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GUIDE

Jersey pension scheme buy-ins and buyouts

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We have seen an increase in approved Jersey schemes undertaking buy-in and buyout exercises over the last year as trustees and employers look to new ways to de-risk their defined benefit pension schemes.

Both options transfer risk from schemes to insurers by insuring some or all of the benefits in the scheme. However, the approach which is appropriate for a scheme depends on a number of factors and the decision-making will be led by what the trustees and employer wish to achieve.

This note sets out a brief overview of buy-ins and buyouts and how the trustees and employers of approved Jersey schemes may wish to proceed.

What is a buy-in?

A buy-in is where, in exchange for part or all of a scheme's assets, trustees buy an insurance policy (effectively, a promise to pay annuities) to insure some or all of the benefits accrued in their scheme.

The policy is held in the trustees' names and will constitute an investment of the scheme's assets. As such, trustees must ensure they have appropriate investment powers under their scheme's rules to make such a purchase before proceeding.

Whilst trustees will remain liable to pay benefits from the scheme to members after a buy-in, trustees may choose whether they wish to insure all benefits under the scheme, or only specific elements of the benefits. This could include, for example, an element of any pensions payable, such as increases, or benefits payable to a particular class of members.

The main advantage of a buy-in is that trustees gain certainty in respect of the scheme's benefit costs. Such an arrangement may be especially helpful to the trustees of schemes which have been closed to future accrual, or where there is a high proportion of deferred members.

What is a buyout?

A buyout also involves the purchase of insurance policies in respect of a scheme's benefits, but these policies will ultimately be held in each member's name and the trustees' liability in respect of those insured benefits under the scheme will terminate.

In a buyout, individual policies in respect of each member's benefits in the scheme will be issued either in that member's name or in the trustees' names before being assigned to the relevant member, depending on how buyout is administered.

Buyouts are most often associated with the winding up of schemes, in which case the full benefit entitlement of each member will be insured and transferred to the member directly. However, it is possible to undertake a partial buyout, exercise in respect of a class of member or benefits.

As with buy-ins, trustees must assure themselves that they have adequate powers under their scheme's rules before proceeding to buyout particularly in the context of a winding up.

Whilst buyouts, particularly on a full scheme basis, may have high upfront costs, once purchased, the advantage is that responsibility for payment of benefits rests with the insurer and not the trustees.

Why are buy-ins and buyouts becoming more popular with Jersey schemes?

In addition to the advantages to schemes in respect of both options (as outlined above), the increased uptake of such de-risking exercises reflects the greater availability of relevant insurance products to approved Jersey schemes.

In our experience, insurers offering buy-in and buyout products are based in the UK.

As such, care must be taken to ensure that a scheme's chosen insurer complies with Jersey's legal and regulatory environment, and the documentation reflects that, and the tax treatment of approved Jersey schemes. This is considered below.

What are the stages of undertaking a buy-in or buyout?

There are a number of steps that trustees and employers will need to take before a buy-in or buyout is implemented and the exact process will depend on the reasons for the de-risking exercise and the specifics of the scheme and its membership.

As a broad overview, we set out some of the key milestones in completing the process:

1 Initial decision-making

When considering a de-risking proposal, the first questions for trustees and employers to ask are:

- can we proceed with the proposal?

  Trustees and employers should together consider the assets they have available to fund a de-risking proposal, time-frames and overall objectives.
- should we proceed with the proposal?

  Trustees must consider their duties to the membership in deciding whether to push ahead with such a proposal. The costs and benefits of such a proposal should be balanced against any other de-risking options available to the scheme and consideration as to whether the proposal will meet the aims of the scheme should also be given.

2 Groundwork and going to market

Before launching into a review of costings and insurers, trustees and employers need to look to their existing arrangements and the current funding and administration of their schemes. This is the time to engage the scheme's legal, actuarial and financial advisers to ensure that the proposed exercise is permissible under the scheme's rules and makes sense in the context of the existing funding arrangements.

This is also the time to agree the scope of the de-risking proposal and consider which members and benefits are to be included. To this extent, it may also be helpful to review the scheme's records to ensure any relevant scheme information is up-to-date.

Once the initial de-risking framework is mapped out, the trustees can start to investigate the options available to them, taking financial advice before selecting the preferred insurer and product. Whilst this work may be trustee-led, it will be helpful to engage with the employer throughout this process, particularly given the funding requirements.

3 Selection, review and implementation

On having found an appropriate option and secured the employer's engagement, trustees should seek advice to:

- assist in respect of completing any due diligence exercises; and
- ensure that the documentation required to effect the buy-in or buyout is appropriate.

Both stages require a review by the scheme's legal advisors of the terms of any insurance policy against the scheme's rules to ensure that the benefits to be insured are adequately covered by the policy and that the terms are compliant with the law governing the policy (usually English law) and Jersey law. The legal advisers will also advise where amendments may be necessary.

Once the documentation is agreed between the parties (and note that this may require the involvement of the employer, particularly where such consent is a requirement of the scheme rules), the legal advisers will advise on any closing finalities.

How does the buy-in and buyout process vary for approved Jersey schemes?

Given the regulatory requirements that must be met by a UK insurer operating in Jersey, ensuring that the relevant insurer is permitted by the Jersey Financial Services Commission to provide insurance in Jersey is a crucial additional step to be undertaken as part of the due diligence process.

Additionally, care will be needed in the review of the associated paperwork to ensure that the necessary requirements of Jersey law are incorporated.

Mourant Ozannes would be happy to assist trustees and employers in the review of buy-in and buyout documentation and to advise on the Jersey law implications generally.

Contacts

Edward Devenport
Partner, Mourant Ozannes
Jersey
+44 1534 676 366
edward.devenport@mourant.com

Carly McIver
Senior Associate
Jersey
+44 1534 676 064
carly.mciver@mourant.com

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