HYMANS ROBERTSON

Accounting for buy-ins and buy-outs

This publication summaries some of the key themes and Q&A from our recent webinar on the company accounting treatment for risk transfer transactions. A recording can be found here of the webinar where James Mullins (Head of the Hymans Robertson Risk Transfer team) and Leonard Bowman (Head of Corporate DB Endgame Strategy) were joined by David Cummings (Head of Technical Accounting at KPMG) to discuss the various treatments.

Partial buy-ins and buy-outs

As covered in the webinar, a working assumption under UK and International GAAP is that the accounting impact of

- a partial buy-in will result in a balance sheet adjustment that will come through Other Comprehensive Income ("OCI")
- a scheme buy-out will be treated as a settlement event and the impact would come through the Profit and Loss ("P&L").

Whole scheme buy-ins, the grey area

Under UK and International accounting standards the accounting treatment under a partial buy-in or whole scheme buy-out is fairly clear cut. However, the treatment of a whole scheme buy-in can be less clear cut.

The treatment of a whole scheme buy-in will be dependent on your auditor's views but will also usually be driven by whether the transaction is seen as an investment decision to reduce risk or as a short-term stepping stone to full buy-out and therefore settlement of the liabilities.

Some of the themes that emerged from the webinar and follow up Q&A around this grey area were:

Memorandum of understanding

A company and trustee Memorandum of Understanding ("MoU") can be put in place to make it clear the company and the trustee are aligned that no decision has been taken to move to buy-out and such a decision to convert the buy-in to a buy-out policy will not be taken for at least a minimum period of time. However, there needs to be a rationale for that decision, that goes beyond avoiding an unwelcome P&L impact on the company accounts.

There may be various legitimate reasons for such an MoU, for example to provide a window of time to resolve issues around discretionary benefits, but this would need to be thought through and articulated at the outset.

There are no hard and fast timeframes that a MoU would need to apply for, but a minimum of 3 years would seem to be a sensible starting point, albeit your auditor's views will be critical.

Do not insure all the liabilities

There may be very practical reasons not to insure all of the scheme's liabilities, for example future accrual of benefits is still continuing or retention of benefit linkage to future salary increases for some members. It was discussed on the webinar that, even where a scheme does not have active or active-deferred members, perhaps if at least 10% of liabilities were excluded from the buy-in this may be sufficient to demonstrate this is not a settlement.

The question was raised whether schemes entering buy-in before equalising GMPs could be argued as not being close to settlement, as the benefits being insured were not the final benefits that would be bought out and were still being finalised. The view on the webinar was this would not be considered to be a legitimate argument as all schemes needed to comply with the equalisation court rulings and could be factored easily into a buy-out process.

The audit trail matters

Auditors will ask for evidence from trustee and company meeting minutes, advice papers and project plans to ascertain the thinking and intentions of the buy-in and whether there is a plan to see it as a route to settlement. It is therefore important that all records accurately reflect the decision making process.

Key takeaways

1. The accounting implications of a risk transfer exercise can be material to a company and can therefore cause issues in a planned transaction.
2. Most accounting issues can be managed with sufficient warning and planning.
3. Early engagement on the question of accounting treatment, by working with the advisers and the company auditors, is essential.

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