IT'S A LEGAL CONTRACT OF SOME COMPLEXITY

A LEGAL EXPERT TELLS **JENNA GADHAVI** THE TYPE OF ISSUE THAT TRUSTEES NEED TO BE AWARE OF

What are the complexities in executing a buyout over a plain vanilla buy-in?
The obvious, but key difference is that a buy-in transaction results in purchasing an asset that matches the cashflows of a pension scheme, whereas a buyout transaction is designed to discharge the trustees fully from liability and pass that liability to someone else. That forces trustees and employers to confront all of the difficult questions that may be lurking in the pension scheme.

Are there timing considerations that must be allowed for?
Liability management exercises affect the timetable. Writing to members to offer them a pension increase exchange, for example, involves a period of time for them to understand the offer, seek advice and decide what to do.

Solvency II means these exercises almost certainly need to happen ahead of contracting with an insurer, because Solvency II makes it difficult for insurers to competitively price optionality.

Now trustees and employers are more likely to run the liability management exercise, identify the population to be insured, then include only those members as insured persons under the contract.

How important is the buyout contract? What are the key features of robust documentation?
Like any commercial contract, the key provisions must be unambiguous so both parties understand their rights and obligations.

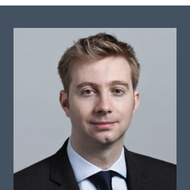
The contract obviously needs to specify the benefits correctly, but time and effort also has to go into understanding key contractual mechanics. When and how is the premium paid? When is any top-up paid? Typically a buyout contract involves payment of an initial estimated premium, followed by a period of data verification. If that verification results in a revised understanding of the liabilities then there can be re-pricing (as opposed to a simple adjustment to reflect a change in data). It is key to understand the circumstances in which there could be a further demand for money. For bigger schemes there will be more scope for tailoring insurers' standard terms.

For schemes coming out of the Pension Protection Fund, what are likely to be the main issues trustees face?
When a scheme comes out of a PPF assessment period because PPF-plus benefits can be secured, the trustees need to ensure that as well as getting the insurance contract right, they deal with all of the issues that have arisen because they have been required to restrict benefits during the assessment period. Some schemes will secure PPF-plus benefits without entering an assessment period. If there is clearly going to be an event that would result in a scheme going into a PPF assessment period, but PPF-plus benefits can be bought, there could be a deliberate structuring so as to avoid an assessment period. In either scenario the key thing of course is that the insurance contract absolutely guarantees PPF-plus benefits and that each member will receive his or her proper share of benefits under the statutory priority order. Careful drafting is required.

How can data-related risks be accommodated in a buyout transaction? Are there particular areas that create complexity?
Some insurers will provide 'data-risk cover', and this can be appropriate for some schemes, but not in every circumstance.

If a scheme is winding up with a deficit, trustees might want to concentrate all their resources on insuring the benefits they know they have, for example. Or trustees could purchase run-off insurance from another insurer, or they could rely on exonerations they might have under their trust deed or an indemnity from the employer if it is still solvent.

Ultimately the courts have the ability to relieve the trustees from personal liability where appropriate. Trustees entering into all-risk cover with an insurer need to understand that this will inevitably result in the insurer doing a high degree of due diligence on the scheme and the insurer may require certain issues to be addressed before going on risk. Importantly, trustees need to assess the need for and value of additional insurance against the backdrop of protections otherwise available to them. ■



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