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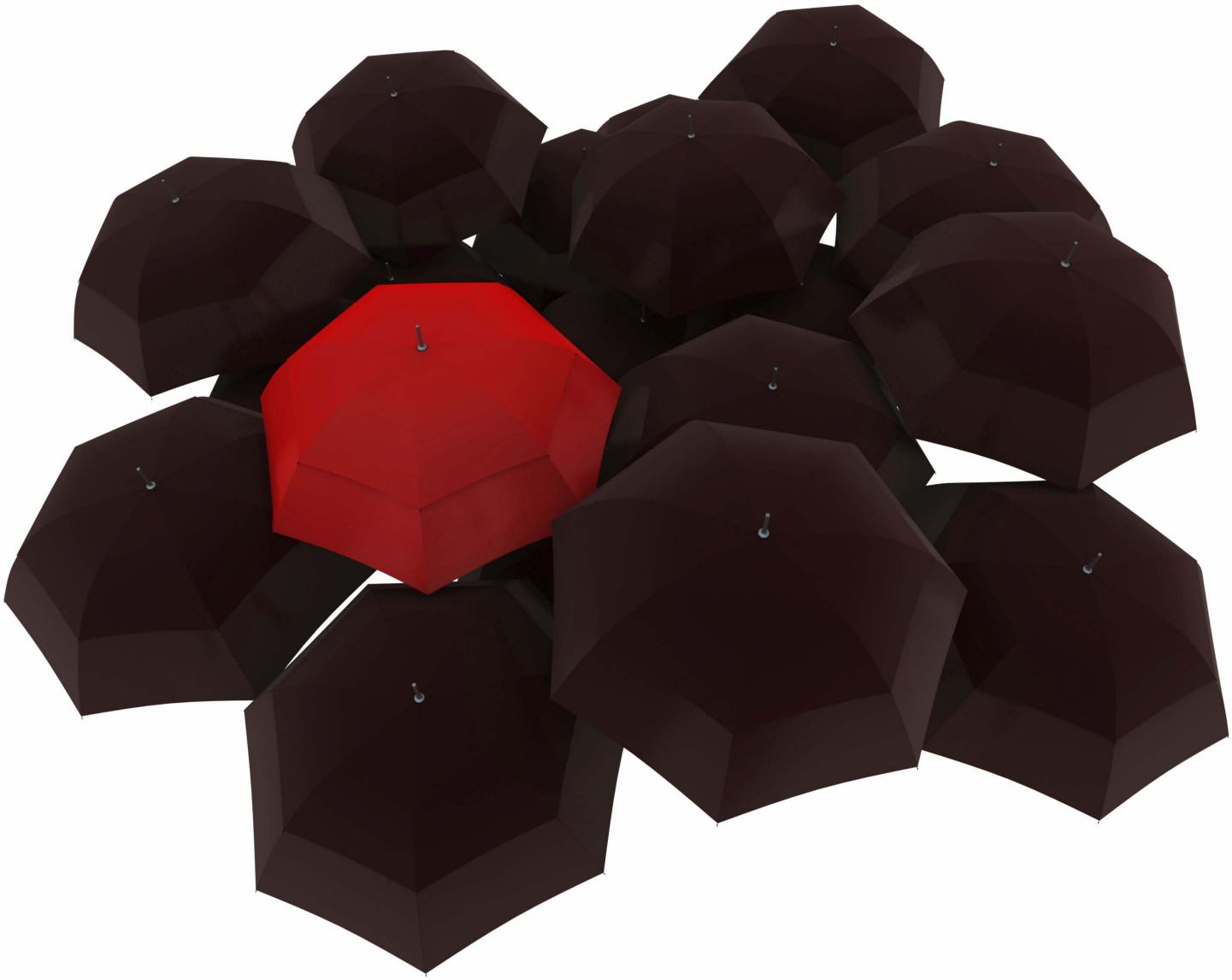

Pension Risk – market update

News from our Pension Risk Group – July 2014

Derisking Consultant of the Year

FT Pension and Investment Provider Awards 2014

We are delighted to have won the title of Derisking Consultant of the Year at the FT Pension and Investment Provider Awards 2014.

Allen & Overy is the first law firm to win this award, which recognises our performance, innovation and client service on a range of market-leading derisking deals.

Read more

"Its cross-disciplinary approach provides clients with an impressively broad service, allowing them access to banking, restructuring, derivatives and regulatory and corporate expertise."

Chambers 2010

This update includes links to more detailed briefings. If you are reading this in hard copy and would like more information, or to receive future issues by email, please contact **pensions.team@allenovery.com**

Market update

The first half of 2014 has been a story of innovation and broken records: new structures for pension scheme funding and for longevity swaps; and new techniques in liability transfer which allow significant increases on previous deal sizes, as the market continues to evolve.

THE UK'S LARGEST EVER BUY-IN:

We helped the trustee of the ICI Pension Fund secure GBP3.6 billion of pensioner liabilities in the largest bulk purchase annuity transaction to date. To obtain the best commercial terms for the trustee, the buy-in was structured as two simultaneous deals with separate insurers.

Read more

GBP16BN LONGEVITY SWAP USING CAPTIVE INSURER:

We advised the trustees of the BT Pension Fund on this historic deal (three times larger than the previous record) – the first time a pension plan has established its own insurer to reduce transaction costs.

Read more

FIRST USE OF SURETY BONDS TO PROVIDE SECURITY FOR SCHEME FUNDING:

We advised the trustee of a FTSE100 company on a ground-breaking new GBP400 million structure which replaces bank guarantees with surety bonds. The deal provides security to the scheme while allowing the company greater flexibility in relation to its own financing arrangements.

Read more

2014 is expected to be a bumper year for **pension risk transfer** in the UK. In fact, the challenge could be finding a provider who isn't too busy on other deals to get your deal done when the timing – and the price – is right. The Government's proposals to change the rules on how individuals can access their pension savings have already had a dramatic impact on the individual annuity market. Provider capacity intended for this space in 2014 is expected to drive favourable pricing for bulk annuity deals.

Partner Neil Bowden comments:

"With an 'end of season sale' effect expected towards the end of 2014, the key is to be ready to transact. These deals can take several weeks to complete, and preparation time is usually a lot longer. It can be easy to underestimate what's involved, so talk to us as soon as possible."

Expert insight

Have you ever wondered what goes on behind the scenes on a derisking transaction?

Read more about the issues involved in Neil Bowden's article, published in Pensions Insight magazine in May 2014.

Regulatory update

Scheme funding: new DB Code in force

The Regulator's new Code of Practice on funding defined benefits sets out how trustees should undertake the task of balancing the three key pension risk areas – funding, investment and the employer covenant – in an integrated way. The focus is on living with risk – that is, understanding and managing risk, rather than necessarily eliminating it – and on contingency planning.

The Code reflects the Regulator's new statutory objective on scheme funding, which is to minimise any adverse impact on the sustainable growth of an employer. However, this is an objective for the Regulator, rather than for trustees, who should focus instead on the fact that their ability to ensure that scheme benefits can be paid as they fall due will be strengthened if the employer supporting the scheme remains successful.

By way of counterbalance, the 2014 annual funding statement sets out the Regulator's view that affordability is increasing due to improved economic conditions, so sponsors may now be able to increase support for their DB schemes.
Read more

PPF levy – changes on risk assessment, guarantees and ABCs

The PPF's new model for assessing sponsor insolvency risk could see dramatic increases in levy bills for 2015/16.

Other proposed changes include:

– The PPF has proposed that only UK property-based asset-backed contribution structures will be taken into account for levy purposes and has put forward new rules on attributing value to ABCs. Some ABCs could therefore fall out of account for next year's levy calculations, and the effect of those which are taken into account by the PPF may be reduced.

–Trustees certifying a Type A guarantee will be required to state a fixed amount (the 'realisable recovery') which they are confident the guarantor could pay if called upon to do so, taking account of the likely impact of the immediate insolvency of all of the relevant employers. Guarantor insolvency risk scores will be adjusted to reflect the potential impact of the guarantee being called on.

The key to managing your levy bill for next year is to plan early. Contact us to discuss measures to mitigate any potential increase.
Read more

Impact of proposed DC flexibility for DB schemes

The proposed changes to member options for accessing DC pension savings from April 2015 have a range of implications for DB schemes. Issues include:

– The impact on flexible retirement options and transfer incentive exercises remains unclear: members may find transferring to DC more attractive than before, so take-up could increase. On the other hand, these exercises could be banned altogether.

– If DB/DC transfers remain an option, schemes should be aware of the potential upturn in demand for transfers out. Although this is generally positive from a liability management perspective, it could affect your scheme's run-off profile and the desirability of holding index-linked gilts/UK corporate bonds.

– Schemes may find that members no longer exchange as much/any DB pension for a pension commencement lump sum on retirement, reducing the positive impact this type of commutation can have on scheme funding.

For a discussion of the impact of the changes to commutation limits which came into effect immediately following the Budget, see page 5.

Date for your diary: Thursday 18 September, 12.30-2pm

Rewriting the rules on retirement income: what do you need to do, to be ready for April 2015?

What will the 'guidance guarantee' mean in practice? How much flexibility will schemes have to provide to members?
What impact will the new DC flexibility have for DB schemes, and for DC investment strategies?

Schemes will have a relatively short time to update their rules, practices and member communications for 'the most fundamental change to the way people access their pension in almost a century'.

In this joint seminar, experts from Allen & Overy and Capita will guide you through the legal and practical implications of the new rules and signpost the key issues and action points which should be on your autumn agenda.
Email us at pensions.team@allenovery.com for more details and to reserve a place.

Current trends

Alternative financing strategies: new options

Funding structures continue to evolve, with a focus in the last few months on the advantages of funding trusts (also known as reservoir trusts). Funding trusts can be used to reduce scheme deficits and provide protection against sponsor insolvency, while reducing the risk of creating trapped surplus through additional sponsor contributions.

Assets are placed in trust, to be transferred to the scheme if a trigger event occurs or if a deficit persists after the specified term. Part or all of any income can be paid to one beneficiary (sponsor or scheme) while capital is held on trust for another. The advantage is that the assets, terms and duration involved are highly flexible to the requirements of the scheme and sponsor, and to future funding requirements; and the trust can be structured for high tax efficiency.

The use of surety bonds, mentioned on page 3, is a further addition to the toolkit of alternative financing structures available to schemes and sponsors.

Read more about the range of options available.

Scheme changes and benefit redesign

It's not uncommon for scheme sponsors to introduce scheme design changes in a series of stages, often over several years, to limit defined benefit liabilities. The High Court's landmark *IBM* decision has underlined that a sponsor's freedom of action may in some circumstances be restricted by member communications made as part of an earlier exercise.

IBM's changes (including closing defined benefit plans to future accrual and imposing a new restrictive early retirement policy) would not in themselves have breached its duty of good faith to active members of its pension scheme. However, its conduct and communications to members in the course of earlier exercises had led members to expect that their pensions were broadly 'safe' from further cutbacks. In the context of those reasonable expectations, IBM's actions were ones that no reasonable employer could have taken. Careful consideration needs to be given not only to the detail of past and present member communications about benefit changes, but also to the overall impression they give to members.
Read more

Increased options to cash out low-value benefits

The increased commutation limits announced in March as part of the Budget changes mean that a wider range of members can now cash out relatively low-value pension rights.

Under the new rules, members aged 60 or over with aggregate pension rights of up to GBP30,000 (up from GBP18,000) will be able to take them as a lump sum. However, this limit applies to benefits across all registered pension schemes of which the member is or has been a member, so is generally only used at the point at which the member retires.

More usefully, members aged 60 or over can cash out pots of up to GBP10,000 (up from GBP2,000) from any occupational pension scheme and from up to three personal pension schemes. There is no requirement to assess the member's entitlements under other schemes (or even, in strict terms, to obtain member consent). It is possible that the minimum age for commutation will be lowered to 55 from April 2015.

These changes may provide useful liability management opportunities. If this could be relevant for members with deferred rights in your DB scheme, talk to us about the issues for trustees and best practice in engaging with members.

About us

The Allen & Overy Pension Risk group brings together experts across a broad range of specialisms to help you achieve a seamless transition through each stage of your de-risking journey.

We deliver tailored solutions to address the unique requirements of each employer and pension scheme, balancing the needs and interests of all parties to reach agreement efficiently.

For more information, visit our website www.allenovery.com/pensionrisk or get in touch with your usual Allen & Overy contact.

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GLOBAL PRESENCE

Allen & Overy is an international legal practice with approximately 5,150 people, including some 525 partners, working in 44 offices worldwide. Allen & Overy LLP or an affiliated undertaking has an office in each of:

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Bangkok
Barcelona
Beijing
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Budapest
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