

What Is Risk Transfer?

Risk transfer is the process of transferring the risks associated with defined benefit (DB) arrangements away from a pension scheme, usually to an insurance company in the form of buy-ins and buyouts or through a longevity swap. This process is also known as “de-risking”.

The pensions risk transfer market has seen a significant growth in recent years, a trend which is set to continue as an increasing number of schemes meet their funding objectives.

What Risk Transfer Options Are Available?

There are various solutions available for schemes to consider in the process of assessing their risk transfer strategy. The chosen option will be dictated by the scheme’s long-term strategy and its own set of circumstances.

Some of the options available to trustees are set out below:

- **Buy-in** – This involves the trustees purchasing a bulk annuity policy to cover some or all of their scheme’s liabilities. The policy is held as an asset of the pension scheme. Under a buy-in, the trustees pay a single premium to an insurer, which is then responsible for paying a monthly amount in respect of the pensions payroll to the trustees who in turn pay their pensioners. At this point, trustees remain legally responsible for paying members’ benefits.
- **Buyout** – This involves converting a buy-in policy to individual policies between the bulk annuity insurer and individual members. Under a buyout, the individuals become policyholders and stop being members of the pension scheme. The insurer takes legal responsibility for paying monthly pensions directly to each scheme member. This allows trustees to discharge their liabilities and the scheme can then be wound up.

- **Longevity swap** – Also known as “longevity hedging”, this involves an insurance company agreeing to pay the monthly pensions for scheme members in exchange for regular payments from the pension scheme, based on a fixed life expectancy assumption for each member. The aim of longevity swaps is to transfer the risk of members living longer than expected to an insurer.
- **DB superfund** – This is a relatively new option available on the commercial consolidation market. A superfund is a trust-based pension scheme, backed by capital from investors, which is set up to accept bulk transfers from other DB pension schemes. The idea is that on paying an entry price, pension schemes transfer their liabilities and assets into the superfund, thereby removing the risk from the company balance sheet.
- **DB master trusts** – This is another consolidation option that is seeing an increase in popularity over the last few years. A DB master trust is a multiemployer DB pension scheme for non-associated employers. The aim of DB master trusts is to transfer risk to a consolidated trustee, administration, actuarial and investment platform, thereby providing a more cost- and time-efficient way of managing a scheme.

Some Practical Points

Risk transfer is the ultimate goal for most DB schemes, but it can take time. It is important that trustees consider the preparation required and make this a part of their journey planning even if the scheme is not quite ready to make any decisions yet.

There are a number of preparatory steps that trustees can be taking now.

Do	Don't
Do plan ahead. Decide on a strategy that works for your scheme. There are a wide range of solutions available and advisers who can provide guidance on what option is most appropriate at which time and how to get there.	Don't wait until your scheme achieves full funding before embarking on a risk transfer project.
Do recognise the importance of good governance. Consider setting up a joint risk transfer working group or risk transfer subcommittee with representatives from the trustee board and the scheme's sponsor, with input from advisers as necessary.	Don't proceed without having a clear idea of your scheme's objectives and proposed timescales.
Do prioritise getting your data and legal documents in good order. This is particularly important in order for your scheme to be able to move quickly in an increasingly busy insurance market. Accurate data means you will be able to obtain an accurate quote, which avoids any last-minute surprises.	Don't underestimate the importance of your benefit specification – this inevitably takes longer than planned and requires detailed input from your legal, actuarial and administration teams.
Do engage with the insurance market to obtain accurate pricing information, check any preferred methods for guaranteed minimum pension (GMP) equalisation and review policy documentation carefully.	Don't forget that you (and the sponsoring employer) will need accurate pricing data in order to make any important decisions about the transaction.
Do review the terms of any illiquid investments to understand your rights and timescales for disinvesting if they need to be sold at short notice to pay an insurance premium.	Don't neglect your investment portfolios.

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