Sackers

Finance & investment briefing

March 2025

Sackers finance and investment experts take a look at current issues of interest to pension scheme investors

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In this issue

Abbreviations

DB: Defined Benefit

DC: Defined Contribution

EEA: European Economic Area

EMIR: European Market Infrastructure Regulations

ESG: Environmental, social and corporate governance

FCA: Financial Conduct Authority

FSCS: Financial Services Compensation Scheme

FSMA: The Financial Services and Markets Act 2000

IGC: Independent Governance Committee

IRR: Insurer Resolution Regime

LDI: Liability Driven Investment

OTC: Over the counter

PLSA: Pensions and Lifetime Savings Association

PRA: The Prudential Regulation Authority

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Finance & investment focus

"Welcome to the first finance & investment briefing of 2025. We hope the new year has started well for you.

In this issue, we share our highlights of 2024 in relation to risk transfer activity. Over the last year, we have advised on 14 risk transfer transactions of all sizes, totalling over £7.9bn. We continue to be extremely active in all areas of the market advising trustees and employers, working with all major insurers and consultants, as well as new entrants.

On page 3, we take a look at the proposed Insurer Resolution Regime and the impact this may have on risk transfer transactions.

We also provide our usual legal update section, focusing on the recent extension to the pension fund clearing exemption, FSCS protection for overseas members in risk transfer transactions, and the PLSA findings on ESG-related issues.

Sackers will be at the PLSA investment conference in Edinburgh in March. If you are attending, we would be delighted to see you at our stand."

Paul Phillips
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Environment

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UK Insurer Resolution Regime

Background

At the time of writing, there is no statutory resolution framework for UK insurers, similar to the UK framework for banks. There has been growing concern from HM Treasury that existing processes available to assist struggling insurers are not sufficient and do not allow authorities to act swiftly to stabilise failing entities and minimise potential risk.

In January 2023, HM Treasury launched a consultation proposing the establishment of a UK framework for the resolution of insurers, the Insurer Resolution Regime ("IRR"). The Government's subsequent response in August 2023 stated that it plans to legislate when parliamentary time allows, and will set out further information in due course.

The proposed IRR would equip the Bank of England with several new tools to manage the failure of a systemic insurer more quickly and is intended to "enhance UK financial stability, protect the wider economy, and minimise disruption to policyholders in the event of a systemic insurer failure". The consultation has now closed, and it is unclear when the regime might come into law.

1

What does it mean for pension scheme trustees?

For pension scheme trustees, the proposed regime could potentially prove helpful in risk transfer transactions, as the Bank of England would have the ability to transfer the business of a failing insurer to another insurer more quickly and easily (ie without court approval, as is currently needed under Part VII of FSMA). This could create greater stability, and subsequent success, for such transactions.

However, key questions for trustees contemplating a buy-in, and subsequent buy-out, include:

- **bail-in –** the IRR would empower the Bank of England (acting in its role as Resolution Authority) to restructure, modify, limit or write down the unsecured liabilities of a failing insurer, in exchange for shares in such insurer. This could result in writing down liabilities to policyholders, but with the plan being for the FSCS to provide "top-up payments" so that coverage continues without net reductions.
- **restriction on policyholder surrender rights –** HM Treasury is concerned that a failing insurer might find itself having to deal with several policyholders all wanting to terminate their policies early in exchange for the cash value. When it is already under stress, having to fund these payments could place "a liquidity and/or capital strain on the insurer". Under the IRR it is proposed that the Bank of England would have the power to temporarily restrict these early termination rights.

2

When would these powers apply?

Firstly, the PRA needs to have assessed that an insurer is "failing or likely to fail". If this first "resolution condition" is met, there are then various other resolution conditions that need to be met consecutively in order to place an insurer into resolution.

3

When will the IRR come into effect?

It is unclear when the IRR will come into effect. The previous Conservative Government stated in August 2023 that it "plans to legislate when Parliamentary time allows and will set out further information on plans in due course". The intention was that, once any legislation is passed, the stabilisation options and related powers would be made available to the Bank of England as soon as practicable with the industry "given sufficient time and notice to make any necessary changes to accommodate these new powers". Indications are that a minimum 12-month lead-in time is likely to be necessary for firms to implement any planning required.

For further detail on this topic please see our recent Hot Topic.

Legal update

Pension fund clearing exemption

On 10 January 2025, HM Treasury published the Government's response to its November 2023 call for evidence on the exemption which pension funds currently have from the obligation to clear certain derivatives contracts. The exemption was made in recognition that clearing contracts through a central counterparty, which typically requires collateral to be provided in cash, could cause particular challenges for pension funds.

The call for evidence requested input from industry stakeholders to inform the Government's review of the exemption and determine a long-term approach. A temporary exemption was introduced in 2012 and has been extended several times since, most recently in June 2023. The Government has now confirmed its intention to retain the exemption "longer-term", and it will take forward legislation to ensure that the exemption does not expire on 18 June 2025 (as currently scheduled) and to remove any further time limit on the exemption. This policy will, however, be kept under review in coordination with the UK regulatory authorities.

It is also worth noting that, although the pensions exemption has expired under EU EMIR, EU EMIR 3.0 includes a specific exemption from clearing for EU counterparties which trade OTC derivatives with non-EU pension schemes which:

- are established in a third country
- operate on a national basis
- are authorised, supervised and recognised under national law
- have as their primary purpose the provision of retirement benefits
- are exempted from the clearing obligations under their national law.

This is useful as UK pension schemes tend to use a number of EU banks which operate through branches rather than separate UK entities.

Update on FSCS protection of overseas members in risk transfer transactions

As discussed in our December 2024 briefing, the FSCS is a statutory compensation fund for customers of financial services firms authorised by the FCA or PRA. It may pay compensation to eligible customers of a financial services firm if that firm is unable, or likely to be unable, to pay claims against it, and is generally applicable to bulk annuity (buy-in) policies held by trustees and individual annuity (buy-out) policies held by members.

There has been growing concern in the market that the FSCS may not provide compensation for members who are resident outside the UK, the EEA, the Channel Islands or the Isle of Man. The Bank of England launched a consultation in April 2024 to address this concern by proposing amendments to the PRA handbook. In November 2024, the PRA published a policy statement in response to the consultation. The statement introduced a new residence test that refers to the habitual residence of the individual at the date they joined the occupational pension scheme. This is intended to clarify that individuals who become members of occupational pension schemes while they are resident in the UK, Gibraltar, the Channel Islands or the Isle of Man would benefit from FSCS protection even if they move to another country before an individual annuity (linked to that occupational pension scheme) is purchased following a buy-out.

We anticipate that these changes are likely to be helpful for most members in the (hopefully unlikely) scenario where the question of availability of FSCS protection arises. However, the PRA's approach does still potentially leave some questions unanswered, so further consideration may be needed at the point of buy-out as to whether to adopt the "two-stage" process discussed in our December 2024 briefing, as this may provide some additional protection in outlier cases.

PLSA publications on net zero and biodiversity

On 4 December 2024, the PLSA published the results of a survey on ESG-related issues. Findings include that:

- 65% of schemes have a net zero commitment in place. Among the third that don't, a further one in five schemes expect to implement one within five years
- 59% cite the lack of high-quality data, and 55% highlight uncertainty around Government policy as major barriers
- knowledge of the recommendations published by the Task Force on Nature-related Financial Disclosures is limited, with only 17% of respondents reporting a "strong familiarity" with them (see our publication "ESG beyond climate" for details of the recommendations).

The PLSA has also published a new guide to help enhance trustee understanding of biodiversity and nature-related risks and to help schemes address the challenges posed by these risks.

Risk transfer highlights 2024

We are delighted to share highlights of our 2024 risk transfer activity and anticipate that 2025 will be another busy year. We remain extremely active in all areas of the market and work on all types and size of transactions.

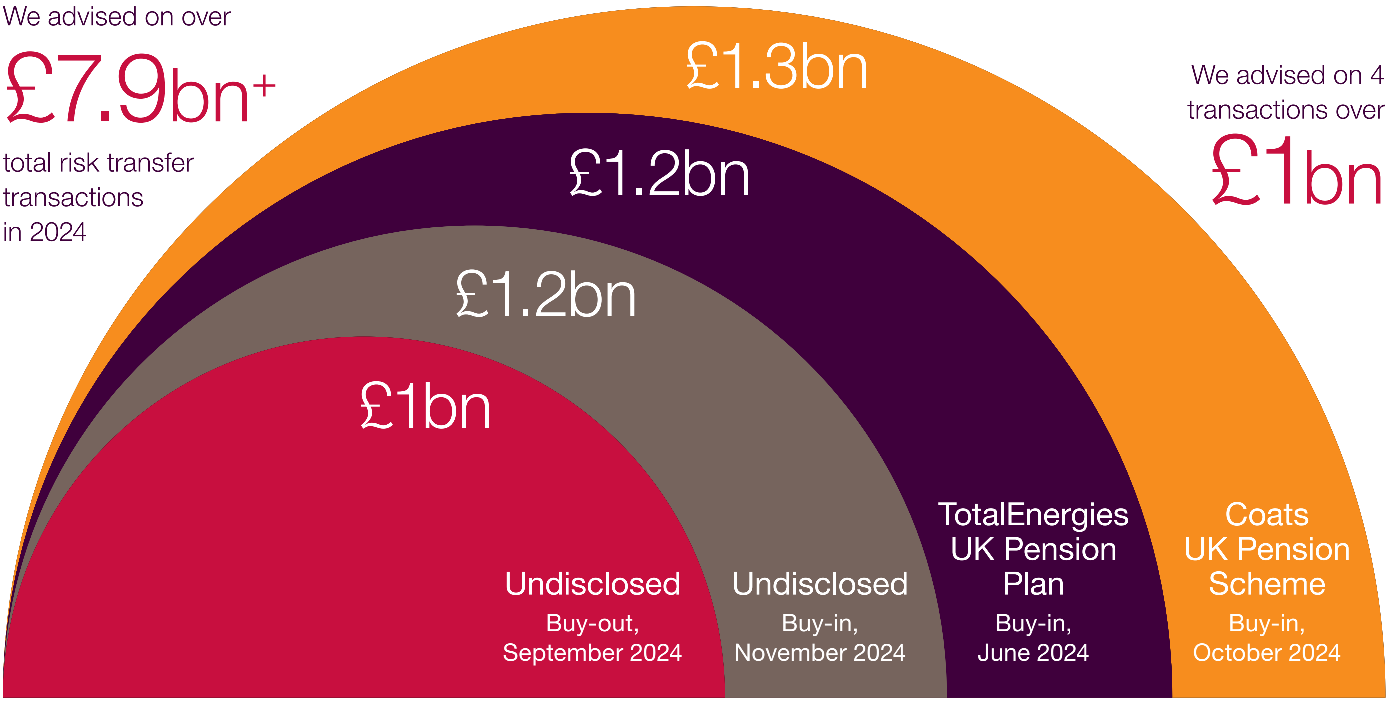
We advised on over

£7.9bn+

total risk transfer transactions in 2024

We advised on 4 transactions over

£1bn



Key highlights of 2024

14

We advised on 14 risk transfer transactions in 2024 of all sizes, including advising the **General Council of the Bar Pension and Life Assurance Fund** in a £20m buy-in, the first Pension Insurance Corporation Mosaic transaction for small schemes.

36

We act for 36 of the top 200 pensions funds in the UK.

41

As at February 2025, we are advising trustees on over 41 risk transfer transactions.

We continue to advise on longevity swap transactions which are becoming an increasingly practical and viable solution for schemes, including for smaller tranches of liability. In December 2024, we advised on a £340m longevity transaction for the **Airways Pension Scheme**.

We continue to advise trustees and employers, working with all major insurers and consultants in the market, as well as new entrants. We have extensive experience of collaborating closely with professional trustees in order to achieve the best possible outcome for members.

We have considerable experience in complex risk transfer transactions. Key features of transactions in 2024 included funding agreements, back-to-back loans, collateral arrangements, sale of illiquids and vendor due diligence in relation to residual risk cover.

Sackers

Contact

Sackers is the UK's leading commercial law firm for pension scheme trustees, employers and providers. Over 70 lawyers focus on pensions and its related areas, including Sackers finance and investment group, a team of lawyers who provide cutting-edge advice on all aspects of pension scheme finance and investment.

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