

Buying in? Think buyout

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Dayle Noonan recommends trustees consider the end-game of buying out when creating the structure of a buy-in

In deciding to buy-in, the trustees have chosen a great vehicle for transferring a wide range of risks from the scheme to an insurer thereby securing the members' benefits now and into the future.

Having made that all-important first step, it is only natural that focus turns to what might come next. For many schemes the buy-in decision was made on the basis of immediate affordability or as a way of initially 'dipping the toes in'. Whatever the reason, the end-game for many of these schemes will be buyout. If that is the case it is important that the structure of the buy-in gives adequate scope to make the conversion and to consider how actions taken during the buy-in period might affect the buyout.

When putting in place the buy-in, we would always recommend that any unusual features, benefits or discretions are discussed and suitable solutions agreed with the insurer up-front. In theory a buy-in contract can be put in place on the basis of a simplified benefit structure, for example insuring fixed pension increases instead of matching a scheme's unusual increase structure. However, this does make the conversion to buyout more problematic.

A standard buy-in structure assumes the insurer will be performing 'shadow administration', which involves tracking member movements and benefit changes, but without the direct contact with members as the insurer will make a lump sum payment to the trustee's administrator for onward distribution. This compares to a buyout, where the members become individual policyholders of the insurer, who will perform all the administrative functions.

The differing administrative structures do result in a pricing differential between a buy-in and buyout. If the trustees intend switching to buyout relatively quickly it is probably worth entering into the buy-in with the additional buyout administrative costs already included in the buy-in price. However, if the trustees have no fixed timeframes for conversion they should insist on a guaranteed per member cost that will only be paid in respect of current membership at the point of switching.

Data cleansing

The way that data cleansing is handled can also affect the move to buyout. In theory for a buy-in it is only necessary to data cleanse the members' personal details and only perform a cursory cleansing of the pension amounts until buyout. That is possible because any divergences in the pension entitlement that emerge over time (as a difference between data held by the insurer and current administrator) can be squared by the trustee before the pensions are distributed to the members each month.

This is particularly relevant for contracted-out schemes. Realistically it can take a year to complete a reconciliation of the scheme's Guaranteed Minimum Pension (GMP) entitlements, so many buy-ins bypass this step to shorten the data-cleansing process.

Any differences in benefits will however need to be accounted for, however, meaning that before the buyout can be completed a further data-cleansing exercise needs to be undertaken.

There are also practicalities to consider when it comes to making the switch. The move from shadow administration to full administration will require provision of the members' contact and bank account details to the insurer. In addition, a well controlled transition would involve parallel payroll runs to iron out any potential pitfalls. All of these aspects require full engagement from the current administrator to ensure a seamless transition for members.

While the trustees have made a great choice in starting with a buy-in, it is worthwhile 'thinking buyout' to ensure a smooth transition when the time is right.