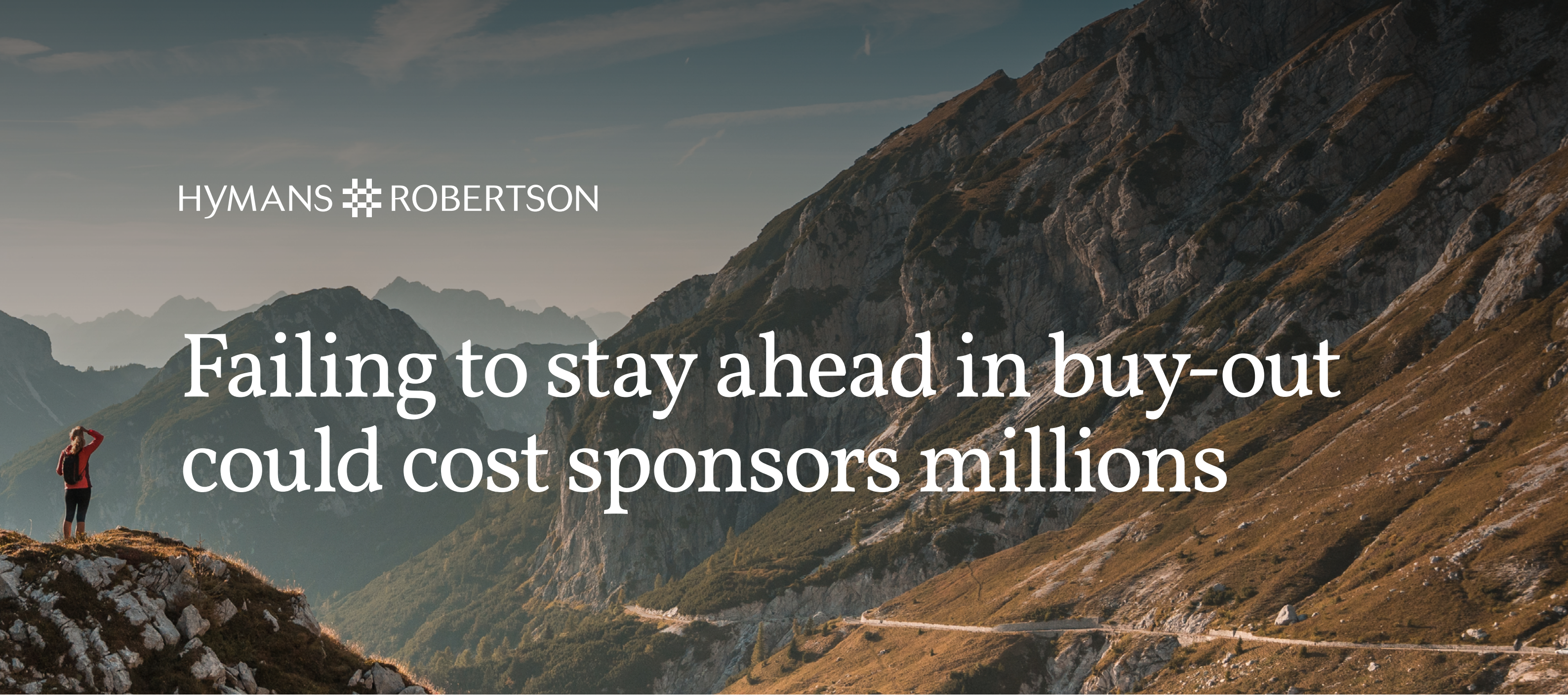

Failing to stay ahead in buy-out could cost sponsors millions

The process to buy-out and wind-up a Defined Benefit (DB) pension scheme is the most substantial project in a scheme's lifetime and carries with it risks to a corporate that can remain beyond the termination of the scheme. For a £500m scheme, these risks could result in companies losing out on over £10m if they're not on the front foot. The risks are typically financial or reputational in nature, and often both.

We believe the main areas of risk are:

Surplus — **Timing** — **Member experience** — **Residual risks**

Highest short term impact ← → Highest long term impact

It's important for corporates to consider their objectives in relation to a DB pension scheme buy-out, as early as possible once their endgame target is set. This means before the scheme even enters into a buy-in policy with an insurer, the first step in a buy-out process. They should be clear on how they rank these priorities in light of their overall risk tolerance. With this clarity the approach taken to manage and mitigate the risks can be tailored to their risk appetite. It will also be clearer to what extent the corporate needs to actively engage with the scheme's trustees and when in the process they should do this – in short, it's never too early to initiate the discussions.

We've summarised below our three key takeaways before diving into the detail on the risks on the next page:

1. **Understand the detail and plan accordingly**
2. **Reflect on your risk appetite and objectives, and proactively raise these with the trustee**
3. **Early signposting to key corporate decision makers and signatories is essential**

The buy-out and wind-up stages can be summarised as follows:

Step 1	Step 2	Step 3
Enter into a buy-in policy with an insurer - investment decision of the scheme covering defined set of insured benefits.	**Convert to buyout with individual policies issued in individual member names and administration responsibility transferred to insurer** - typically follows a period of data cleansing to finalise the insured benefits.	**Complete a scheme wind-up** - following which the trust no longer exists.

We set out at a high level how the risks can manifest themselves and what action corporates can take now to manage them.

Surplus

Surplus gets all of the headlines. The reduction in the taxation level for surplus returned to a sponsor went from 35% to 25% from 5 April 2024, and there is much anticipated government reform to increase access to surplus for schemes in the future, even if not winding up. However, where surplus is being accessed as part of a buy-out and wind-up, corporates will want assurance on the mechanism for distributing any surplus and the amount expected to be available.

It's important to have early clarity of who has the powers over the surplus (between the sponsor having an automatic right to it, the members having an automatic right via augmented benefits and the trustee's discretion to distribute it) and who triggers a wind-up to enable access to that surplus.

Finally, a corporate will want to have a handle on the expected level of surplus and potential remaining areas of uncertainty. This will be important for managing expectations with internal and external stakeholders including shareholders and in any discussions with the trustees if surplus is being shared.

While the final level of surplus distributable at wind-up will not be known until later, typically once data and benefit cleansing has been completed following the inception of the buy-in to finalise the benefits insured under the policy, corporates and trustees can discuss the principles of any sharing arrangement upfront. This helps avoid the potential for challenges, and delay, later in the process.

Risk of:

- **Sponsor access to surplus.** ☑
- **Expected £ amount changes.** ☑
- **Timing is delayed.** ☑

Example

Poor planning around use and access to surplus, could mean that an example £10m surplus, to which the company was expecting to have access to, is no longer accessible.

Timing

It's common across the industry for the process to move to buy out to take longer than planned after the buy-in has transacted. This primarily occurs where data and benefit issues are being addressed prior to a scheme winding up. The buy-out market is extremely busy with both scheme and some insurer administration teams under considerable pressure as more schemes move though this phase. If project milestones are missed, schemes risk going to the back of the queue. Unexpected delays can cause two issues:

1. Firstly, they mean a continuation of the expenses for running a scheme (with the business as usual costs usually dwarfing additional project costs whilst delays are incurred). This can be a significant unexpected annual cost or a reduction in expected surplus.
2. Secondly, as well as the financial impact, a delay can be a source of reputational risk if timeframes have been committed to internal and external stakeholders.

Upfront engagement from corporates can help avoid delays by considering their risk appetite early, encouraging trustees to schedule necessary data and benefits work ahead of a buy-in and by understanding their role throughout the process. For example which decisions they'll be involved in and when signatories will need to be available.

Risk of

Additional costs and timing changes for stakeholder management.

Example

Delaying buy-out could add on a few years' worth of additional fees. If ongoing scheme expenses were in the order of £1m pa, this could be a further £2-3m. Reducing potential for a sponsor to obtain a surplus or requiring additional funding.

Member experience

Trustees have a duty here to ensure, as far as they can, that members interests will be looked after in the future. We don't expect any party would wish for a decline in member experience, but the extent to which a corporate wishes to be involved may vary. For some, it may be a primary objective, particularly paternalistic sponsors who recognise that from the point of buy-out, the DB pensions of the corporate's former (and in some cases active) employees are now in the hands of the insurer. Involvement might include the upfront due diligence when selecting an insurer through to the implementation of a buy-out, the communications strategy during the transition period, understanding the likely member service post buy-out, and consideration of how member complaints might be dealt with post wind-up.

Risk of

- [x] **Member complaints.**
- [x] **Decline in member service with. associated reputational risk.**

Example

key non-financial risk.

Residual risks

These are the risks that relate to the potential for further unknown liabilities to emerge after benefits have been fully insured and even after a scheme has wound up. They're typically categorised as coming from three sources: data, benefits and missing beneficiaries. Understanding the corporate's appetite for these risks, which are often long term and unknown in nature, can influence a scheme's activities in the run up to a wind-up and even ahead of the buy-in transaction. Whilst protection measures such as run-on or residual risks insurance and statutory protections may be considered, these will only provide partial protection, and the trustees may be expecting an indemnity from the corporate to cover the remaining risks following termination. Some trustees may ask for a commitment to this effect before any buy-in transaction.

Some corporates will be happy, following reasonable steps to minimise the risk, to provide an indemnity to the trustees and deal with claims as and when they arise, as would have been the case in the ordinary running of the scheme. This approach may be considered as a pragmatic way to balance risk with a more straightforward path to buy-out and wind-up but clearly brings with it the potential for unexpected issues to arise in the future.

Others may have a lower tolerance for future claims, citing financial or reputational risk. These corporates may wish to minimise risk further by undertaking more detailed data and benefits due diligence ahead of buy-out and wind-up and, as far as possible, to reflect the outcome in the benefits and risks insured. Given such work can be time consuming and costly, it's important to test the appetite well ahead of buy-out in order to complete the necessary steps and avoid delaying the wind up timeframe. Some may wish to start this work even before the buy-in transaction to ensure issues are identified, quantified and allowed for when considering overall transaction affordability and before transferring the majority of the scheme's assets to the insurer.

Given the propensity for corporates to indemnify trustees in some way, regardless of what other protections may be in place, early consideration of how future claims will be handled is likely to be helpful. Identifying the key individual at the company and ensuring they have the documentation to support the claims process will be important from the outset to ensure members are not adversely impacted.

Risk of

Unexpected liabilities arising. ☑

Member complaints. ☑

Costly rectification exercises. ☑

Example

Schemes generally consider holding a reserve to cover potential additional liabilities when assessing transaction affordability. However, without upfront due diligence, the reserve is unlikely to be accurate, it may not be sufficient or may be too much. A change in the overall liabilities of over 1% due to this is certainly possible.

Further, additional adviser project fees could materialise if the approach is not agreed or scoped out upfront reflecting the preferred approach for both the trustees and corporate (for the example, say one year of fees).

If available for the scheme, the cost of residual risk cover may need to be funded by the company in addition. In all, this could result in around an extra £10m of unknown fees and liabilities if not appropriately planned for from the outset.

For corporates who have settled on a buy-out target as the endgame for their DB scheme, we believe its key to set their ultimate objectives as early as possible. Being on the front foot will provide control over the long-term risks and costs faced in relation to its DB scheme. With a risk tolerance defined, the approach taken to manage and mitigate the risks can be tailored to their appetite and factored in from the outset. This in turn will deliver a much smoother journey through to the scheme's buy-out and eventual wind-up and ensuring key decisions are not taken too late.

If you would like to discuss anything further, please reach out to your usual Hymans Robertson consultant, or get in touch here.

Sachin Patel
Senior Actuarial Consultant
Head of Corporate DB Endgame Strategy
sachin.patel@hymans.co.uk

Joanne Gyte
Partner
Buyout and Wind up Transition Services
joanne.gyte@hymans.co.uk

Verity Hastie
Senior Actuarial Consultant
Risk Transfer
verity.hastie@hymans.co.uk

This communication has been compiled by Hymans Robertson LLP, and is based upon their understanding of events as at March 2025 and therefore may be subject to change. For further information, or to discuss any matter raised, please speak to your usual contact at Hymans Robertson LLP or one of the contacts named in this update. The update is general in nature, it doesn't provide a definitive analysis of the subject matter covered and it's not specific to the circumstances of any particular employer or pension scheme. The information it contains is not to be construed as investment advice and should not be considered a substitute for specific advice in relation to individual circumstances. Where the subject of this update refers to legal issues, please note that Hymans Robertson LLP is not legally qualified to give legal opinions; therefore, you may wish to obtain legal advice. Hymans Robertson LLP accepts no liability for errors or omissions.

London | Birmingham | Glasgow | Edinburgh   T 020 7082 6000 | www.hymans.co.uk

Hymans Robertson LLP (registered in England and Wales - One London Wall, London EC2Y 5EA - OC310282) is authorised and regulated by the Financial Conduct Authority and licensed by the Institute and Faculty of Actuaries for a range of investment business activities. A member of Abelica Global. © Hymans Robertson LLP.