

# Pre-transaction planning: Getting asset-ready

## Preparing scheme assets for an insurance transaction is one of the key steps trustees need to take to get their schemes ready to go to market, but what does this mean in practice?

There are several key considerations that go beyond the value of the assets required to pay an insurance premium.

### Should/can the assets of the scheme be reshaped to make them more suitable for an insurance transaction?

Many smaller transactions have a premium that is paid in cash and gilts only. Often, schemes will have such assets as part of their asset portfolio. Larger transactions may have a premium that can also be paid using corporate bonds, synthetics (such as derivatives) and other more complex assets.

If the assets of the scheme need to be transitioned, who will do this? It could be an existing manager, or the trustee may need to appoint a dedicated transition manager. In either case, trustees should liaise with their investment and legal advisers to prepare a transition plan. Where possible, early engagement with the insurer can help to ensure that when the scheme enters price-lock, its assets are in good shape.

A note of caution here is what happens if the transaction does not go ahead for any reason? Are the transitioned assets the sort that trustees would want to hold long term? Would they be suitable for transacting with a different insurer?

### Can the assets be transferred to the insurer, and will the insurer want those assets?

Scheme assets will be subject to pensions-specific regulations, which insurers are not subject to. Similarly, the assets of an insurer will be subject to insurer-specific regulations, which pension schemes are not subject to. This impacts the desirability of certain types of assets from an insurer perspective and whether an insurer will want to hold assets itself for the longer term. This, in turn, can have pricing implications. Whilst trustees don't need to have a detailed understanding of the regulatory and capital requirements of the insurer, having a working understanding will help to assist in a smooth transaction, and might also inform the decisions that are taken to re-shape assets pre-transaction.

### How will the assets be transferred to the insurer, or realised for cash?

Assets held directly, albeit in custody, can normally be transferred to an insurer on instruction. However, there will be different requirements and settlement periods for different types of assets. Trustees should ensure they have a detailed plan for the asset transfer process, as well as a contingency plan to deal with any assets that fail to transfer.

For assets that need to be sold in advance of an insurance transaction, how will this value be realised? For investments held indirectly, for example in a pooled fund, trustees are unlikely to have any rights in respect of the underlying asset and so will need to redeem their fund interest instead.

This will require consideration of the permitted redemption dates as well as any restrictions on the number of interests that can be redeemed on any date. For synthetic assets (for example derivatives used as part of a scheme's LDI strategy), often these will need to be 'closed out' for a cash value, which will require advance engagement with counterparties.

### Illiquid fund assets – case study

A key focus in recent years has been in relation to illiquid fund interests held by pension schemes (e.g. in private equity or private credit). Many insurers are reluctant to accept such assets, meaning that trustees will need to arrange a sale in what is known as the secondaries market.

Trustees are unlikely to have a unilateral right to sell an illiquid asset and so will need to engage with the relevant manager to obtain its consent. In advance, the transfer provisions (and any conditions that apply) and any applicable restrictions will need to be considered. These may include other investors having a right of first refusal or a right of first offer. There may also be restrictions on who the asset can be sold to, limiting the number of potential buyers for the asset.

Trustees may wish to appoint a specialist third-party broker to help with marketing the illiquid asset, providing advice on valuation (because it is unlikely that there will be a public price) and to support the transfer of the illiquid asset.

Once a buyer has been sourced, and consent has been obtained from the manager, a secondaries transaction operates like a mini M&A transaction. There will be various transfer documents and, importantly, a sale and purchase agreement, which will deal with considerations such as any liabilities retained by the trustees and the taxes that are payable.

A final practical point to note is that it is likely to be challenging to sell an illiquid asset during any price-lock period. This should be factored in



through early engagement or, in certain cases, by reaching agreement with the insurer to defer a portion of the consideration payable until the asset is sold.

#### **Surplus assets on wind-up – a nice problem to have?**

Having done the hard work to ensure that assets are transaction-ready, what happens if trustees end up having more than they need? Dealing with a surplus on wind-up is something that an increasing number of trustees are having to get to grips with.

There is no one-size-fits-all solution, and the options available in relation to use of surplus will depend on a number of factors. Some key issues to consider are:

- **Is there really a surplus?** Trustees and sponsors will want to have a clear picture of the likely amount of any surplus, after taking into account expected expenses, premium adjustment or other contingency that may be needed to deal with data cleanse or other benefit issues.

- **Who owns the surplus?** What scheme rules say on this point will be key, but reputational risk can also play a part in shaping any agreement about how surplus is used. It is a legal requirement that members must be notified about any proposal to return surplus to an employer on wind-up and given an opportunity to make representations. Experience to date indicates that some trustees and sponsors are open to revising proposals about how surplus is used in response to feedback from members.

- **Benefit augmentations** Trustees and sponsors might want to consider whether part or all of any surplus could be used to augment member benefits. Scheme rules should be reviewed carefully when weighing up this option.

Careful planning is needed to decide what form a benefit augmentation will take and when. A key consideration for trustees will be ensuring value and fairness between different cohorts of members. Other factors (including potential tax implications) may also be relevant to the shape of benefits provided.

Trustees don't necessarily have to

pin down details of any augmentations at the point of transacting, but if benefit augmentations are likely in future, it is advisable to build flexibility into the contract terms agreed with any insurer upfront so that these can be reflected in the benefits secured at buyout.

- **Payment of surplus to an employer** Where surplus is being returned to a sponsor, the timing of any payment will be important to ensure that the scheme retains sufficient assets to cover the costs of buyout and wind-up. Return of surplus does not always need to take the form of a cash payment. Different considerations (including in relation to tax)

will apply if surplus is being returned in other forms, for example, through transfer of an illiquid asset.

For trustees preparing for an insurance transaction, the message is clear: plan ahead. Ensuring that scheme assets are of the right type and in the right place at the right time will be key to ensuring that a scheme is in the best possible position to transact.



➤ **Written by Joseph Wren, Partner, Travers Smith (Derivatives & Structure Products) & Niamh Hamlyn, Partner, Travers Smith (Pensions)**

➤ **Other key contacts**  
**Susie Daykin, Partner and Head of Pensions, Travers Smith**  
**Chris Widdison, Partner, Travers Smith (Pensions)**

In association with

**TRAVERS  
SMITH**