

Legal considerations on buy-out – Skeletons in the Closet

Buy-ins and buy-outs

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Buy-ins and buy-outs

Agenda

- Market context
- What is a buy-in / buy-out / partial buy-out?
- Legal issues when considering a deal
- Key terms
- Questions/comments

Introduction

Some market context

- Demand is rising, but so is supply
- The Budget was good for bulk annuity pricing
- Reinsurer interest in hedging longevity risk
- A record £10bn+ of bulk annuities written in '14
- Competitive pricing expected to continue into '15

Introduction

Some market context (continued)

Insurer	<£100m	Mid-market	>£1bn	Medically underwritten
Aviva	✓	✓		✓
Just Retirement	✓			✓
L&G	✓	✓	✓	✓
Partnership	✓			✓
PIC	✓	✓	✓	
Pru	✓	✓	✓	
Rothsay Life	✓	✓	✓	

Introduction

What is a buy-in?

- An insurance policy purchased by trustees
- Held in their names as an asset of the scheme
- Covers some/all benefits (of pensioners)
- Investment that (almost) exactly hedges liability
- Can hold and extend, but usually go to buy-out

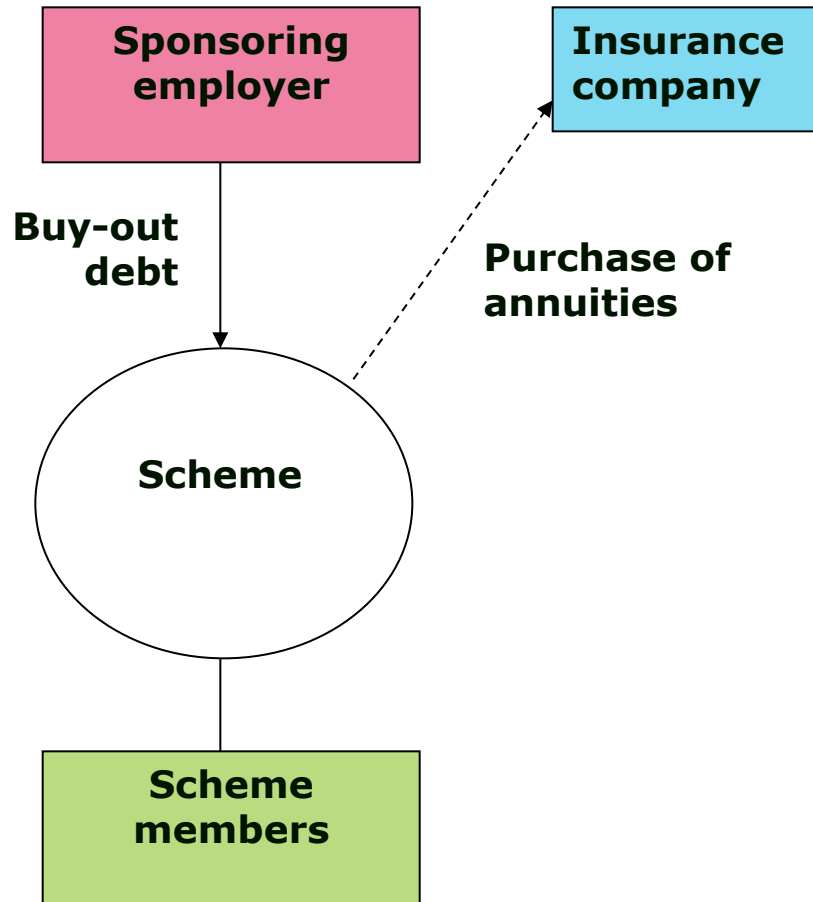
Introduction

What is a full buy-out?

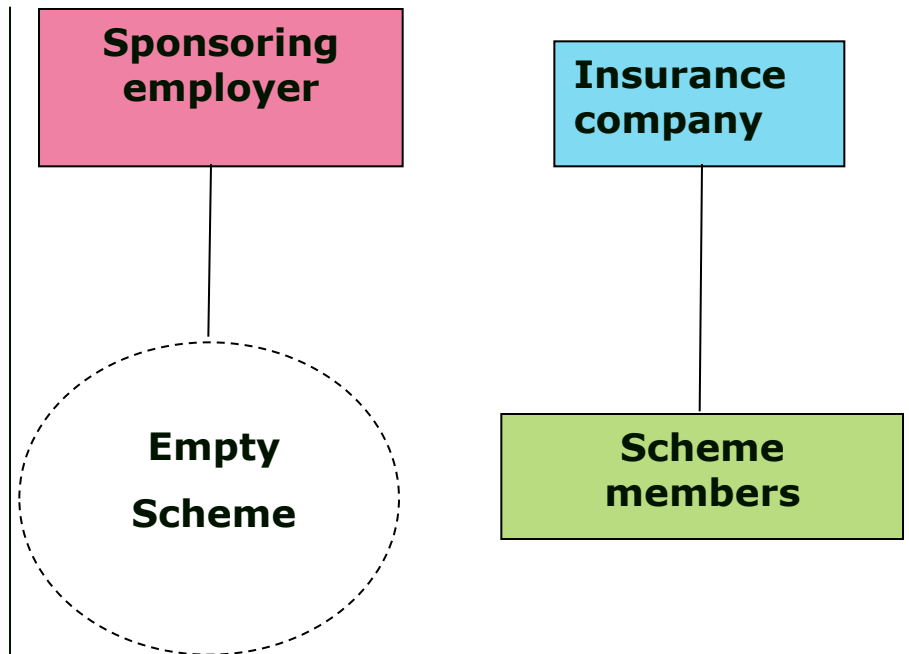
- Transfer of liability to an insurance company
- Members become annuitants holding own policy
- Shift from OPS regime into FS regime
- Trustees usually get a full statutory discharge
- Conventionally preceded by a buy-in

What does a buy-out look like?

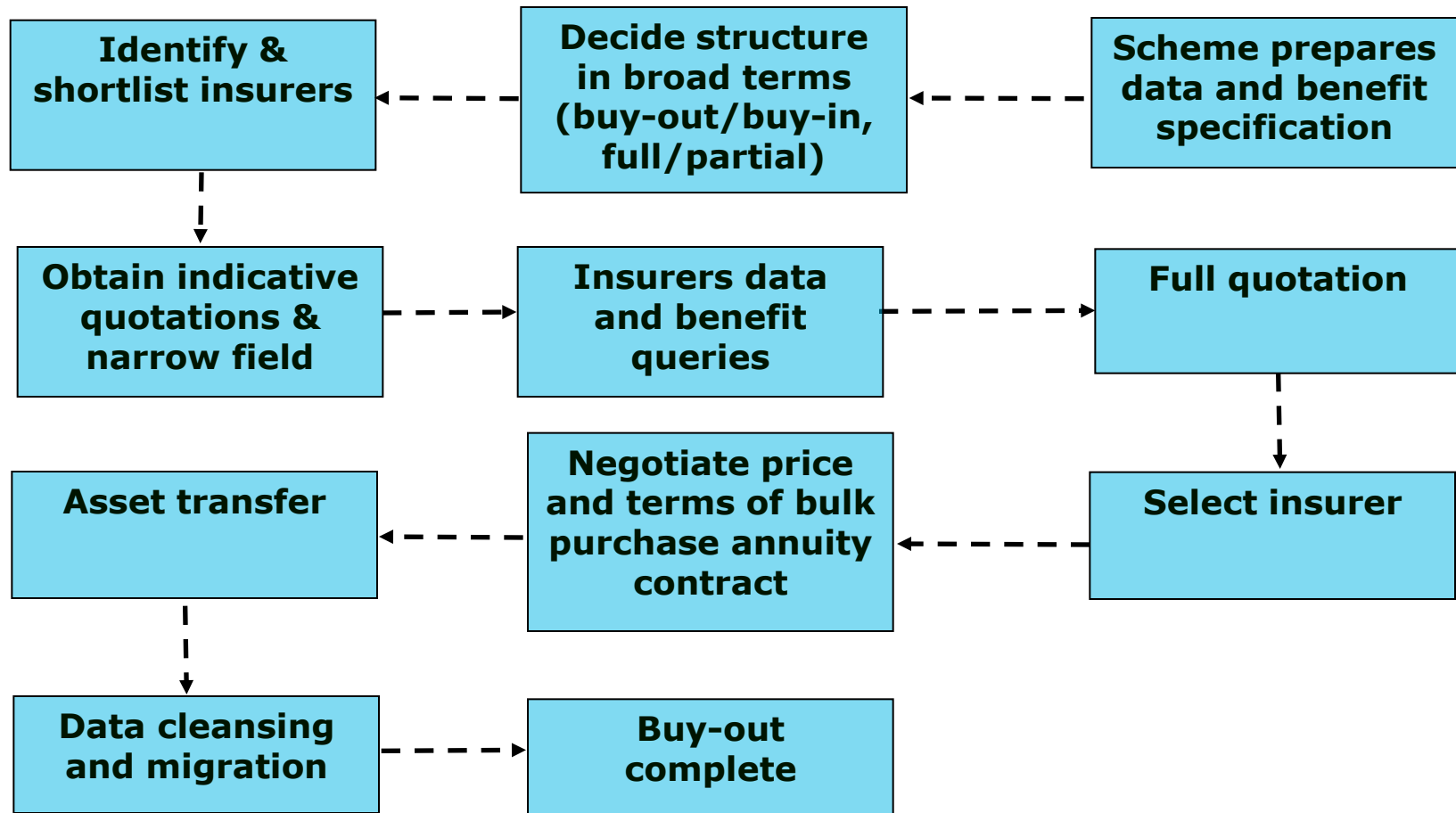
Before



After



Buy-outs - *Implementation*



Full buy-outs

Legal Issues to consider when advising trustees

Best
(financial)
interest of
members

Power to buy-
out?

Member
consent

Ongoing
trustee
liability

Data issues
including
GMPs

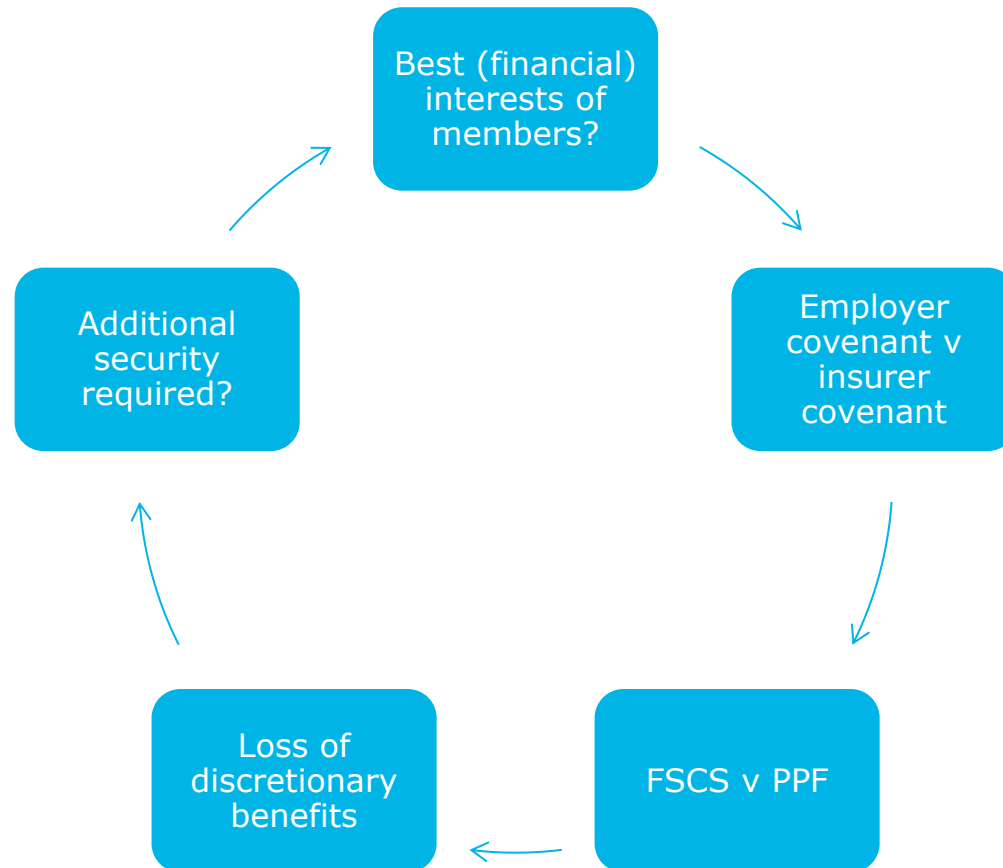
Conflicts of
interest

Authorisation
under FSMA and
Finance Act 2004
requirements

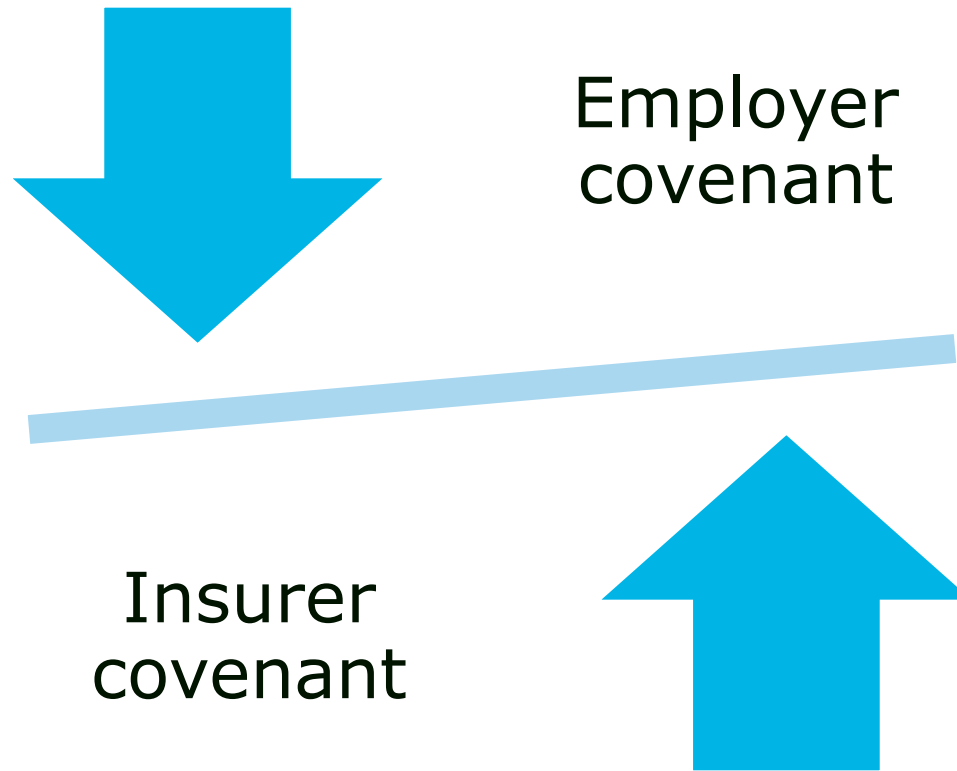
Budget
flexibilities



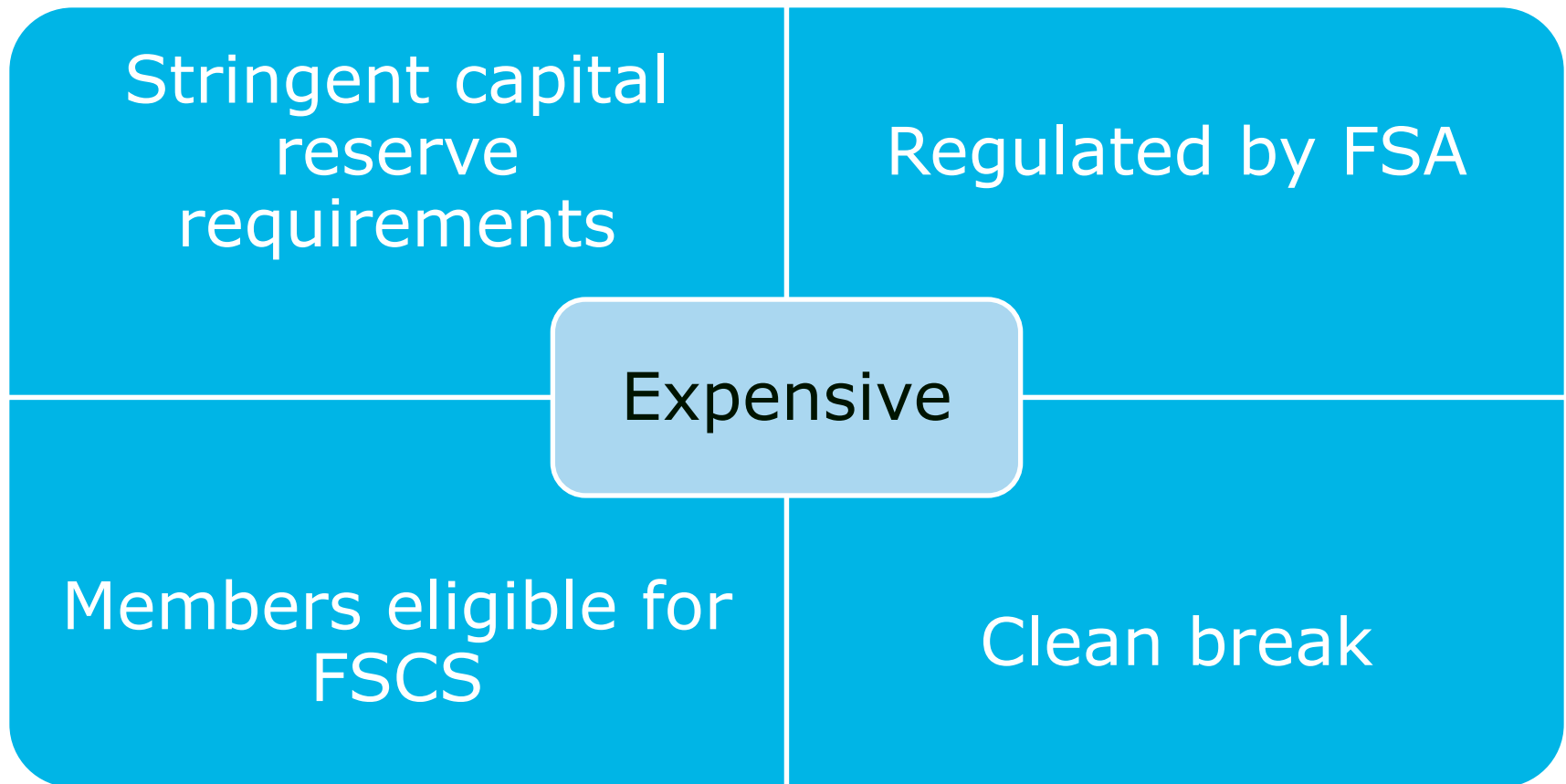
Security of members' benefits



Full buy-outs



Full buy-outs - advantages



Power to buy out – what does the deed say?

Power to buy out in members' names?

Open to accrual?

Need to insert power?

With or without consent?

Full buy-outs

Additional security

Trustees can negotiate additional security under policy, such as:

- return of premium
- collateral over specific assets
- pay premium in instalments

Does this infringe insurers duty to “*treat customers fairly*”?

Full buy-outs

Financial Services Compensation Scheme

FSCS covers business conducted by “*authorised firms*”, including insurance companies

Pays compensation when an authorised firm is unable, or likely to be unable, to satisfy claims against it

Compensation payable to “*eligible claimants*”, this includes (for long-term insurance business):

- individuals resident within EEA
- trustees of occupational pension schemes

Full buy-outs

Financial Services Compensation Scheme

- Continuity of insurance
- If not, cash compensation equal to 90% claim*
- No upper limit

*Consultation ongoing with regard to increasing to 100%



PPF v FSCS

	PPF	FSCS
Member above normal pension age (or in receipt of pension)	Pension = 100%* Pension increases = RPI (capped at 2.5%) for post 6 April 1997 service	90% of claim
Member below normal pension age	Pension = 90%* (subject to cap) Pension increases = RPI (capped at 2.5%) for post 6 April 1997 service	90% of claim
Spouse	50% of member's pension	90% of spouse's pension payable under annuity

*Capped at £36,401.19 (£32,761.07)

Member consent

No consent
required
where:

- scheme is being wound-up, and
- policy can be assigned or surrendered in accordance with Regulation 3, Discharge of Liability Regulations 1997

Contracted-out rights including
GMP and s.9(2b) rights

Data issues

Data cleansing process

Potential issues:

- Missing/incomplete data
- Discrepancies in payment/calculation of members' benefits
- Equalisation issues including of GMP
- GMP

Full buy-outs

Conflicts of interest

- Need to be identified and managed
- For example, trustees who are board directors and costs



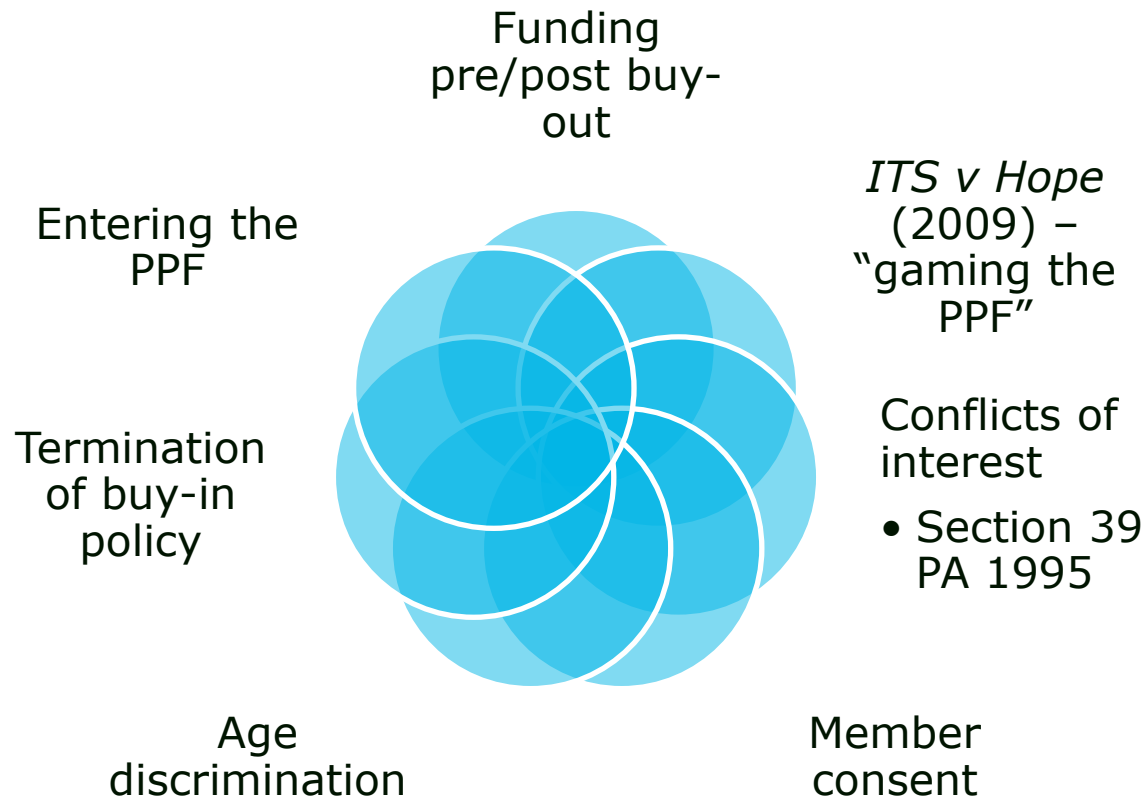
Introduction

What is a partial buy-out?

- Partial in sense of membership (not benefits)
- Usually done for pensioners not deferreds
- But relatively uncommon
- Preferring those bought-out over other members
- Discharge conditions are more difficult to satisfy

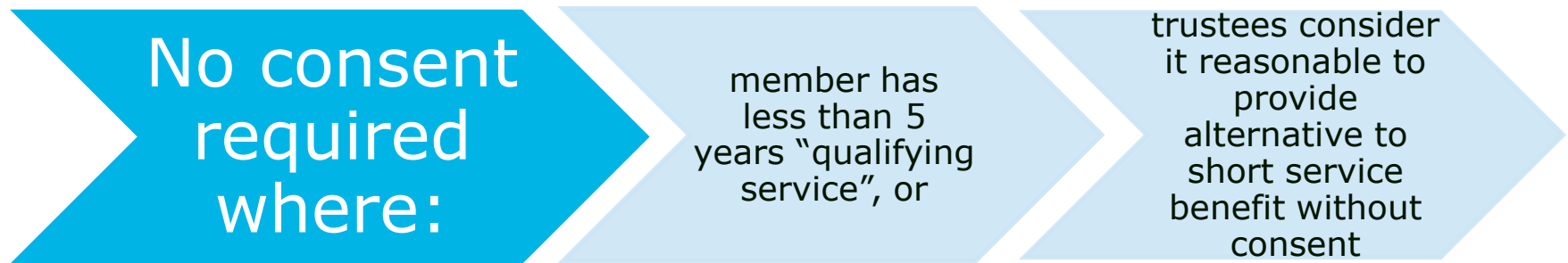
Partial buy-outs/buy-ins

Additional considerations



Partial buy-outs/buy-ins

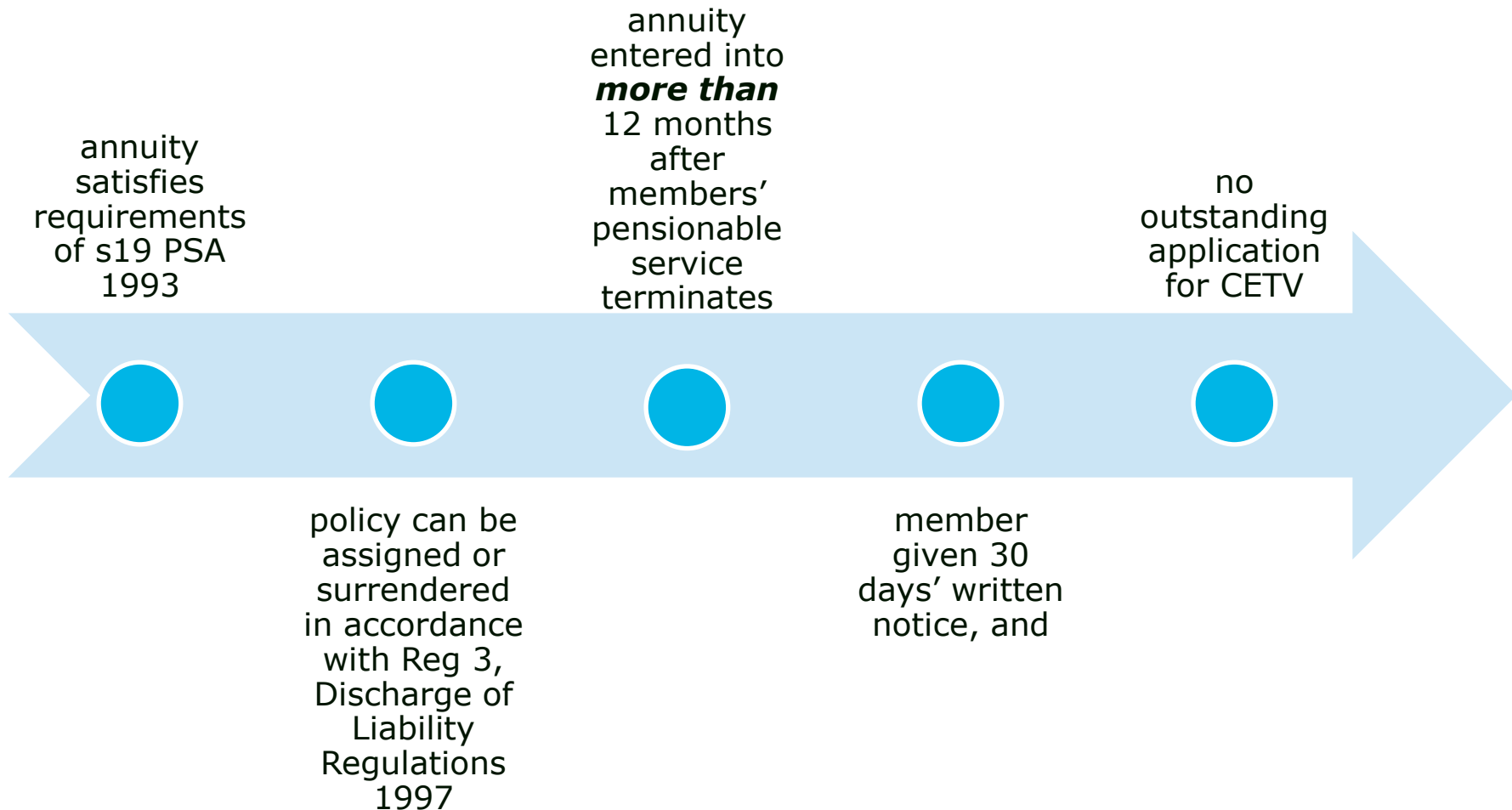
Member consent



AND

Partial buy-outs

Member consent (cont)



Buy-outs

Statutory discharge (non-GMPs)

What do trustees need protection for?

- Wrong benefits being paid
- Missing beneficiaries

How can it be given?

- Statutory discharge
- Deed and rules
- Run off insurance

Buy-outs

Statutory discharge (non-GMPs)

Available where:

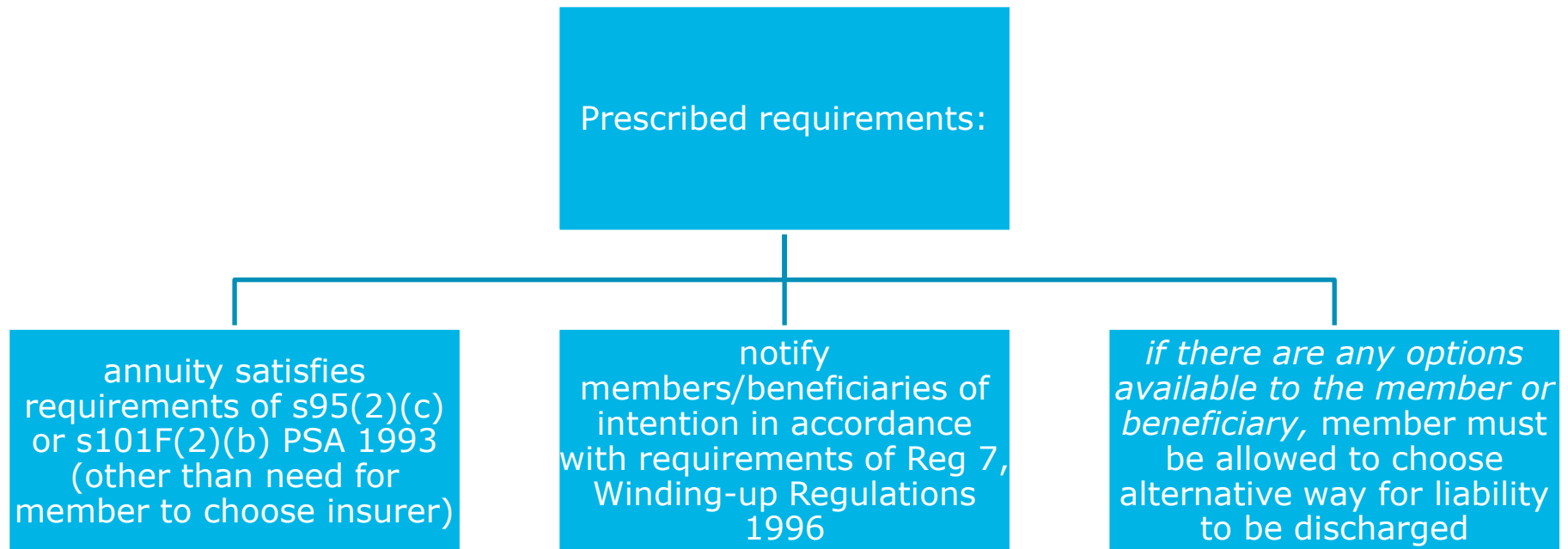
- scheme is being wound-up
- liabilities are discharged in a prescribed manner
- process satisfies prescribed requirements



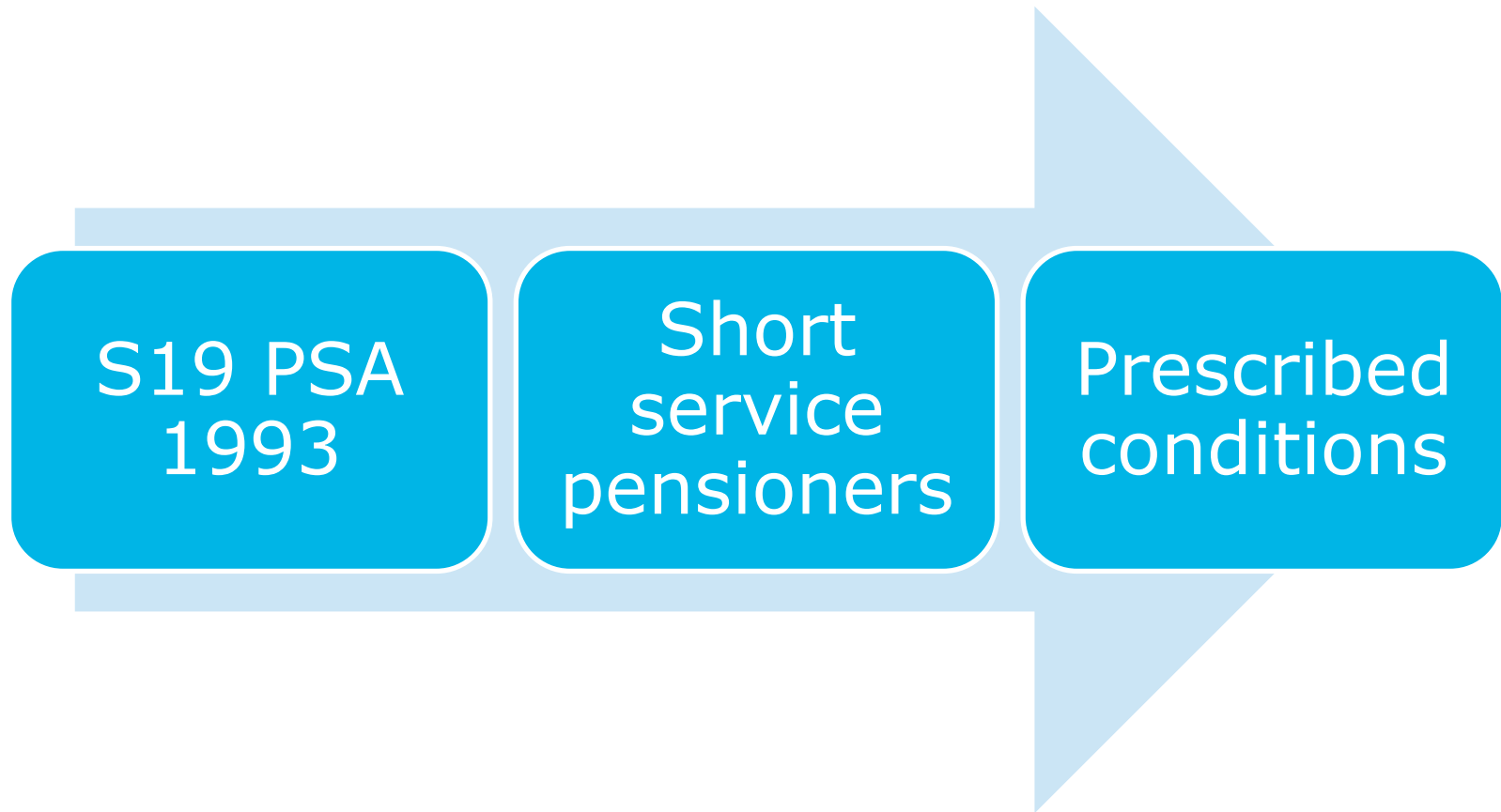
Partial buy-outs

Buy-outs

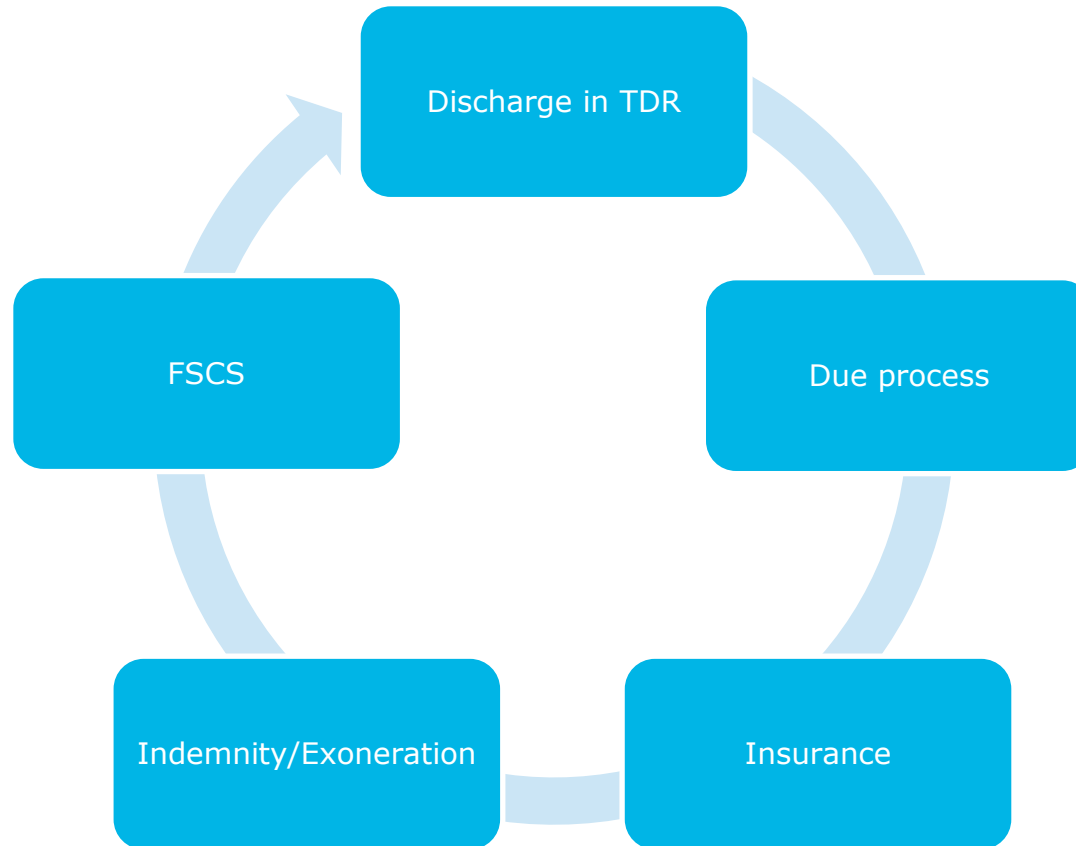
Statutory discharge (non-GMPs) s.81 PSA & s.94 PA95



Statutory discharge of GMPs



Buy-outs – ongoing trustee liability



Buy-out / buy-in policies

Key terms – contractual issues

- Trustees' liability
- Insurer's indemnity
- Assignment
- GMP equalisation methodology
- All risks / unidentified beneficiaries cover

Buy-out / buy-in policies

Key terms – risk transfer and financials

- Assumption of risk before full premium payment
- Calculating inception cost / balancing premium
- Price moves with market conditions
- Balancing premium non-payment: consequences

Buy-out / buy-in policies

Key terms –data cleansing

- Material change (90% / 95% threshold)
- Consequences of material change
- Data cleansing time period

Buy-out / buy-in policies

Key terms – administration issues

- Policy valuation
- Transfer of administration
- Data protection

Buy-out / buy-in policies

Key terms – future amendments to benefits

- Additional beneficiaries
- Post-data cleanse alterations / augmentations
- Changes to inflation indices

Buy-in policies

Key terms – future wind-up / insolvency

- Issue of individual policies - timing
- Restructuring of benefits

Commoditised products

Lawyers / consultants working together

- Pre-negotiated terms with the main insurers
- Pre-written legal advice
- Fixed fees for contract terms
- Goes well with fiduciary management platform
- Attractive to small schemes

Questions/comments





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