# RISK TRANSFER JOURNEY PLANNER

Q1 | 2023

## Buy-out and other endgame options

Welcome to Quantum Advisory's Q1 2023 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.

### IN THIS ISSUE

- An update on buy-out pricing
- Interview with Just Group
- A recent Quantum Advisory case study
- Advice for Trustees setting buy-out as their long term objective

### Pensioner buy-out & buy-in pricing

We have provided 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 Q4 2022 were dominated by volatile bond yields, with short-dated gilt yields falling slightly and long-dated gilt yields rising slightly. Market implied inflation fell by around 0.4% pa. The net impact was lower insurer pricing for benefits with inflation linkage.

On the asset side, equities ended the quarter at a higher level than they started, with bond prices volatile but ending at a similar level to where they started. The impact on individual schemes will depend on their asset allocation, but most schemes will have seen slight rises in asset values.

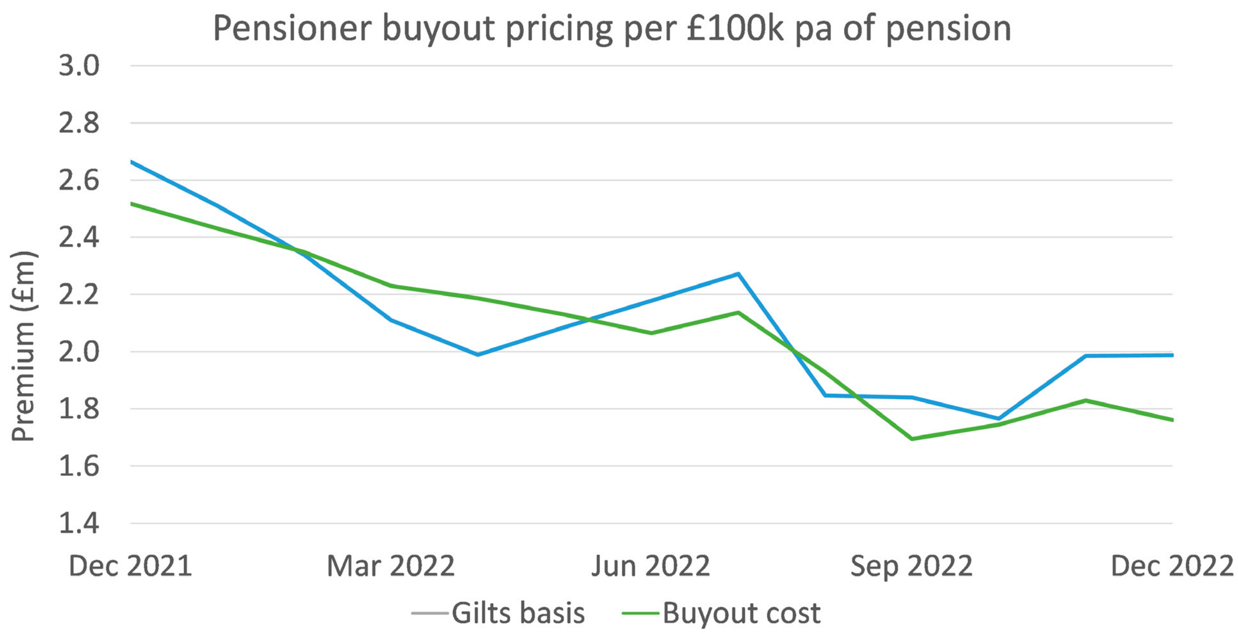
## Pricing update and de-risking opportunities

The chart below shows that insurer pricing remains just slightly cheaper than gilts (shown by the green line sitting below the blue line). 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 materially 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.

# The Interview: Just Group Plc

In this issue we interview Harriet Fallows of Just Group. Harriet works in the Commercial Team, where she is responsible for managing Just Group's Indicative Quotation Service, with a particular focus on supporting smaller schemes.
Just Group is a specialist UK financial services provider of retirement income products and services to individual and corporate clients.

**What is your target market?**

We target whole of market from very small Defined Benefit pension schemes to very large schemes (>£1bn).

**What are the three biggest obstacles to achieving a successful transaction?**

The biggest obstacles centre around the preparedness of the scheme when coming to market.

1. **Ambiguity in Data/ Benefit Specification, including but not limited to:**
   - Ambiguous benefits
   - Trustee discretions not being codified
   - Benefit Specification not legally signed off
   - Data items missing
   - Inconsistent data

2. **Certainty of transaction:**
   - Affordability issues
   - Understanding around costs to get to transaction
   - Missing key stakeholders from decision-making process, e.g. legal adviser, administrator, investment adviser, Scheme Actuary, sponsor etc.
   - Shifting asset portfolio for transaction readiness

**What innovations have you brought to the market?**

Just offer an innovative Indicative Quotation Service which provides schemes with a way to track our buy-in pricing on a monthly basis. It incorporates reinsurer pricing, has a low barrier to entry (only basic data required) and is free at source with no obligation to transact with Just. Tracking pricing helps schemes to understand affordability. It aids conversation with sponsors and other key stakeholders to prepare schemes for transaction. In addition, we have developed a number of solutions to deal with illiquid assets and member AVC funds.

**What are your targets over the next 5 years?**

Over the last few years, Just has transitioned to become capital generative. Our focus now turns to growth, whilst maintaining our capital generative position. Our ambitious growth plans align well with the increased demand from UK sponsors and Trustees for an insurance solution to de-risk their DB pension schemes. This ultimately means competing on larger transaction sizes, whilst maintaining our pricing discipline. Both will lead to a great outcome for DB pension scheme members.

**What do you see as your biggest challenges?**

Attracting the right talent to help with our growth plans, in this growing area of the pension industry.

We are committed to ensure we provide Trustees and members with the best service possible. This means making sure we are fully equipped for onboarding the increasing number of schemes we transact on.

**What do you see as the future for small schemes?**

We believe our streamlined quotation service is the future for small scheme transactions. This is a clear and efficient process that provides a solution for small schemes, ensuring they are not side-lined as the market gets increasingly busy. Small schemes should look to simplify overly complex benefit specifications, to be as pragmatic and efficient as possible. The utilisation of professional trustees and experienced advisers will aid in ensuring transactions are as smooth as possible.

**Quantum's view**

With improvements in funding level over the last 12 months the need to "Get Buy-Out Ready" is more important than ever for DB pension schemes. Planning for buy-in is the first step and certainly the ability to track live insurer pricing for individual schemes has been a benefit for our clients. As 2023 progresses we expect to see more clients transacting in the market.

JUST.

Quantum Advisory case study

## Helping Trustees to navigate the challenges of a buy-in/buy-out.


### Background

This is a long-standing DB client of Quantum Advisory, which has had a long-term aim of buying-out members benefits with an insurer and ultimately winding up the pension scheme. Over the last several years, we had worked closely with the Trustees to improve and protect the funding level of the scheme, whilst waiting for the opportune market environment to secure members benefits.

Having considered a range of low risk buy-out focused investment strategies for the client, we implemented the most suitable portfolio using a range of levered and unlevered gilts, corporate bonds, and cash for liquidity and to meet cash flow. We then set up an automatic rebalancing agreement with the investment manager, to ensure the scheme's assets were regularly balanced back to the strategic asset allocation; and within matching assets, that the hedge ratios are monitored and automatically rebalanced back to the target hedge ratio.

By early 2022, the scheme's funding level had improved significantly and we noted the scheme would be able to buy-out the liabilities without any further contribution from the sponsor. The trustees were therefore able to proceed with searching for a suitable insurance provider to secure the members benefits.

The initial aim was to remove the investment, inflation and mortality risks associated with the scheme through a buy-in policy. The secondary aim of winding up the scheme could then be achieved by converting the buy-in to a buy-out policy.

### Preparation work

The first stage of the project was to provide the trustees with suitable training to ensure that they were comfortable with what a buy-in and buy-out entailed and the process that the scheme would need to go through. We then produced an indicative project plan and worked closely with the scheme's legal advisers to set out of the steps that would be completed.

As with any buy-in/buy-out, the initial steps focus on the scheme's data and the governing documentation – it is key to identify any potential issues as soon as possible in the project.

There are two elements to the scheme's data. Firstly, it is important that all data held on the administration systems is accurate and reliable and, with our regular monitoring and data quality assessments, this step could easily be achieved for the scheme. Secondly, insurers require additional information of the scheme's membership and our data assessments can readily be adapted for these requirements.

### Approaching the market

Once the data and scheme documentation are in good order, we can approach the market with a request for detailed quotations.

Quantum Advisory case study:

# Helping Trustees to navigate the challenges of a buy-in/ buy-out.

**Asset transition phase 1:**

**The "price lock" portfolio**

Each insurer has its own pricing methodology and will advise on their "price lock" portfolio, which effectively tracks the movements in the premium before assets are transferred across to the new buy-in policy.

We worked closely with the insurer and the scheme's investment manager to implement the price lock portfolio smoothly, efficiently, and crucially in a timely manner.

The manager at the time, had a range of single-stock bond funds that invest solely in each of the bonds specified by the insurer. These funds had reasonable liquidity, which was an important consideration in the run up to execution of the buy-in policy. Furthermore, the asset management fees on these funds were competitive, and the costs of trading the funds were expected to be low.

We therefore recommended that the trustees transition the Scheme's assets into these bond funds.

**Asset transition phase 2:**

**Transfer to insurer**

Some insurers will accept an "in specie" transfer for some, or all, of the portfolio, which can help to manage transition risk (and costs). In this instance it was not possible to facilitate this with the manager and insurer, so we organised a cash transfer, where managing out of market risk was critical.

When the premium was due to be paid, we arranged for the bond portfolio to be sold down, and the proceeds paid into the Scheme's bank account, before subsequently transferring to the insurer on the same day to minimise out of market risk.

## Finalising the buy-out

With the initial buy-in phase complete, the scheme had transferred all of its investment and mortality risk to the insurer with the attractive premium leading to a small surplus remaining in the scheme, which was used to meet adviser fees in the first instance. Over the next few months, we worked closely with the insurer to validate the scheme data and ultimately handover the ongoing administration and payroll for the scheme.

Once everything was in order, the buy-in policy was converted to a buy-out and the members of the scheme issued with individual policies from the insurer. All the liabilities of the scheme had now been discharged and the scheme could then be formally wound up.

## This quarter's buy-out preparation tip : Investment Strategy

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 investment strategy in the early stages of buy-out preparation.

At Quantum we offer clients a structured pathway to buy-out, which we call "Getting Buy-Out Ready". This involves preparing schemes for buy-out, whilst monitoring the buy-out funding level to ensure any opportunity to secure benefits is acted upon.

We build flight-paths for clients with a Long-Term Objective of Buy-Out and gradually de-risk portfolios as clients reach pre-agreed funding level triggers. This process gradually shifts the focus away from managing funding volatility against Technical Provisions towards Low Dependency and ultimately Buy-Out. For schemes wishing to Buy-Out with an insurer, the biggest risk as they approach the market is the funding level movement against the Buy-Out price (and not against Technical Provisions). Moving into a "Buy-Out friendly" investment strategy is therefore a crucial stepping-stone for schemes.

### 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. We can advise on liability management exercises, 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 was prepared by Amanda Burdge, Partner at Quantum Advisory.**

With over 25 years' industry experience, Amanda leads our investment and risk transfer teams. She prides herself on delivering innovative and pro-active advice and has extensive experience of working on a range of clients of different sizes and complexities.

Amanda has worked as an examiner for the Pensions Management Institute and as an adviser for The Pensions Advisory Service. She currently sits on the Regulation Committee for the Pensions Management Institute, overseeing the professional standards of the Institute.

Amanda is also a Trustee of Wales Air Ambulance Charity.

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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.

## 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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