QUANTUM ADVISORY
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RISK TRANSFER JOURNEY PLANNER

Q4 | 2022

Buy-out and other endgame options

Welcome to Quantum Advisory's Q4 2022 Journey Plan newsletter. Each quarter, our risk transfer team will bring you details of market pricing in relation to various risk transfer options as well as sharing useful tips and experience to ensure that your risk transfer journey is as smooth as possible.

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- An update on buy-out pricing
- Spotlight on data - interview with Matt Elguezabal
- A recent Quantum case study for a legacy DC scheme

Pensioner Buy-out & Buy-in pricing

This note gives an update on pricing for pension schemes looking to buy bulk annuities for pensioners. This could be as a buy-in (where the members remain in the scheme) or a buy-out (where the members leave the scheme and are paid directly by the insurer).

Overview of insurer pricing

Insurers price business based on gilt and corporate bond yields, plus the cost of setting aside regulatory capital, their desire for new business and how well any particular scheme would fit with their existing portfolio. This means there is no one figure for the buy-out cost for a pension scheme. However, we receive monthly data from a number of insurers which allows us to monitor how pricing moves over time.

Market background – financial drivers

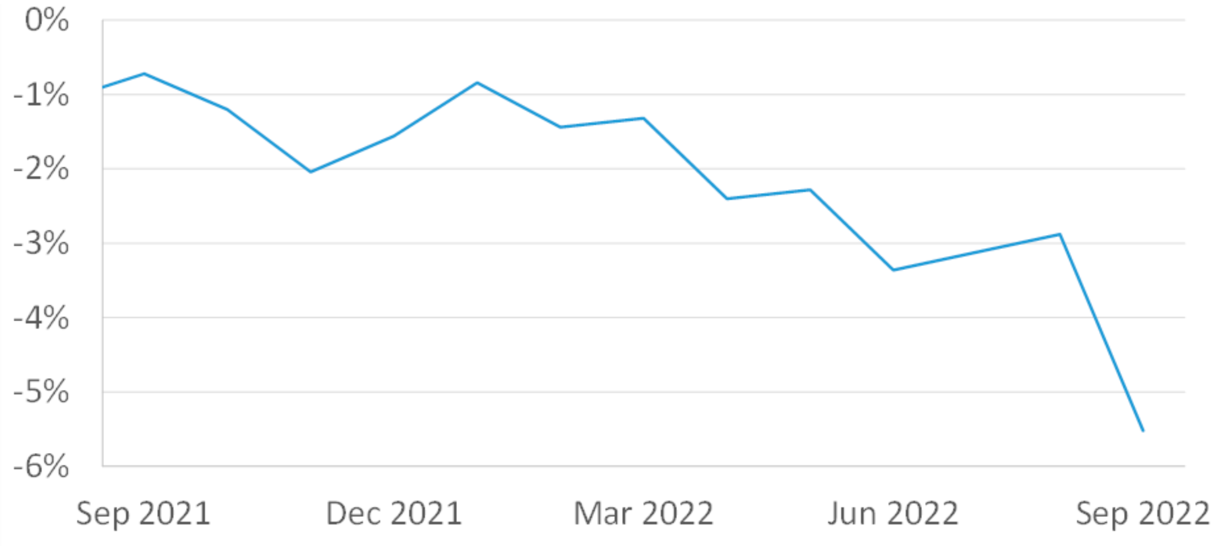
Market movements in Q3 2022 were dominated by rising bond yields, with gilt yields ending the quarter around 1.5% pa higher than at the start of the quarter. Market implied inflation also rose by around 0.4% pa. The net impact was lower insurer pricing for all benefits, but especially benefits without inflation linkage. This can be seen on the chart overleaf.

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

Pricing update and de-risking opportunities

The chart below shows that insurer pricing relative to gilts has become more attractive over the last year (shown by the downward-sloping line). Buy-ins for pensioners are available at around 5% less than the cost of funding the same benefits with a portfolio of gilts.

Pensioner buy-out pricing relative to 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 also come down in absolute terms.

The difference between liabilities on a gilts basis and the buy-in/buy-out cost 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.

The buy-in process

Transacting a buy-in will usually take a few months, however there are steps you can take to plan ahead and speed this up. 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 (now confirmed to be required by the Lloyds judgement).

Any schemes considering buying bulk annuities should be aware that insurer capacity will ultimately be limited by availability of assets and re-insurance. These steps 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.

Next steps

Prices vary both between insurers and over time, so a full quote is the only way to obtain accurate pricing. If you would like more information, please speak to your usual Quantum contact.

Spotlight on.... How to get data ready

This quarter's buy-out preparation tip

Completing a risk transfer exercise will usually take several months, however there are steps you can take to plan ahead and speed this up to ensure the project can be completed in a timely and cost efficient manner. These steps can also make your scheme more attractive to risk transfer providers increasing your chances of obtaining attractive pricing.

Each quarter we will give you tips based on recent experiences which we hope will help you tackle your exercise.

This quarter we focus on Data through an interview with Matt Elguezabal. Matt leads our administration projects team who, among a number of other projects, work to ensure that our clients' data is robust and accurate.

What are the most common data issues that you see for schemes looking to buy-out?

The most common issues are around overall quality and consistency of the data held.

Almost inevitably a mature pension scheme will have accumulated a lot of historical data which has then been stored in many places, in many ways and by many people.

This means it's all too easy for the overall picture of benefits and liabilities to be become uncertain, at least for certain categories of members. Often this manifests itself in relation to issues around the calculation of secondary or contingency benefits (i.e. member marital status, pre commutation spouse entitlements, spouse dates of birth) or awkward or complex benefit terms (i.e. GMPs, bridging pensions or special and non-standard benefit categories).

Running a pension scheme at the best of times requires a combination of lots of money and lots of data. And certainly in terms of buy-out options, the less you have of one, the more you will need of the other!

What solutions are available for these challenges?

Regular monitoring and maintenance of your data can address most of these problems and often for a very modest ongoing cost. A good place to start is to engage with your tPR record keeping scores around common and scheme specific data items. It is important to be able to ask the right questions to get a sense of what you have and understand what you need to have. Often, measurable improvements can be made fairly easily over time as an added benefit of ongoing good administration practice, without the need for large scale retrospective exercises, which can add unnecessary costs and delays to a buy-out project.

Why do insurers require more data than typical third-party administrators?

Again, it's really a question of timing. Third party administrators have the benefits of time and an ongoing client relationship, giving them access both to the Company/Sponsor and the Trustees. Issues can therefore be dealt with sequentially as and when they arise in a pragmatic and targeted way through specific project work.

However, for an insurer at buy-out, immediacy is everything. They are being tasked with guaranteeing the future of every member simultaneously at today's date. Therefore the scale and depth of data they require to satisfy their underwriters can seem daunting in comparison.

For schemes at the beginning of their de-risking journey, what can trustees do now?

Ask not what your data can do for you, ask what you can do for your data! Preparation is everything. Take an interest in the wider data issues and data health of the scheme. Ensure your benefit specification is comprehensive and up to date and your database is a match for it in terms of each benefit payable. Understand what you have, how and where it is stored, and what it is telling you about any potential problems that certain missing or uncertain pieces of information may cause.

Ongoing incremental improvements can pay dividends way beyond their immediate or accumulative cost. If you want to have data stored and understood in a way that will give you options, thus saving you time and money when your market/funding buy out position looks favourable, start small but start now.

Quantum Advisory case study - A money purchase scheme buy-out

Helping Trustees to wind-up and transfer their money purchase pension scheme members to a new arrangement.

Background

As risk transfer activity has been increasing in recent years, we thought it would be good to reflect on one of our old buy-outs to see what has changed in the market since they bought-out their money purchase scheme in 2006. One of our first clients was a well-known manufacturer with a factory located near our Cardiff office. Quantum acted as both adviser and administrator for their pension schemes.

Preparation and implementation

In 1997, the client's business was sold to another company. However, it was not until 2006 that a decision was made to wind-up the pension schemes. There were two pension schemes:

- a money purchase scheme and
- a final salary scheme.

The options were considered by the Trustees and Sponsor and a decision was made to transfer all final salary scheme members' benefits to the new company's pension scheme.

Quantum Advisory managed the transition and assisted the Trustees with the member communications (a critical area whenever any scheme changes are being considered). A transfer to the new company's pension scheme wasn't suitable for money purchase scheme members, so the Trustees sought advice from Quantum on how to secure those members' benefits. At the time, a common solution was to use a 'section 32' buy-out policy and this was agreed by the Trustees as the most appropriate option for the members. This type of policy allows members to preserve their protected tax-free cash; it can also accept contracted out rights, which was important in this case, as some members had been contracted out on a protected rights basis which the recommended buy-out provider was able to accept.

To implement the wind-up, the Trustees offered money purchase members the full range of options:

- those who were old enough (50 plus at that time) could take retirement benefits (in the form of a tax-free cash lump sum and an annuity)
- those with small enough pots could take a winding-up lump sum
- anyone could transfer their pot to another scheme of their choosing, but not many people did so.

The default option (for those who didn't make an active choice) was the buy-out policy. This was the usual route in those days, although transferring to a Master Trust is more common for a lot of money purchase schemes winding-up now. A buy-out policy is still an option nowadays and may be attractive when contracted-out benefits are involved, rather than having to convert those benefits. Of course, today, we may also see an UFPLS added to the list of options but this is available only to the over 55s.

Finalising the buy-out

The transfer to the buy-out policy took place in 2007, with winding-up lump sum payments, for members who had chosen that option, being made thereafter. It also took some time for age-related rebates to come through for contracted-out members and there were tax rebates to resolve, as well as final accounts to be produced, so the scheme was not finally wound up until a couple of years later.

To help with future enquiries, we produced a list for the client showing which option each member had chosen. This did not stop Quantum getting enquiries from ex-members for many years afterwards and we were happy to assist those members who had contacted us. We feel this is a duty incumbent on administration teams as often members, or their dependants, find an old piece of correspondence regarding a pension scheme with our contact details and we are happy to pass on the new contact information during the period where we continue to retain historic member data.

Quantum's risk transfer team

At Quantum Advisory we have a dedicated team of senior actuaries and investment consultants helping to advise on and implement all types of risk transfer strategies, from liability management exercises, to buy-ins, buy-outs and consolidation vehicle transfers. 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 edition of the Journey Planner was prepared by Chris Mason. Chris is key member of our Risk Transfer team, heading up the service for our London office. He has worked on traditional insurer buy-outs for many schemes with a particular focus on schemes at the smaller end of the market.

Chris is a qualified Actuary and, alongside his Risk Transfer work, is a Scheme Actuary practising certificate holder helping trustees across a wide range of traditional actuarial consulting issues including scheme funding, the setting of actuarial factors and PPF related work.

Quantum has offices in Amersham, Birmingham, Cardiff and London. Get in touch to see how we can help with your risk transfer, pension and employee benefit challenges.

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Quantum Advisory

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

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

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