SLAUGHTER AND MAY/

TO RUN ON OR BUY-OUT

considerations for UK DB schemes

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As part of Slaughter and May's Horizon Scanning programme, we were delighted to host a panel discussion on 3 March 2025 on the case for running on defined benefit schemes versus buying-out with a bulk annuity insurer or, indeed, both. Arguing the case for running on were Brightwell's Chief Executive Officer, Morten Nilsson and Chief Investment Officer, Wyn Francis. They were joined on stage by John Towner, L&G's Managing Director of UK Bulk Annuities who advocated for buy-out, and Anne-Marie Morris, Head of DB Solutions Strategy at L&G who argued that schemes can have the best of both worlds.

THE CASE AS PUT FOR RUN-ON	THE CASE AS PUT FOR BUY-OUT
Security of benefits can be achieved where the scheme is well-funded on a prudent basis and there is good visibility over the future strength of the employer covenant.	Buy-in/out is likely to remain the ultimate end-game solution for many schemes and be built into long term funding and investment strategies and used to access and release any surplus.
An investment portfolio can be put in place which manages risk effectively and can make use of flexibility outside of the prudential framework that applies to insurers.	It removes the risks of investment, longevity, interest rate changes, inflation and future running expenses of a DB scheme. It also means there is no reliance on a potentially uncertain employer covenant.
Planned changes to regulation are set to make it easier for sponsors to access scheme surplus.	Sponsors draw a line under their historical obligations, knowing they have secured them for the long-term. This enables them to focus on their core business and the future.
Members can continue to benefit from discretionary increases as trustees will retain control over discretionary decisions.	Members receive enhanced security - their benefits move from the pensions regime to the prudently regulated insurance environment.
Trustees will control the quality of the member experience in relation to the scheme.	Trustees settle their obligations and fulfil their fiduciary duties to their members.
Where schemes have a long and complex history, there is more flexibility to adapt to emerging issues.	Insurers are able to deliver member administration services cost-effectively and at scale indefinitely and are open to discussing how they can secure discretionary benefits.
Surplus can be recognised in sponsor accounts.	Moving scheme liabilities to an insurer is likely to unlock significant funds for productive finance. Insurers typically invest 20-50% of premiums into 'direct investments' such as housing, infrastructure and clean energy, so completing a buy-in/out also delivers on the Government's economic growth agenda.

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TAKEAWAYS

- The general consensus was that increased choice benefits trustees and sponsors by enabling schemes to develop strategies that are more specifically tailored to their individual circumstances. Buy-outs are often viewed as the gold standard for long-term member security and can lead to positive outcomes (including accessing any surplus) for members, trustees, companies and the wider economy. Nonetheless trustees can legitimately decide not to buy-out – there is no legal obligation to do so - a trustee's primary obligation is to promote the purposes of the scheme and pay benefits to the scheme's beneficiaries in accordance with the scheme's rules.
- Run-on doesn't necessarily mean continuing until you pay the last beneficiary. It may make sense to run-on for a period of time in order to obtain better buy-out pricing further down the line.
- Trustees who do not buy-out when a scheme is ready and can first afford to do so will inevitably be concerned about the risk of future challenge from members should scheme funding deteriorate and affect benefit security. To that end, agreeing a robust and reasonable framework with the scheme sponsor for running-on the scheme and any triggers for a change in strategy is often a prudent approach. Any such framework would need to be reviewed at periodic intervals to ensure it reacts to changing circumstances.
- Following the market changes in 2024, insurers are now also pricing buy-out portfolios with significant gilt exposure. Therefore, the investment strategy for run-on and buy-out, can be very similar, hence facilitating planning for the best of both. To that end, schemes may want to keep their options open and complete their scheme due diligence and other preparatory steps up front, so that if buy-out pricing moves in a favourable direction, they are ready to transact. As such, it is possible for Trustees to balance the benefits of surplus extraction and the security of buy-out by adopting a strategy that combines running-on for a period, before buying-out at a time of the trustees' choosing, capturing for example attractive buyout pricing.
- With the forthcoming launch of pensions dashboards, data quality will be key no matter which path you choose so there is significant merit in conducting a benefit and data audit so that you have certainty over your liabilities. Be clear when speaking to your advisers that both scheme and sponsor know and understand the level of due diligence to be carried out and the risks of the methodologies adopted.

WHAT THE AUDIENCE THOUGHT

55% had yet to agree their end game strategy. Whilst 23% said they were targeting an insurer buy-out, 18% were aiming to run on, with 9% aiming to do so with a view to generating surplus. 5% were waiting to see how the Government's policy on surplus develops.

The main priority when setting end game strategy was ensuring benefits are paid as required. Reducing funding volatility, ensuring a positive member experience, intergenerational fairness and reducing regulatory burden and the risk of legal change of law also featured highly as objectives.

35% said priorities included obtaining a share of surplus for members and / or employers whilst accounting/tax considerations were voted as the least significant priority.

In terms of the steps taken by audience members to prepare for their long-term objectives, 81% said they had completed a data and benefit audit and implemented a LDI investment strategy. Furthermore, 71% had carried out a GMP reconciliation / equalisation exercise. Just under half (48%) had undertaken asset transitioning and 38% had completed member address tracing and a marital survey.

Interestingly, only 14% had completed a member options exercise.

If you are interested in the options for your scheme and would like to talk to us about how you can take them forward and what a good governance framework around deciding whether to buy-out or run-on would look like, please contact Charles Cameron.

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