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PENSION BUYOUTS: WHAT CAN WE LEARN FROM THE UK EXPERIENCE?

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Managing (or at least slowing) the decline of private defined benefit (DB) pensions has been a top priority for US policymakers. Any market-related developments or regulatory changes that alter the provision or sustainability of private DB pensions in other countries are thus relevant to policy and worth understanding. One such development taking place in the United Kingdom, pension fund buyouts, has enjoyed measured success.

A DB pension buyout refers to a transaction in which a pension plan sponsor pays another company a fee to take over the assets and liabilities of the pension plan. Clearly such transactions are relevant to the provision and long-term sustainability of this institution. So, while the increasing popularity of these transactions is restricted to the UK, the market has garnered the attention of US financial services firms, plan sponsors and policymakers.

This paper analyzes the growing market for DB pension buyouts in the UK and considers its implications for the US. It contributes to our understanding of the future prospects for employer-sponsored DB pensions, and how they will contribute to retirement income over time. To achieve its objectives, this paper adopts a multi-method approach grounded in qualitative, interview-based techniques and case studies. The interview findings are cross-checked with other situated accounts and empirical data through a process known as triangulation, thereby conferring credibility to the proffered conceptual arguments that drive the paper's logic. Still, rigor requires elite-level access, as only the testimony of key stakeholders and decision-makers will afford confidence in the discussion and empirical findings. Accordingly, the observations that underpin the paper's analysis were collected during interviews with 37 individuals across 27 organizations in New York, Washington, D.C. and the greater London area.

The paper has several findings of relevance. First, it shows that, in the UK, pension buyouts were originally for sponsors facing insolvency; the buyout was a mechanism to lock in payment of as much of the pension as possible before the firm simply disappeared. However, the added burdens created by the 2004 Pensions Act and new accounting rules in 2005 drove solvent firms to offload their liabilities. Seeing this as a potential gold rush, new mono-line insurance companies, designed exclusively for buyouts, flooded the market with supply. Compared to the £1-2 billion in annual transactional volume that marked the pre-Pensions Act era, the UK market was £8 billion in 2008. Consequently, the price of buyouts came down dramatically, making plan sponsors all the more interested in getting rid of the liability of their DB plans.

Second, the paper analyzes the two sides of the solvent buyout market: insured and non-insured. By illustrating the changing nature of demand and supply through a comparison of the two types of buyouts, the paper further crystallizes the role for solvent buyouts in the UK economy: these transactions offer firms a mechanism to offload a burdensome liability, all the while living up to their pension obligation. While non-insured buyouts were a source of controversy, solvent buyouts of the insured variety saw their popularity spike in 2008.

Finally, the paper finds the outlook for solvent buyouts to be mixed. Beyond the few transactions in 2007, the non-insured buyout market appears to be stillborn. However, the experimentation and innovation within the buyout market has continued apace, allowing for ongoing growth in insured buyouts. Indeed, phased buyouts, bulk transfers, partial-buyouts and especially buy-ins are all bespoke insured buyouts available to plan sponsors that help to circumvent the original insured limitations that led to the non-insured experiments. As such, while current market conditions are not favorable, the long-term prospects for insured buyouts are quite good. The increasing burden of the DB pension plan for plan sponsors seems to assure this market's ongoing vibrancy.

Those concerned about the future of private DB pensions should therefore remain interested in the UK pension buyout market. In a sense, the rise of solvent buyouts is a direct response to the increasingly burdensome nature of DB pensions, and the popularity of buyouts is a barometer for the unpopularity of private DB pensions.

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