

# Burges Salmon Pensions Law Summary

## Alternative to Buy-Out, Consolidators and other options

### Introduction

This note provides a summary of some key considerations and options for alternatives to schemes buying out as at August 2021. The long-term aim of schemes and employers to seek secure member liabilities is of growing importance, both as schemes mature and as trustees and employers wish to provide greater certainty for their members and corporate groups.



Key points include:

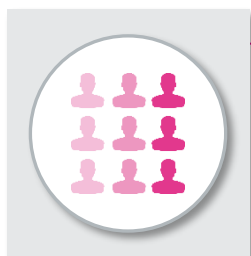
- The securing and transfer of all scheme liabilities to an insurer (Buy Out) continues to be an important and effective option for many schemes.
- However for some schemes, these options may not be economically viable or there may be other factors such as market capacity and pricing which mean that trustees and employers may wish to consider alternative options.
- The issues below including the summary table may be relevant to schemes and employers to help plan ahead, even if Buy Out or alternatives to it may be a number of years away for many.

### Summary of Options

Options that may, in varying degrees, be alternatives to buy out are set out in the table below. Key themes from these options are:



**For Trustees:** central issues are the level of benefits provided to members under each of the options and the likelihood of those benefits being paid. Where trustees consider options other than Buy Out, it will be more important to consider and obtain advice on the employer's financial and legal covenant to help determine whether any option represents a good outcome for members. The question of any residual liability for a scheme will also be a central consideration.



**For Employers:** in addition to understanding the level of benefits that may be provided under each option, employers will generally wish to understand the extent to which there is any ongoing liability, the cost of each alternative and the degree to which each option is readily available in the market.

Option	Summary of Option	Some Considerations re Scheme Liabilities	Extent of ongoing Employer liability to schemes/other Considerations for Employers	Considerations for Trustees	Availability in Market
<b>Buy Out</b>	Scheme liabilities are transferred to and secured with an insurer, who issues individual policies to beneficiaries at the end of the process.	<p>Liabilities removed from scheme to the extent that the insurance buy out policy fully and accurately describes the benefits.</p> <p>Residual risks can sometimes be covered.</p>	<p>Buy Out will allow the scheme to be wound up and end employer liability to its scheme.</p> <p>Trustees may seek employers to pay for run off / missing beneficiary insurance and/or indemnities to cover risk that benefits are not fully mirrored.</p> <p>Employers may wish to consider whether Buy Out is the most cost effective option.</p>	<p>Trustees will wish to ensure that:</p> <ul style="list-style-type: none"> <li>- the insurance policy fully mirrors scheme benefits</li> <li>- that run off / missing beneficiary insurance cover is sought</li> <li>- that trustees receive a full discharge of liabilities</li> </ul>	<p>An established option</p> <p>Availability, degree of insurer interest in quoting for buy out and pricing will depend on market conditions</p>
<b>Buy In</b>	Scheme liabilities are in part or full secured with an insurer but not transferred to insurer (until potential next stage of Buy Out).	<p>Buy In will generally secure tranches of liabilities e.g. in relation to pensioners or deferred members. Only the benefits specified in the policy are insured. The liabilities insured remain within the Scheme until any transfer to Buy Out.</p>	<p>Until any transfer to Buy Out, the employer will still be liable to the scheme. This will include e.g. funding liabilities not secured, ongoing running costs and levies.</p> <p>Buy In can be used as part of ongoing process towards securing all liabilities and may potentially be cost effective mechanism to do so depending on the nature of the liabilities secured.</p>	<p>There may be benefit in securing tranches of benefits.</p> <p>Consideration still needed as to how to fund unsecured liabilities</p> <p>Buy in likely to form part of broader plan over time to secure benefits</p> <p>The insurance policy fully mirrors the relevant scheme benefits.</p>	<p>Similar to Buy Out above</p>
<b>Self sufficiency funding of scheme</b>	Scheme funded with a high degree of prudence, estimated	Liabilities remain in the Scheme.	The employer remains liable to fund any shortfall for benefits,	This option may be used together with buy in for tranches of liabilities.	

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	to cover all scheme liabilities, costs and levies.		ongoing running costs and levies.	A degree of covenant reliance may continue to be implied	
<b>Consolidators</b>	<p>Transfer of liabilities to consolidator (option still under development).</p> <p>The consolidator is a special purpose vehicle.</p> <p>Usually the employer will need to contribute a capital sum into the consolidator's capital buffer.</p>	<p>Liabilities will be secured to the extent set out in the contractual terms of the consolidator.</p> <p>Consolidators will generally seek to target full benefits.</p> <p>The likelihood of ensuring full benefits are paid will depend on each consolidator and its approach.</p>	<p>A transfer to a consolidator will end employer liability to a scheme, subject to the contractual terms with the consolidator and any additional agreements with the scheme trustees.</p> <p>The use of consolidators is still under review by the Pensions Regulator.</p> <p>TPR guidance as at October 2020 and "gateway principles" (<a href="#">DB superfunds guidance for trustees and employers   The Pensions Regulator</a>) include that:</p> <ul style="list-style-type: none"> <li>- TPR expects that employers will be required to apply to it for clearance for a transfer to a consolidator</li> <li>- Consolidators should only be considered where buy out is not affordable now and there is no reasonable prospect of doing so in the foreseeable future</li> </ul>	<p>TPR guidance for due diligence includes that trustees should:</p> <ul style="list-style-type: none"> <li>- have considered other options available to them to improve the scheme's position.</li> <li>- ask the consolidator for the summary outcome of TPR's assessment and make any further enquiries they think necessary.</li> <li>- consider whether the consolidator is right for the members</li> <li>- consider what the consolidator is offering, their associated fees, their funding and investment objectives, their methods for implementing and achieving those objectives</li> <li>- take into account conflicts of interest to ensure they are satisfied with how these are managed.</li> <li>- where member enhancements are being offered, to undertake appropriate due diligence of these proposals, including professional advice.</li> </ul>	<p>This option is still under development including ongoing work with the Pensions Regulator.</p> <p>The Government intends to legislate to require approval of consolidators but transfers can proceed in the interim.</p>

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			<ul style="list-style-type: none"> <li>- The transfer must improve the prospect of members receiving full benefits.</li> </ul>	<ul style="list-style-type: none"> <li>- review with their advisers any modelling outcomes that the superfund produces for their scheme.</li> <li>- be satisfied the gateway principles are met and understand the risks, as well as how the transfer to the consolidator results in improved member positions.</li> <li>- consider the risks to any residual liabilities left in the scheme.</li> </ul>	
<b>Consolidator Example – The Pensions SuperFund</b>	As above for other Consolidators.	As above for other Consolidators.	<p>The Pension SuperFund is intended to generate the economies by combining a scheme’s assets and liabilities together with those of other pension funds which have entered the SuperFund.</p> <p>Scheme members become SuperFund members.</p> <p>The SuperFund is intended to pay member benefits in full on an ongoing basis.</p> <p>Member benefits are not transferred to a Buy Out.</p> <p>The Pension SuperFund includes a contractual</p>	As above for other Consolidators	As above for other Consolidators

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			<p>mechanism for outperformance in asset management above certain levels to be shared with scheme members by way of a periodic bonus to their existing benefit.</p> <p>A mechanism to top up the funding from the capital buffer applies when necessary.</p>		
<p><b>Consolidator</b> <b>Example Clara</b></p>	<p>As above for other Consolidators</p>	<p>As above for other Consolidators</p>	<p>Clara also combines the schemes assets into one scheme with other pensions funds, on a segregated basis</p> <p>Clara intends to pay member benefits in full on an ongoing basis</p> <p>Clara intends to buy out each section's pensions with an insurer over time rather than pay scheme benefits from the Clara scheme long- term</p> <p>There is no additional bonus over and above scheme benefits</p> <p>A mechanism to top up the funding from the capital buffer applies when necessary.</p>	<p>As above for other Consolidators</p>	<p>As above for other Consolidators</p>

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<b>Capital Backed Option</b>	A contractual agreement is entered into with a third party, usually giving rise to that party providing a capital buffer to assist with achieving Buy Out at a later stage. In return the third party may apply ongoing fees and/or retain any surplus funds post Buy Out.	This will be defined by the contractual agreement and structure of the capital backed option.  Full benefits are likely to be targeted, subject to the financial circumstances.	Degree of transfer of liability again a matter of the contractual agreement. Full transfer of employer liabilities can take place depending on the structure of the agreement.	Trustees will need to consider the new covenant provided in the arrangement compared to the existing covenant. This will include any prospect of default prior to eventual Buy Out.	A small number of capital backed agreements have taken place. There is potential for this option to grow in availability.
<b>Transfer to Master Trust</b>	A transfer of the scheme liabilities to a Master Trust. The degree to which the scheme is segregated from other schemes in the Master Trust will depend on its terms.	Master Trusts will generally be ongoing in nature, with liabilities not fully secured until Buy Out (if any). Potential for increased security in respect of benefits dependent on structure of Master Trust – for example degree to which the trust is segregated.	The Employer will generally have an ongoing duty to fund the scheme, the scope and degree to which it is required to do so (including funding liabilities from other schemes in the Master Trust) will depend on its terms.  There is potential for savings in respect of cost base on economies of scale with one centralised trustee board.	Trustees will need to consider the degree to which the Master Trust reflects the original scheme including in respect of balance of powers.  Trustees will also need to consider the degree to which fiduciary obligations and governance will be met within the Master Trust, and how any conflicts of interest are managed.  Trustees will wish to ensure a full discharge of liabilities transferred and protection in relation to any residual liabilities.	Available through a number of providers in the market.
<b>PPF plus Buy Out</b>	A Buy Out with an insurer at a lower level of benefits than full Buy Out – where the Trustees believe that this represents	The level of benefit provided will be less than full benefits but	The Employer will generally have no further liability after the PPF plus Buy Out.	The decision to support buying out at a level below full benefits must be taken with care and on full	Available dependent on relevant financial circumstances applying, such that the

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	<p>the best outcome for members – commonly where there would otherwise be an insolvency of the employer. (Required where the Scheme has emerged from PPF assessment with insufficient assets for full Buy Out).</p>	<p>intended to exceed PPF levels of compensation</p>	<p>PPF plus Buy Outs will be dependent on this outcome being preferable to any other available alternatives (likely to be a distressed scenario).</p>	<p>advice and on the basis that this outcome is the best for members. Run off / missing beneficiary insurance cover considered.</p>	<p>PPF plus Buy Out is the best outcome for members.</p>

## Practical Steps

### ■ For trustees

- to consider the long term prospects of the scheme and employer and to analyse the available options
- this review is likely to require covenant and legal advice, both in respect of the respective financial merits of each option (and the covenant of the employer) and the legal terms of any proposal
- run off / missing beneficiaries insurance and other trustee protections may need to be considered for all or some of the options depending on the circumstances
- to retain a clear and complete audit trail in case of future investigation or challenge

### ■ For employers

- Employers will need to consider the respective costs of each of the options and also the legal terms including in respect of any ongoing liability and the security of member benefits
- This work is likely to give rise to dialogues with the trustees and also a recognition of advice being required by the trustees as well as employer
- to prepare a clear business case reflecting the regulatory landscape and their duties, and retain a clear and complete audit trail in case of future investigation or challenge

**Please contact us if you would like further information or advice on anything in this note.**

This practical summary is not intended to be a full statement of the law on this topic and is not legal advice. It does not take account of any developments since it was written or last updated.

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