

RISK TRANSFER JOURNEY PLANNING

Q2 | 2022

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Buyout and other endgame options

Welcome to Quantum Advisory's Q1 2022 Journey Plan newsletter. Each quarter, our risk transfer team will bring you details of market pricing on buy-in, buyout and consolidation vehicles. As the name suggests, we manage schemes and their journey towards an ultimate aim of securing all benefits. Along the way we will share our insights and knowledge helping schemes manage their risk transfer issues and get "buyout ready".

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- An update on buyout pricing
- A recent Quantum case study
- Advice for Trustees setting buyout as their long-term objective

Buyout pricing update

Market background – financial drivers

The first quarter of 2022 was a volatile period for markets, particularly during March, and gilt and corporate bond yields rose significantly by around 0.7% - 0.8% pa. Market implied inflation also rose by around 0.3% pa. The net impact was lower insurer pricing for all benefits, but especially benefits without inflation linkage.

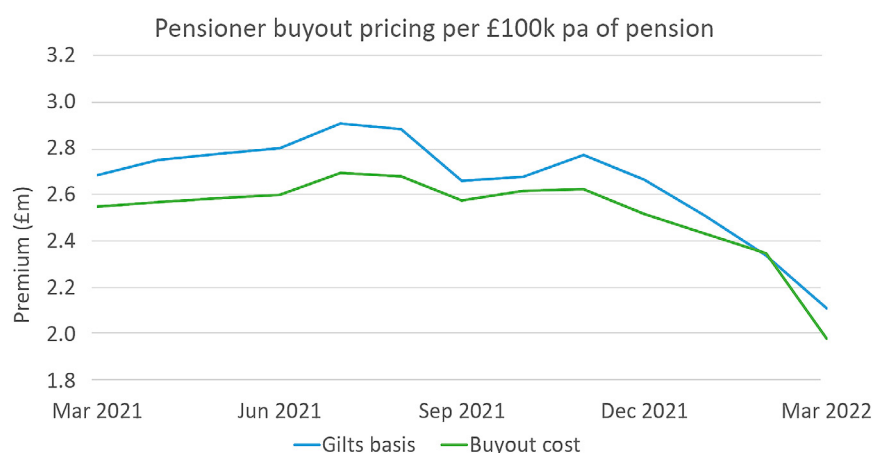
On the asset side, both equities and bonds ended the quarter at a lower level than when they started. The impact on individual schemes will depend on their asset allocation, with almost all schemes seeing falls in asset values.

Pricing update and de-risking opportunities

The below chart shows that insurer pricing relative to gilts has become slightly more expensive over the last year (shown by the narrowing gap between the blue and green lines). Buy-ins for pensioners are available at around 5% less than the cost of funding the same benefits with a portfolio of gilts. A pension scheme looking to buy bulk annuities as a cash buyer will see this pricing as more attractive than a year ago because prices have come down in absolute terms.

The difference between liabilities on a gilts basis and the buy-in/buyout cost (the difference between the blue and green lines) offers an opportunity for schemes with a large proportion of gilts backing their pensioner liabilities to reduce risk for little, if any, cost.

Pricing for deferred members remains higher than for pensioners because of the additional risks they represent for an insurer. A scheme looking to sell gilts to fund a deferred member buy-in would still need to find an additional c10% on top of the value of the gilts.



A recent Quantum Case Study Leading manufacturer of electronic components



Background

The Scheme was in surplus on a proxy buyout funding basis. The Trustees' primary objective was to buyout the Scheme within 12 months. In the meantime, the Trustees wished to reduce risk within the Scheme's investment strategy and reduce the likelihood of the Scheme's funding level falling before assets were transferred to an insurer (which may result in either a delay in buying-out benefits, or the Sponsor needing to pay further contributions). Furthermore, the Trustees wished to maintain sufficient liquidity to be able to pay benefits due over the next 12 months.

The Brief

The key focus was to align the Scheme's investment strategy with potential changes in buyout pricing, increasing the correlation between the Scheme's investment strategy and buyout pricing, and helping the Scheme maintain a surplus on a buyout basis.

The Project

We considered a range of options with the Trustees, factoring in the best liability match, potential transaction costs and whether any of the Scheme's current assets could be retained. The Trustees agreed an asset allocation which blended the Scheme's current holdings with shorter dated credit and gilts to achieve a tailored solution, reflecting both the Scheme's liability characteristics and the buyout provider's funding basis.

The Result

The Trustees were able to reduce the risk of the Scheme's surplus being eroded, thereby increasing the probability of the Scheme being in a position to buyout, whilst maintaining a high degree of liquidity within the Scheme's investment strategy. Acting on our advice, the Trustee has successfully transferred the Scheme's assets to an insurer and has set an objective to buyout the Scheme within 12 months.

Advice for Trustees setting buyout as their long-term objective

Buyout might be the long-term goal in the distance or that big exercise you hope to tackle over the next few years. Whatever your circumstances, preparing your pension scheme before the pressures of a buyout exercise really take hold is a wise step for any set of Trustees. It ensures that the key tasks are given due care and attention and will usually lead to an overall smoother and more efficient buyout process. These include:-

Ensuring that all Scheme documentation is in good shape, including common sticking points such as Barber benefit equalisation.

Ensuring that your membership data is complete and accurate.

Reconciling GMPs with HMRC (which should be in progress now that HMRC have issued final data).


Equalising GMPs for differences between male and female benefits.

Any schemes considering buying bulk annuities should be aware that insurer capacity will ultimately be limited by availability of assets and re-insurance. The steps above will help in showing insurers that you are serious when seeking quotes.

We can assist with planning for a buy-in if you are considering this route.

Quantum's risk transfer team

At Quantum Advisory we have a dedicated team of consultants assisting with risk transfer projects, from liability management, to buy-ins, buyouts and the potential use of consolidation vehicles. Our experience has been built up over many years both within Quantum Advisory and while working at other leading pension consultancies, so there are few issues we have not collectively encountered and overcome.



This quarter's newsletter was prepared by Simon Hubbard. Simon leads the risk transfer team at Quantum Advisory, helping to manage projects and working with major insurers to track market prices and market sentiment. He is also a member of Quantum's Defined Benefit Strategy Group and assists with the development of Quantum's in-house actuarial models.

Simon holds a Scheme Actuary certificate and is currently Scheme Actuary to a number of pension schemes. He has fifteen years of experience delivering trustee and corporate consulting advice including valuation negotiations, benefit change projects, company pensions accounting and member option exercises.



Simon is also an Examiner for the Institute and Faculty of Actuaries, helping to develop the course content and set the exam in financial economics.

Contact us at: risk-transfer@qallp.co.uk

Who we are

Established in 2000, Quantum Advisory is an independent financial services consultancy that provides solution based pensions and employee benefit services to employers, scheme trustees and members.

We design, maintain and review pension schemes and related employee benefits so that they operate efficiently and effectively and are valued by employees. This means that you can get on with doing the things that you do best, therefore saving you time and money.

Products and services

We offer a range of services to companies and pension trustees, all designed to focus on your specific needs, including:

- Actuarial services
- Administration of defined contribution and defined benefit pension schemes
- Banking, accounting and pensioner payroll
- Company advice
- Employee benefits consultancy
- Governance
- Investment consultancy
- Pension and employee benefit communications
- Risk benefits advice
- Pension scheme wind up
- Trustee training
- Flexible benefits

Risk transfer team

We have offices in Amersham, Birmingham, Bristol, Cardiff and London. Give us a call to see how we can help with your risk transfer, pension and employee benefit challenges.

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