the members in the scheme have left the business or retired. Sponsors also have their own challenges and priorities – managing their businesses, overcoming manufacturing or service delivery hurdles, sourcing equipment,

"Imagine an insurer offering car cover that completely eliminated your risk. Not just crash damage – all of it. No breakdowns. No fines. No maintenance. No admin. And you don't even have to do the driving. That would be revolutionary. In pensions, it's just what we do"

hiring teams or preparing for their own regulatory changes or new global tariffs. Managing and funding the pension scheme is important, but it's not core to their everyday business. And with one in four listed companies identifying that the DB pension scheme is a risk on their balance sheet, there's clear value in the responsibility being moved elsewhere.

Navigating constant regulatory change

Thinking about regulatory change is certainly not new, particularly in the context of the government's commitment to pension reform. While it doesn't happen quickly, it can nonetheless be difficult to predict and prepare for, not to mention expensive. The impact of regulatory change can also be wide ranging, touching anything and

everything from member service provision, to investment decision-making, to data management processes. BPA insurers do this at scale, for all of the schemes and members we support.

Very strong security and good value

This is where BPA insurance makes its case. If we were insuring your car, these risks wouldn't need to be managed, they'd simply disappear. We are prepared for complexity, volatility and uncertainty whether that's interest rate changes, sponsor covenant strength, evolving longevity trends or new cyber threats.

Let's go back to that car analogy one last time.

Imagine an insurer offering car cover that completely eliminated your risk. Not just crash damage – all of it. No breakdowns. No fines. No maintenance. No admin. And you don't even have to do the driving. That would be revolutionary. In pensions, it's just what we do.

The BPA model offers unmatched security, a robust regulatory framework, and an impressive track record in which member security sits at the centre of our model, underpinned by capital buffers and regulatory oversight. We believe we offer excellent value, with a dynamic and well served marketplace driving competitive pricing. We're also supporting the UK economy, investing in UK productive assets such as social housing, wind farms and more.

As we enter a new phase of market maturity, with many schemes well-funded and sponsors and trustees evaluating endgame options, taking a step back to consider the value of eliminating uncertainty seems a good move.



In association with

Written by Just Defined
Benefits director of
commercial, Rob Mechem

JUST.

