PASA De-Risking Journey Management Working Group

De-risking Jargon Buster

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PASA

Acknowledgements

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1. Introduction

As DB schemes mature, many are now actively navigating their own version of a de-risking journey. This process involves a series of strategic decisions aimed at reducing risks. While these decisions are often taken over several years, their impact on scheme administration can be immediate and far-reaching. We recognise understanding the terminology and practical implications of this evolving landscape is critical for administrators, trustees and employers. This Jargon Buster is the first in a series of resources designed to support better understanding and improved outcomes. It aims to clarify the options available and highlight the administrative and governance responsibilities which come with each step of the journey.

Over the coming months we'll provide further detail and thoughts on best practice through a series of 'myth busting' updates. The overall aim is to improve knowledge in this complex area of pension scheme administration, thereby improving the experience for everyone involved.

2. Jargon Buster

De-risking: This process refers to any actions taken to reduce the risks in a DB scheme. The main risks typically include investment, inflation, interest rates, longevity, and sponsor (employer) covenant. Derisking is a broad term encompassing both liability management exercises and pension risk transfers, as well as investment strategies like Liability Driven Investment (LDI).

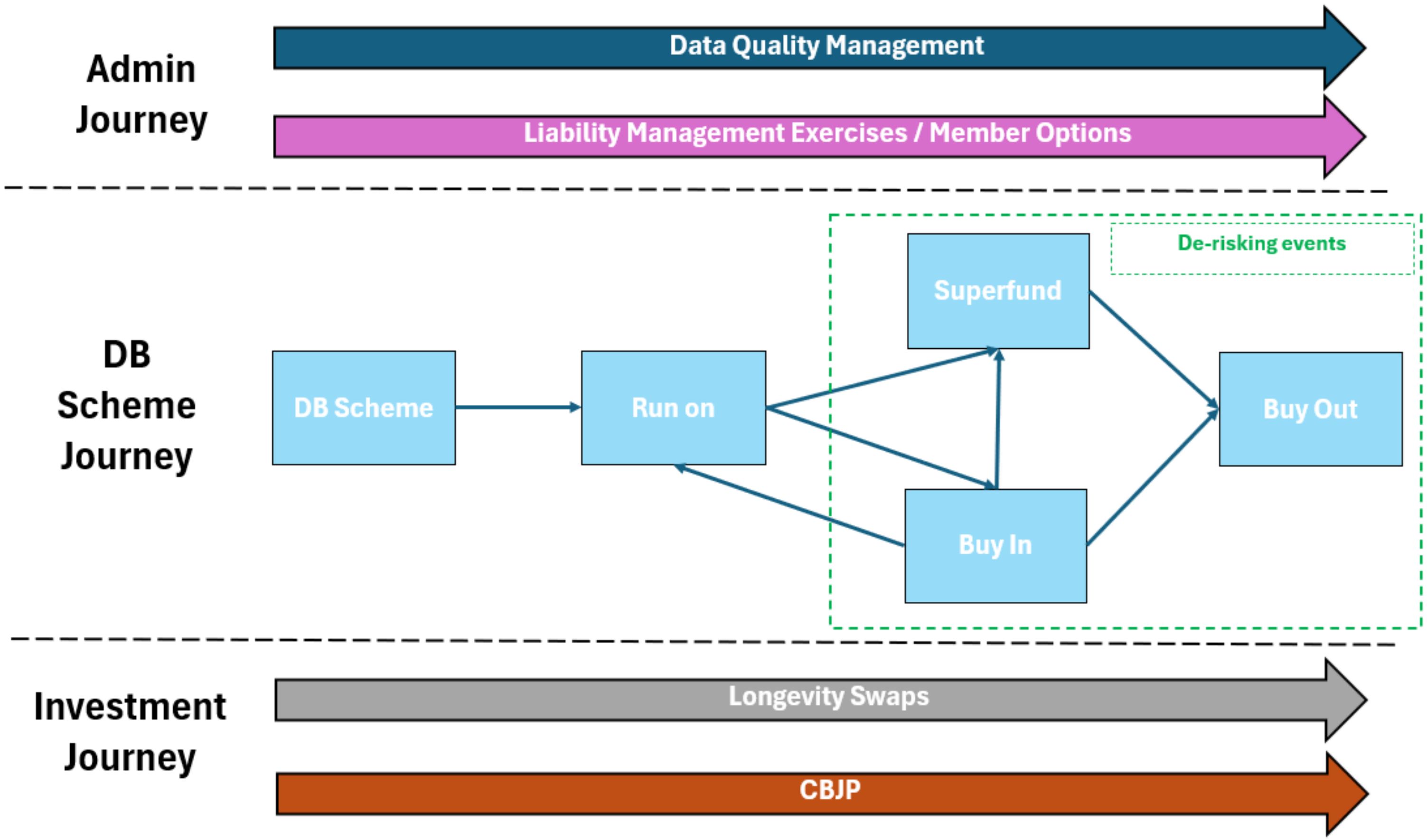
Pension Risk Transfers (PRT): PRT specifically refers to transferring pension risk to an insurance company or Superfund. The key types are buy-ins, buy-outs, superfund or longevity swaps.

Liability Management Exercises: These are specific projects aiming to give members options to reshape their benefits, often reducing risk and cost for the scheme. Common examples include:

- Pension Increase Exchange (PIE) - offering members a higher level (or non-increasing) pension in exchange for giving up future increases
- Enhanced Transfer Value (ETV) exercises - members are offered an enhanced cash value to transfer out of the scheme, reducing liabilities
- Flexible retirement options – members can be offered bridging pensions providing higher payments until state pension age, which then reduces, ensuring stable income during early retirement
- Trivial commutation exercises for small pensions-- small pensions are converted into lump sums, removing liabilities from the scheme

It should be noted these exercises can be significantly expensive to undertake and implement, as well as introducing additional cost and risk to ongoing administration.

The graphic below demonstrates the different options which can be followed during the de-risking process. Subsequent pages explain each option further, highlighting the administration and governance requirements and expectations. There will be multiple permutations of options, and while the graphic isn't exhaustive, it illustrates the different routes a DB scheme may take.



Buy-in: This refers to when a scheme purchases a bulk annuity policy from an insurer, covering some or all members' liabilities. The policy remains an asset of the scheme, and the trustees continue paying benefits. Scheme structure remains intact.

Administration & Governance

- ✓ Existing administration team/TPA continues to manage member services
- ✓ Coordination required between administration team and insurer for benefit payments. There can be added complexity, time and cost in this phase
- ✓ Annuity reimbursement, benefit payment and member movement monitoring needed
- ✓ Likely to be a move to insurer factors and benefit calculations There is added complexity if scheme factors are also retained
- ✓ Data cleanse and benefit specification required pre-transaction
- ✓ A member communication strategy is crucial
- ✓ Dedicated project management (which can sit outside administration function)
- ✓ Trustee governance continues and benefits remain payable in line with the Scheme Rules

Buy out: The scheme purchases individual annuities for members from an insurer, fully discharging liabilities. Members become direct policyholders of the insurer, and the scheme is wound up (see below for definition).

Administration & Governance

- ✓ Administration transfers to the insurer, which takes over responsibility for all administrative tasks inclusive of pensioner payroll, member communications, benefit calculations and data management
- ✓ The administrator has no further responsibilities for the scheme or its members

Capital Backed Journey Plan (CBJP): Additional funding capital is provided to schemes at risk by external investors to support an agreed target funding objective (e.g. self-sufficiency or buy-in/buy-out) by an agreed time – typically 5 to 15 years. The existing sponsor remains adhered to the scheme.

Administration & Governance

- ✓ Administration remains with the scheme but additional actuarial, investment and legal oversight is required to manage the CBJP contract
- ✓ Access to expertise to better manage risks
- ✓ Governance around potential conflict of interest between investors, trustee and scheme sponsor

Liability Management Exercises: In the lead up to a buy-in, schemes may look to undertake liability management exercises such as:

- PIE
- Flexible Retirement Option
- ETV
- Trivial commutation and small pension lump sum exercises

Administration & Governance

- ✓ There may be some project management
- ✓ Amended calculations and processes
- ✓ Updates to member communications and facilitation for financial advice and guidance
- ✓ These can be BAU items not necessarily standalone projects
- ✓ For trivial commutation will require work assessing the total benefits a member has to determine eligibility (unless under £10k value)
- ✓ These exercises can introduce complexity to benefit specifications and additional data challenges when liaising with an insurer

Longevity swap: A contract where the scheme retains assets but transfers the longevity risk to an insurer or reinsurer, typically via a swap or captive insurer. The scheme still pays pensions but receives payments if longevity exceeds expectations. Investment risks remain with the scheme and often comes with reporting requirements.

Administration & Governance

- ✓ Administration remains with the scheme, but additional actuarial and investment oversight is required to manage the swap contract

Run On (Status Quo): Scheme continues to be operated by trustees with employer covenant support. Investment and longevity risks remain with the scheme.

Administration & Governance

- ✓ In-house administration team or third-party administrator (TPA) manages member services
- ✓ Regular actuarial valuations are required
- ✓ Ongoing investment management and monitoring
- ✓ Full trustee governance structure maintained

Superfund: Transfer to a consolidator vehicle replacing employer covenant with capital backing.

Administration & Governance

- ✓ Administration typically moves to superfund's preferred provider
- ✓ Data quality assessment and benefit specification required pre-transaction
- ✓ New governance structure under superfund including immediate transfer of responsibility to the Superfund Trustee

Winding Up: Following the assigning of all benefits for members this is the process where the Trust structure used to pay the benefits is formally closed. There are a number of statutory steps to adhere to.

Administration & Governance

- ✓ Administrators may be involved with assisting the trustees with some of the necessary tasks to wind up the scheme (this list isn't exhaustive):
  - Advising member of the use of any surplus and how the benefits have been assigned
  - Regulatory notices to TPR and HMRC
  - Determine data retention periods and compliance with data regulations
  - Assistance at final meeting
  - Preparation of final accounts

3. Other factors to consider

Having explored the various de-risking options available, it's important to recognise successful implementation depends on careful consideration of several key factors which apply across all approaches. These considerations will influence both the choice of strategy and the effectiveness of its execution:

- **Data Quality:** All options require high-quality data but buy-outs and superfund transfers have the highest standards. While generally the different parties need data require similar data items, the format and timeliness of provision of data required can differ widely between providers
- **Cost Implications:** Options vary significantly in cost, from relatively low-cost member options to expensive buy-outs
- **Timeline:** Implementation timeframes range from months (member options) to potentially years (buy-in to buy-out)
- **Regulatory Requirements:** Each option has specific regulatory considerations and requirements for trustee compliance
- **Member Impact:** Options vary in their impact on member experience and security of benefits

Adhering to the administration best practices set out below will ensure your scheme's readiness for de-risking:

- ✓ Maintain comprehensive data quality standards
- ✓ Document all processes and decisions
- ✓ Regular training for admin teams on specific requirements
- ✓ Clear communication protocols with all parties
- ✓ Regular audit of processes and outcomes
- ✓ Robust risk management procedures

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