

Pensions Stability Buffer

Reducing the risk of a trapped surplus



An increasing number of sponsors are becoming concerned about the risk of trapped surplus in their defined benefit pension schemes. Trapped surpluses, which can be difficult and costly for sponsors to recover, are an inefficient use of business resources. That's why many sponsors are looking to establish an alternative funding vehicle outside of their pension scheme which can act as a funding buffer ensuring security for the trustees whilst meeting the sponsor's requirements.

A survey of Aon clients showed that, on a best estimate basis, 30% were substantially above 100% funded while 42% of them were around 100% funded. Similarly, when viewed on an accounting basis, around 25% of FTSE350 schemes are now over 100% funded.

Benefits of the Pensions Stability Buffer

The primary benefits that may be gained from establishing a strategy like Aon's Pensions Stability Buffer include:

For scheme sponsors

- The flexibility to return excess contributions to the scheme sponsor
- Reducing substantially the risk of a trapped surplus within your defined benefit scheme


For trustees

- The scheme sponsor to contribute more by reducing the risk that excess contributions will be lost
- Having access to a wide range of investment options via Aon's Delegated Consulting Service (when compared to a traditional escrow arrangement).

The Pensions Stability Buffer has been developed by Aon in collaboration with Eversheds. It provides a complete service for those wanting to establish an easy and efficient funding vehicle to reduce the risk of a trapped surplus. Combining Aon's and Eversheds' many years of experience advising on alternative funding vehicles, assets are securely held within a charged custody account. Aon advises and implements the strategy whilst Eversheds provides legal input. Our template documentation (which includes pre-agreed terms with a custodian) means that you will not be re-inventing the wheel, making this a cost-effective and efficient solution.

Who is more likely to need a buffer?

Individual circumstances will dictate which pension schemes should be most concerned about a trapped surplus. However, the key circumstances are summarised in the table below:

	Scheme rules	Scheme status	Company tax status	Investment strategy	Funding target
 <p>More likely to need a buffer</p> <p>Less likely to need a buffer</p>	Refunds not permitted	Frozen DB scheme	Don't pay tax	High target return, Low hedging, No de-risking triggers	Well funded and prudent funding target
	Require/allow benefit improvements before refund	DB scheme closed to new entrants	Expects to pay tax in future	Medium target return, Low hedging, No de-risking triggers	Prudent funding target
	Refunds permitted	Open DB scheme or DC section in same trust (with ability to cross subsidise)	Expects to always pay tax	Low target return, High hedging, Has de-risking triggers	Poorly funded and weak funding target

Key features of the Pensions Stability Buffer

The Pensions Stability Buffer includes the following key elements:

- Free initial meeting with Aon or Eversheds to assess whether the Pensions Stability Buffer is appropriate or whether another funding strategy or alternative financing solution may be more suitable
- Comprehensive advice regarding the appropriate triggers for funds to be released to the scheme or returned to the sponsor
- Investment advice from Aon on how to invest the assets held in the custody account
- Flexibility to adopt template or bespoke legal documents according to your requirements
- Flexibility to adopt pre-agreed legal documentation with the custodian, enabling a cost effective, 'fast-track' set up process, or the ability to undertake a bespoke investment approach.

In addition, the following optional elements are also available:

- Aon assisting your team with the company accounting treatment
- Eversheds' advice on the tax treatment of the buffer, alternative trust structures to achieve the buffer and the impact on other banking and security arrangements
- Aon's detailed modelling on the net present value of the buffer and its alternatives.

Advantages for you

These features ensure that you benefit in the following ways:

- A cost effective process, with cost predictability via competitive fixed fees for the key elements
- A more efficient and shorter implementation process than is often seen
- The ability to invest in a wide range of asset classes.

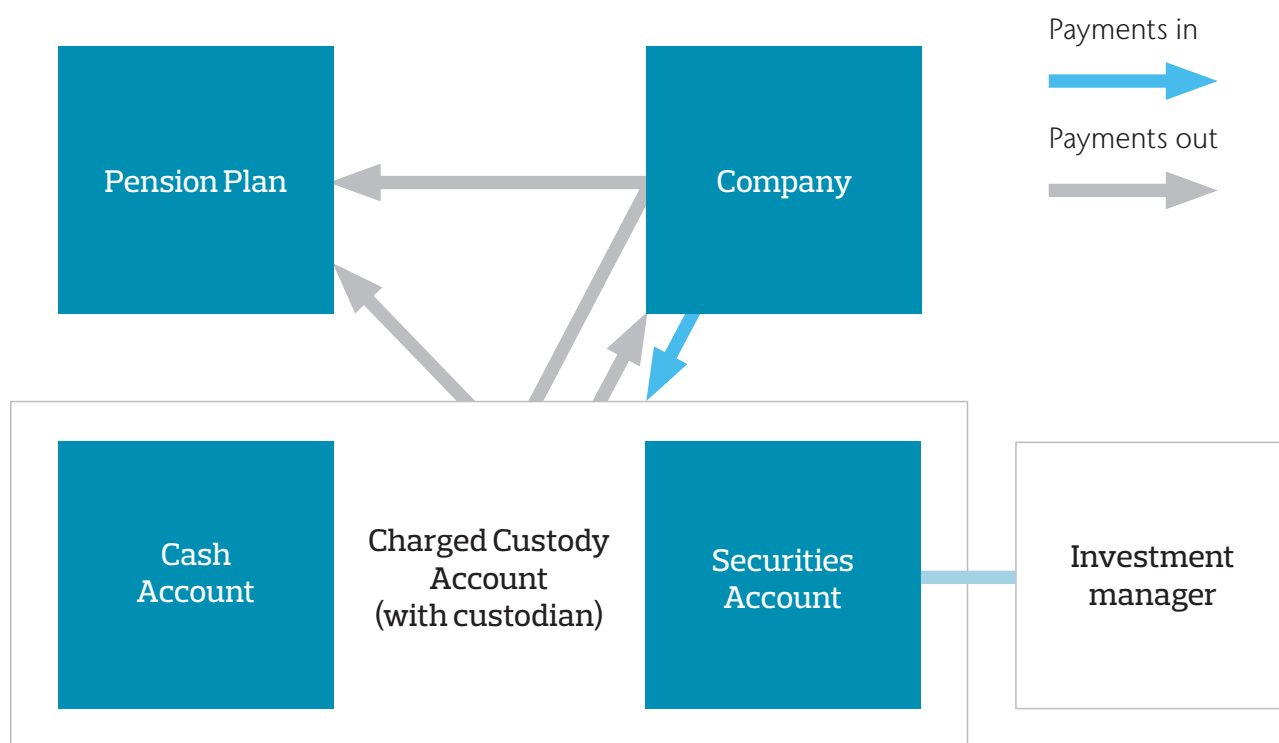
There is also flexibility for you to choose which elements of the service you need and what support you require to suit your particular requirements.

Pensions Stability Buffer Process

We follow a clearly defined process with the potential barriers considered early to avoid wasting time and money. Optional investigations in Phase 2 depend on the complexity of the triggers being considered.

Phase 1	Phase 2		Phase 3
Planning	Optional - Analysis and advice	Negotiation with Trustees	Implementation
Free initial meeting to assess whether the Pensions Stability Buffer is appropriate or whether another funding vehicle or alternative financing solution may be more suitable.	Company accounting treatment.	Finalisation of the role of the buffer in any other negotiations, for example, to help resolve a scheme funding negotiation, M&A transaction or pension scheme merger.	Update template legal documentation to reflect agreement between sponsor and Trustees.
Agreement in principle that there is interest in proceeding, including deciding how to approach the Trustees.	Detailed modelling of the net present value of the structure and alternatives (allowing for tax, triggers and the sponsor's internal rate of return). Agreement of proposed triggers.	Negotiation of the triggers for payments either to the pension scheme or back to the sponsor.	Appointment of custodian on pre-agreed terms.
Identifying whether optional elements are required.	Advice on tax treatment.	Decide on appropriate investment strategy.	Ability to invest through Aon Hewitt's Delegated Consulting Services.
	Advice on the impact on other banking and security arrangements.	Decide on ongoing control of investment strategy.	Co-ordination with timing of other projects e.g. valuation, M&A or scheme merger.

Structure of the Pensions Stability Buffer



Aon and Eversheds – experience, expertise and flexibility

Aon is a leading adviser on a wide range of alternative financing solutions, including developing the use of surety bonds. Aon's specialist Alternative Financing team have researched the area of funding strategies, such as the Pensions Stability Buffer, and a detailed White Paper is available on request on what self-sufficiency might mean and how a funding buffer can help achieve Pensions Stability.

Eversheds has the largest team of specialist pension and financial services lawyers in the UK, with in depth knowledge of pensions, investment, banking and tax law. Eversheds regularly advises on a wide range of alternative funding solutions including asset backed contribution structures, escrow accounts and funding trusts, parent company guarantees (UK and international) and charges over assets.

Together, Aon and Eversheds have the capacity to provide as much support as you require but we can also work flexibly to provide the support that you need.

Contacts

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