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Pension captives - An alternative endgame solution?

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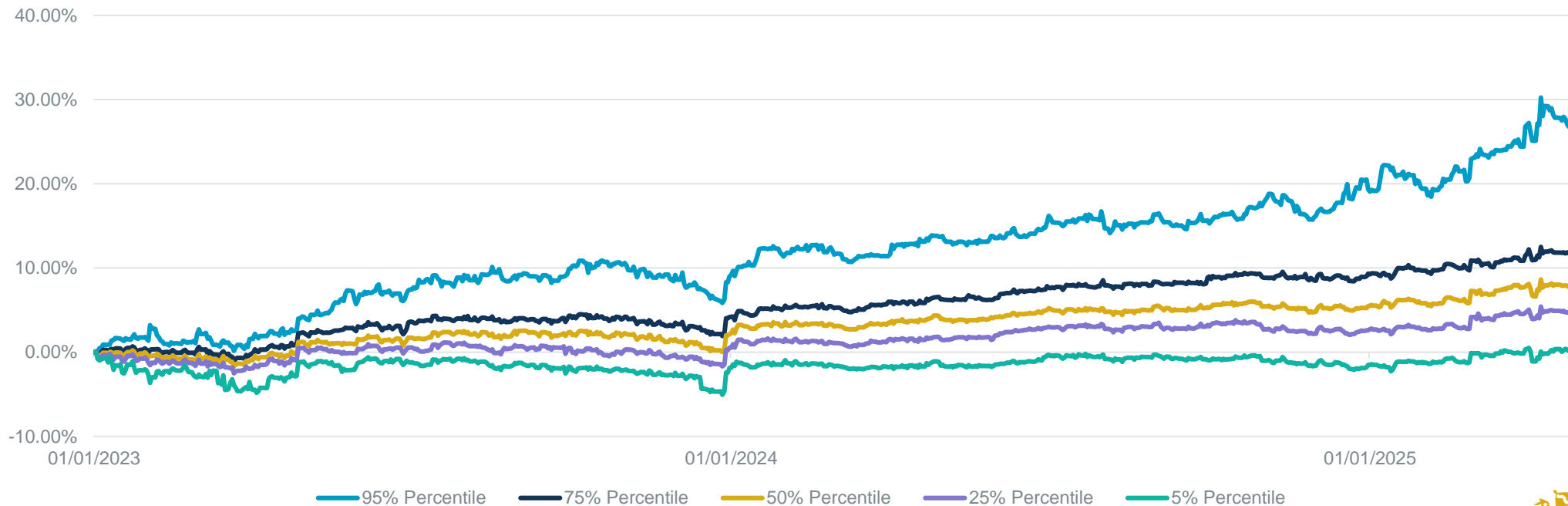
The Road to DB Endgame

03 July 2025

UK pensions industry is at a seminal moment

Many UK DB pension schemes have seen significant improvements in buy-out funding level and are now (or could soon be) fully-funded or within sponsor “cheque-writing” distance of buy-out.

This has led to increased demand for full-scheme bulk annuities but **also increased demand for alternatives to buy-out** from those sponsors who want a different endgame.



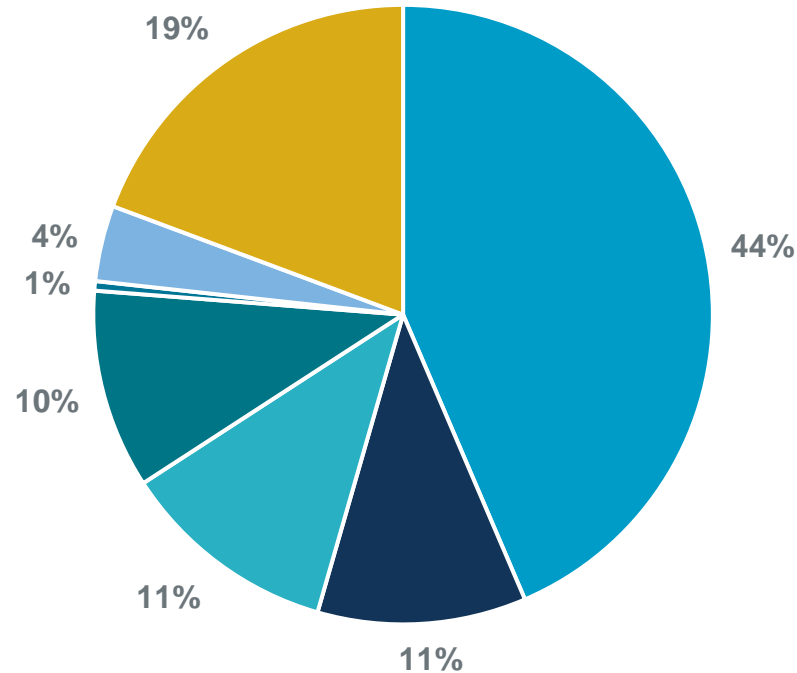
Median
funding level
Improvement
of **c.9%**

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Headlines from Aon's 2025 DB Endgame Survey



- Buy-out or full buy-in (once affordable)
- Run-on to complete settlement readiness actions with a view to buy-out when ready
- Run-on for a period beyond that needed for settlement then consider buy out in future
- Run-on indefinitely
- Commercial consolidator/Superfund
- Deliberately staying flexible
- Undecided

Around **23%** of schemes described themselves as either **undecided** or **deliberately staying flexible** (up from 11% in our 2024 survey).

Of the **remainder 77% of schemes** surveyed that have reached a view on their endgame:

- **71% intend to insure their plan** once affordable or once settlement readiness actions (e.g. data cleanse, GMP equalisation, addressing illiquid assets) have completed (compared with 83% in our 2024 survey)
- **28% intend to run-on beyond the point needed for settlement readiness** (up from 17% in our 2024 survey)
- **1%** plan to transfer benefits to a **Superfund/commercial consolidator**.

Of the 28% planning to run-on beyond the point needed for settlement readiness, **around half** describe themselves as **running-on indefinitely** as opposed to running-on for a finite period beyond that needed for risk settlement readiness.



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DB Endgames

Endgame strategy is a plan for how benefits will be provided in the long-term. The main options are below.

Buy-out or full insurance	Superfund	Captive	Active run-on	Self-sufficiency
<p>Insurer takes responsibility for providing member's benefits. Two-step process of purchasing insurance policy as scheme asset ("buy-in") followed by direct insurer-to-member contract ("buy-out").</p> <p>Helps to ensure members benefits are secure - relieves sponsor and trustees of duty to manage scheme.</p>	<p>Full scheme transfer into sectionalised pension scheme within a regulated UK superfund (or alternative consolidator), subject to meeting TPR's gateway tests.</p> <p>Additional capital provided by superfund at outset to help to protect members' benefits.</p> <p>Passes risk and governance to superfund.</p>	<p>Buy-out (or buy-in) to sponsor's own captive insurer.</p> <p>For members, this is a buy-out (or buy-in) with a regulated fronting insurer.</p> <p>For sponsors, captive structure enables value extraction and greater corporate control.</p>	<p>Run scheme beyond full funding in a risk-controlled way.</p> <p>Aims to deliver additional value to members and sponsors.</p> <p>Active run-on can be for a short or long term.</p> <p>Run-on is not a one-time decision, as most schemes will eventually buy out.</p>	<p>Run scheme on with focus on delivering core member benefits, rather than seeking to deliver additional value.</p> <p>Can include securing member benefits through buy-ins.</p> <p>Can be short-term or long-term.</p>



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Deep Dive into Pension Captives

03 July 2025

What is a fronted pension captive?

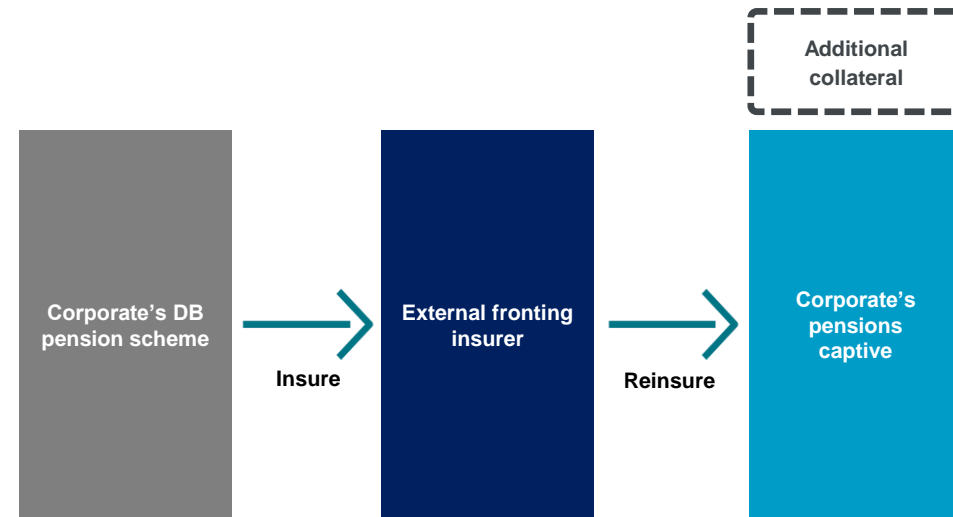
Trustees of corporate's Defined Benefit (DB) pension scheme purchase bulk annuity from external fronting insurer in regulated bulk annuity market

For a fee, external fronting insurer reinsures DB liabilities to corporate's captive

DB assets transfer to captive as reinsurance premium. Additional collateral provided by corporate as security for external fronting insurer e.g. surety bonds

Over time, captive expects to crystallise profit comparable to an insurer's expected profit, released from captive back to corporate. Corporate also retains risk of downside.

External fronting insurer is still responsible for paying pensions. Collateral ensures external fronting insurer takes on fully-funded DB liabilities if captive is terminated

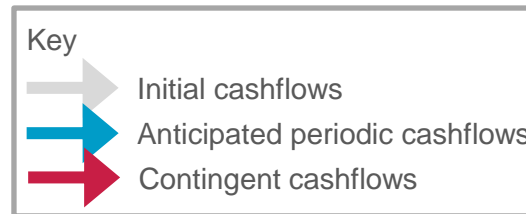
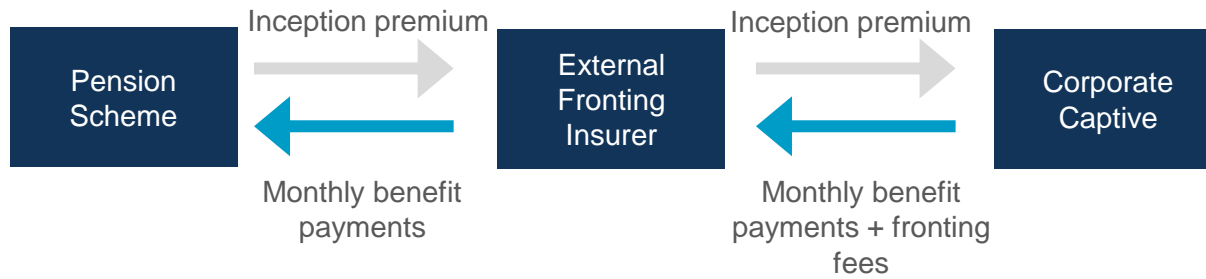


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Captive Structure

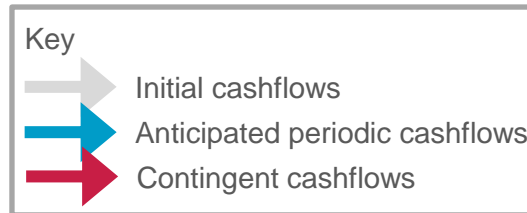
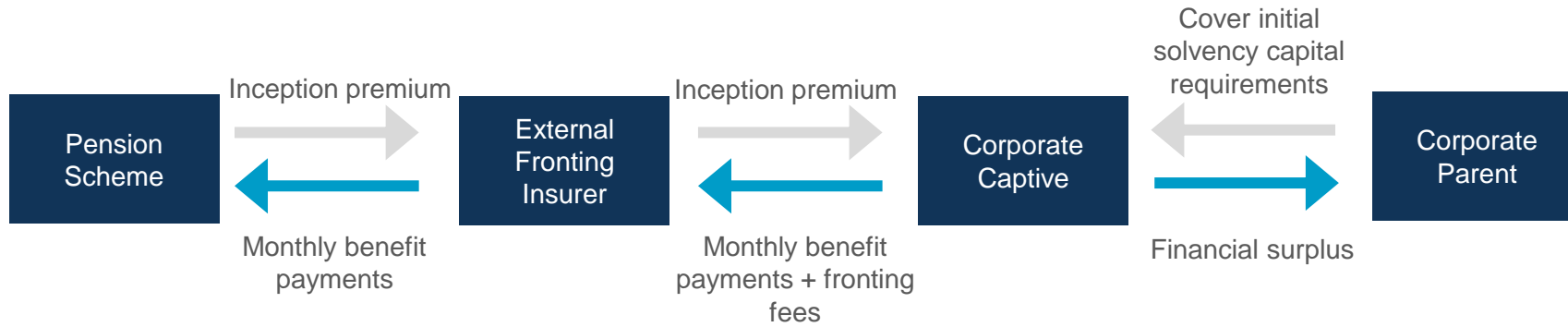


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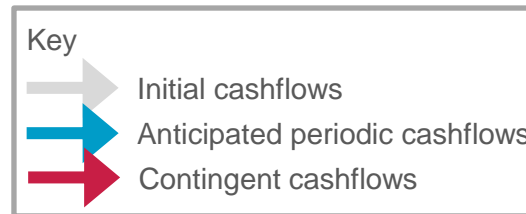
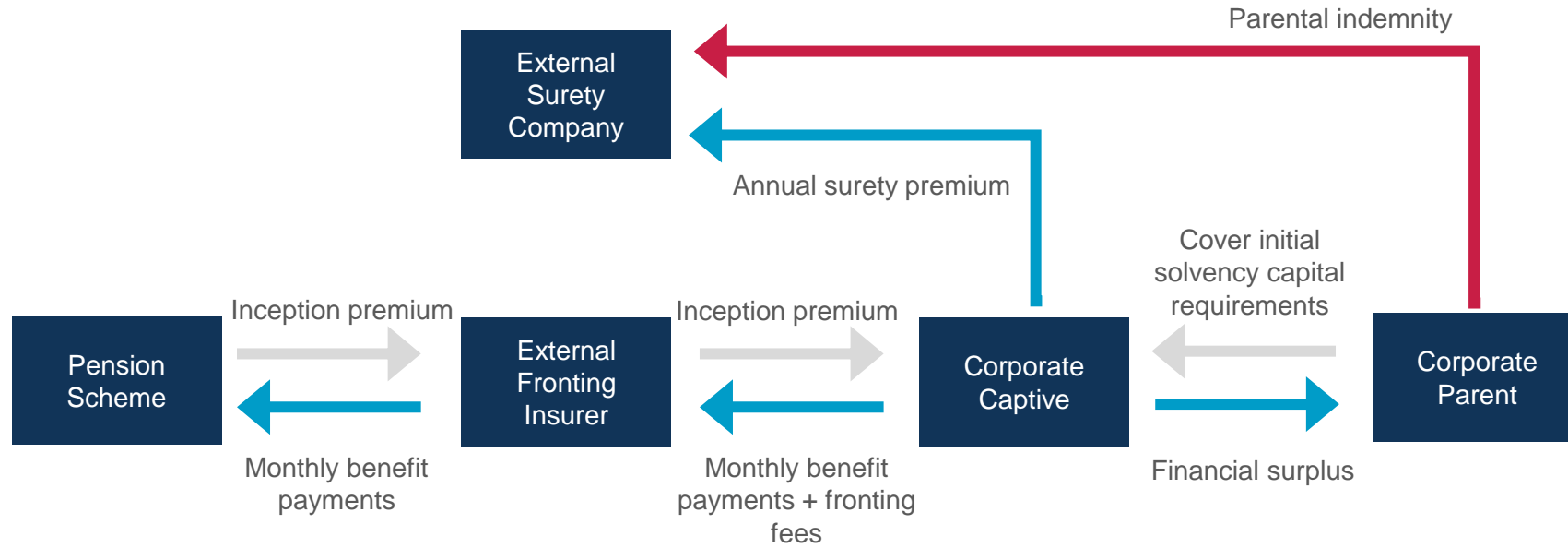
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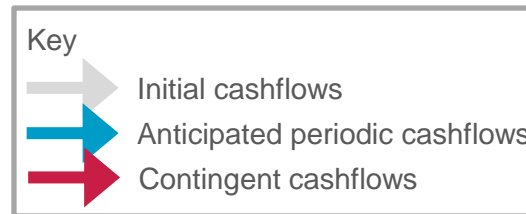
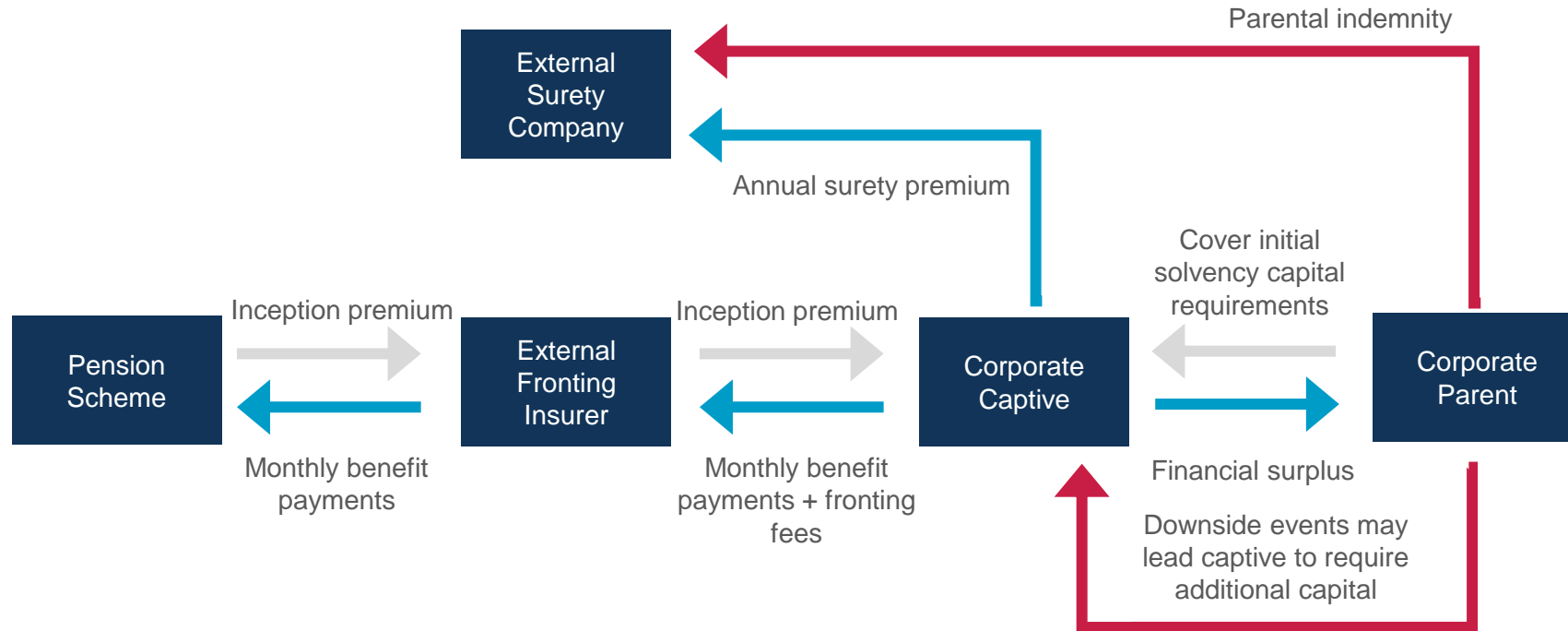
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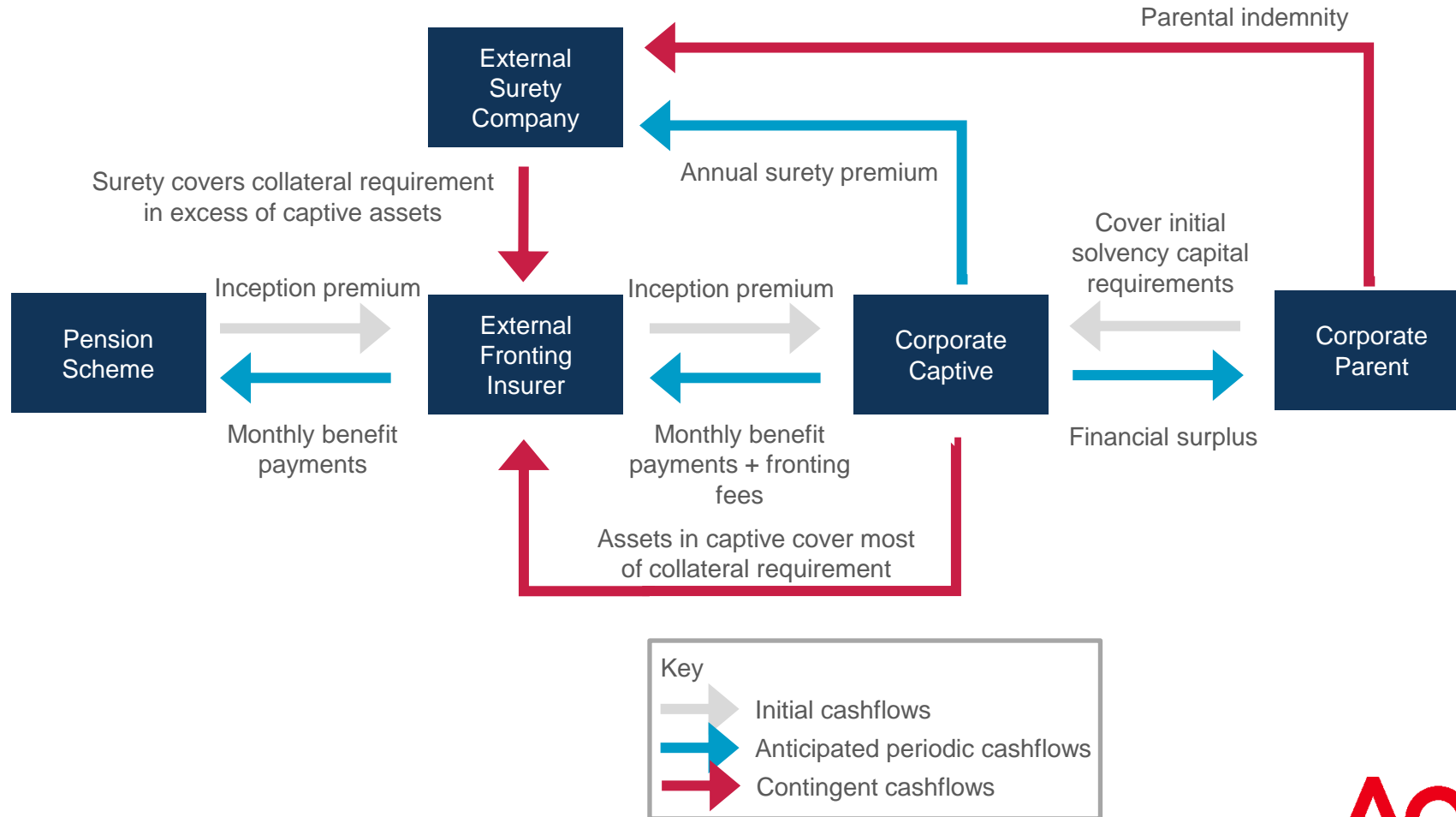
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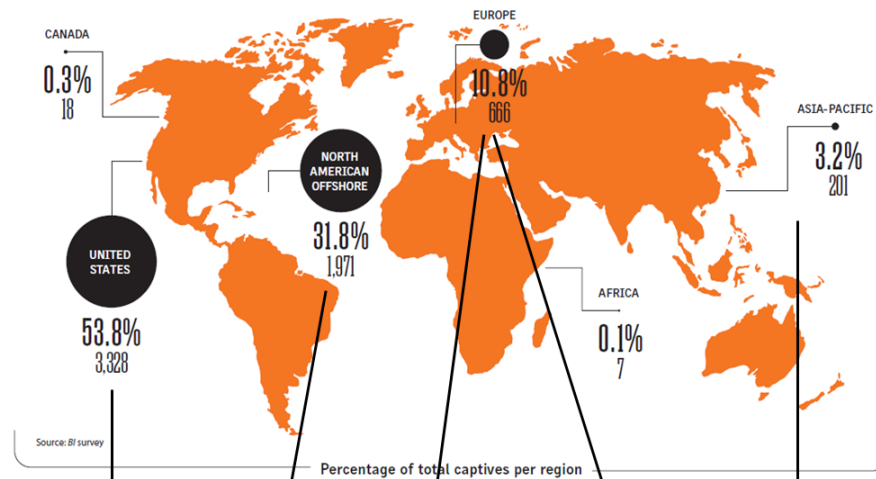
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Captive Structure



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Captive Domiciles



	USA	Offshore N. America	Onshore Europe	Offshore Europe	Asia Pacific
Regulatory Framework	●	●	●	●	●
Developed Infrastructure	●	●	●	●	●
Capital & Solvency	●	●	●	●	●
Equalisation Reserves	●	●	●	●	●

Common shortlisted domiciles

- **Bermuda** – One of the world’s largest domiciles by captive numbers and longest established. Has licence classes that give the potential for Solvency II equivalence.
- **Guernsey** – The most popular domicile for UK companies and the largest European domicile. It is outside Solvency II.
- **Isle of Man** – A European domicile outside the Solvency II regulatory framework that has a substantial life insurance sector.
- **Malta** - Within Solvency II with a relatively small captive sector but with some high-profile captive owners. Offers PCC legislation
- **Luxembourg** – Within Solvency II and one of Europe’s largest domiciles by captive numbers.
- **Vermont** – The world’s largest domicile by captive numbers and offering captive-specific regulations.

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Benefits and Considerations

Benefits to Parent Companies



Unlock economic value

- Emerging captive surplus
- Any Day 1 captive surplus



More corporate control

- Investment objectives
- Risk management



More efficiency

- Less governance in captives than pensions
- Compliments wider captive strategy
- Leverage in-house capabilities



Secure DB scheme members' benefits

- Fronting insurer is fully responsible for benefits
- Giving the same security as a regular bulk annuity

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Further Considerations

	Regular buy-in/out	Captive buy-in/out
Considerations	<ul style="list-style-type: none"> • Passes material economic value to 3rd party insurer • Forgoes expected future surplus • Possible P&L implications • Effectively irreversible 	<ul style="list-style-type: none"> • Relatively complex • May require additional capital to enable transaction • Remain exposed to investment and demographic risks • Exposed to a level of regulatory risk in chosen captive domicile • Irreversible (but can be flipped to buyout via recapture)
Overview of key risks	<ul style="list-style-type: none"> • Removes almost all risk from corporate balance sheet • Residual risks may remain after buy-out • Allows members' benefits to be secured with external insurer with backing of Financial Services Compensation Scheme 	<ul style="list-style-type: none"> • Corporate still exposed to investment and demographic risks comparable to those in the pension scheme. • Downside or stress scenarios may mean further top-up to the captive • Allows members' benefits to be secured with external insurer with backing of Financial Services Compensation Scheme

Practical considerations for a pension captive:

- Requires agreement and active participation of the trustees.
- Significant work on scheme data, scheme benefits and scheme assets ahead of a transaction.
- The corporate will need to consider the financial, regulatory and operational requirements of the new captive.
- A pension captive transaction requires a fronting insurer willing to participate in the transaction.



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Case Study

Headlines From Pension Captive Deal Completed in January 2024

- Large multi-national now has a pension captive in Bermuda
- £1Bn of UK liabilities across two DB schemes
- Largest ever 'full-scheme' pensions captive deal for UK liabilities
- First pensions captive deal to use surety bonds
- Significant DB scheme surplus to be refunded to corporate
- Significant cash distributions from captive to corporate expected
- Operational control and efficiencies from aggregation and scale
- No different to regular buy-in / buy-out for Trustees and members

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Summary

Continued engagement and innovation around endgame solutions from BPA insurers is required for strong member outcomes.

A cross disciplinary understanding of different specialisms is required for successful execution.

With larger schemes more likely to consider run on for longer, pension captives offer an attractive middle ground.

With captives set up around the globe an understanding of different regulatory frameworks is required for successful execution.

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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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