Many stops en route

Dominic Moret explores the different ways a pension scheme can de-risk while on the route to full buyout

The ultimate goal for many defined benefit pension scheme trustees is to buy out their scheme liabilities with an insurance company. In our discussions with schemes and their advisers, trustees frequently say that insurance solutions are a distant goal or – in some cases – an unachievable aim.

Working with pension schemes to help them realise their de-risking goals, Legal & General has put in place more than 3,000 bulk annuity policies over the last 30 years.

Phased buy-in

Although the traditional view of a flight path to buyout is of a smooth increase in funding level over time to the point at which a buyout becomes affordable, the journey, in reality, will be more volatile.

The upside of this volatility is that opportunities may present themselves over time as scheme assets increase in value relative to insurer pricing. As schemes move ahead of their journey plan, a buy-in arrangement can be put in place to secure a proportion of the scheme's liabilities and lock in to advantageous pricing.

The emergence of a range of liability tracking toolsprovided by leading consultancies makes monitoring the occurrence of these opportunities more available to schemes on a journey to buyout.

Forward starting buy-in

Another way to secure favourable insurer pricing and de-risk a significant proportion of the scheme is to consider a forward starting buy-in. Under this solution, the premium is paid at the point at which the policy is taken out, but the insurer only starts to make pension payments at a point in the future and, as such, the scheme retains responsibility for pension payments during the interim period and the risk associated with these short-term payments.

Schemes coming out of an actuarial valuation with a deficit relative to insurer pricing but with a sponsor commitment to provide deficit repair contributions, may find this solution is an efficient way to insure a significant proportion of their liabilities. In practice, this approach involves using existing scheme assets to purchase the forward starting buy-in and the agreed sponsor funding to cover the short-term payroll requirements.

Deferred premium

Another approach is for the scheme to enter into a deferred premium buy-in policy. In this arrangement, the scheme enters into a buy-in which covers all future benefit payments in respect of the members covered by the policy, but only a proportion of the premium is paid in advance. The remainder of the premium is paid in line with a pre-agreed schedule over a number of years.

This solution enables trustees and sponsors who are not able to immediately fund the scheme to full buyout levels to immediately remove the risks associated with their pension scheme.

Incomplete data and / or benefit structure

Pension schemes may delay approaching bulk annuity providers due to concerns around the quality of their member data and certainty on the benefits payable. Typically, insurers prefer robust data and a legally approved benefit specification but many are now happy to provide 'all risks' cover. This means that the insurer accepts the risks of certain data and benefits changing in future, enabling schemes to achieve buyout sooner.

The above solutions all enable trustees to accelerate their journey to buyout, but what about schemes that consider buyout to be unachievable due to structure?

Hybrid schemes

Trustees of schemes with hybrid benefit structures, such as DC schemes with a DB underpin, may be concerned that these cannot be secured with an insurance company. There are, however, some insurers, including Legal & General, who will insure these benefits.

At Legal & General, we can supplement our defined benefit de-risking expertise with our defined contribution product base to partner with hybrid schemes in meeting their de-risking goals.

Section 615 schemes

Section 615 schemes are set up by UK-based companies to provide benefits in a tax-efficient manner for employees working overseas. Typically these are challenging to buy-in and buyout due to tax implications, but Legal & General has worked with such schemes to enter into buy-in arrangements.

This article only covers a few examples of the ways that insurers can help trustees to achieve or accelerate their de-risking plans. We continue to work with trustees, corporate sponsors and their advisers to develop the right solution to meet their objectives.

For more information on how Legal & General can help please contact Dominic Moret on 0203 124 2028 or email derisking@landg.com

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