



RISK TRANSFER JOURNEY PLANNER

Q3 | 2023

Buy-out and other endgame options

Welcome to Quantum Advisory's Q3 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
- A buy-in case study involving Legal & General
- Recent transaction activity

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.

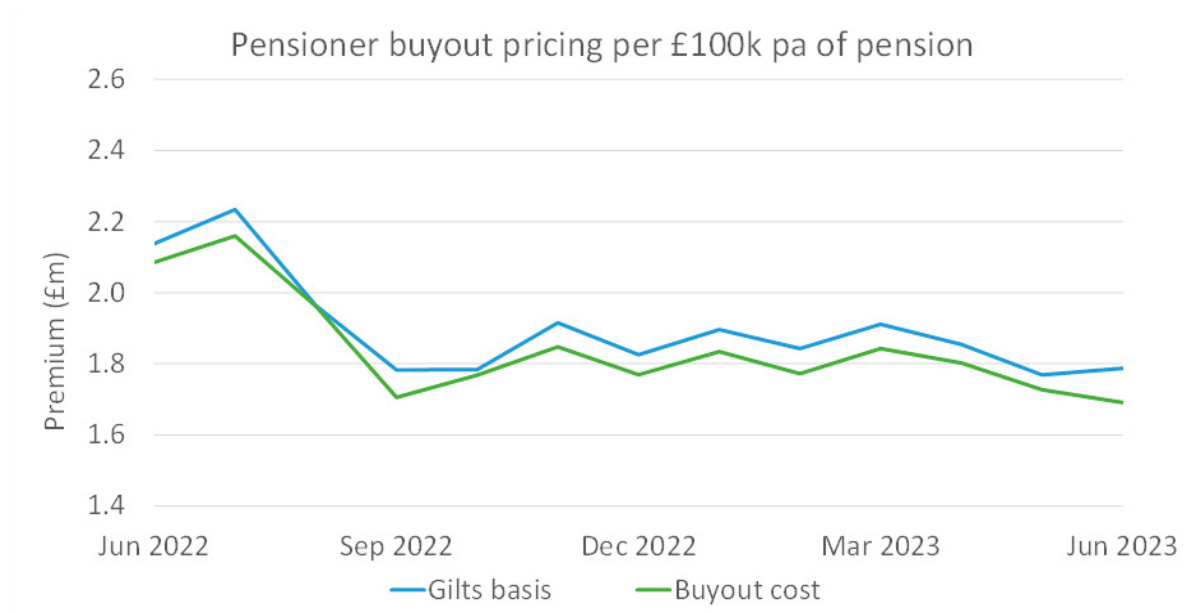
Market background – financial drivers

Markets in Q1 2023 were much more stable than in the previous quarter, with gilt yields falling by about 0.2% and market implied inflation remaining broadly level. The net impact was higher insurer pricing for most benefits.

On the asset side, equities generally ended the quarter at a higher level than they started at, with bond prices ending slightly lower than where they started. The impact on individual schemes will depend on their asset allocation.

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 5-10% 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, but 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. 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.

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.

Disclaimer

Quantum sources information from the insurance market monthly and is reliant on this information to produce pricing updates. This information is high-level and not specific to any individual pension scheme. Pricing for an actual scheme will therefore differ.



Case Study

Quantum Advisory completes a buy-in transaction with Legal & General

Background

Our client was an agricultural supplier based in the Southeast with a large foreign parent company.

Quantum Advisory had provided pension consultancy support to the Trustees since 2012 and in 2019 the Trustees also appointed Quantum to deliver Pension Administration, Secretarial and Actuarial Consultancy services.

The significant increase in gilts yields over 2022 resulted in the scheme not only being fully funded on a funding basis but also an estimated solvency basis. The parent company requested that the Trustees and Quantum therefore work together to investigate the possibility of securing the benefits through a buy-in with an insurance company.

Preparatory work

Quantum had previously carried out a significant amount of work for the Trustees in respect of correcting historic errors in the calculation of the members' benefits and therefore we were confident in respect of the high quality of the Scheme benefit data. We worked with the Trustees and their legal advisers, Mills & Reeve, to produce a detailed benefit specification as well to consider how the Trustee discretions in the rules should be treated once the buy-in transaction was completed.

At this time the Trustees also appointed Quantum to provide investment advice so to protect the funding position.

Investment work

Once the decision had been made to secure benefits through a buy-in, Quantum and the Trustees immediately began work to align

the investment strategy with insurers pricing. The Trustees compared and contrasted the different approaches available to them and it was decided that Quantum would design a buy-out focused solution utilising the Legal and General Investment Managers ("LGIM") Buyout Aware Fund range.

The fund range is a straight forward, low governance solution for Scheme's looking to better align investment strategies. Quantum's in-house strategy team used the pooled funds in the suite, to design a high interest and inflation hedge relative to the Scheme's liability profile. Credit allocations are also considered a key allocation in many buy-out portfolios, credit is managed within the fund range and leans on LGIMs relationship with L&G in order to better equip Scheme's preparing for transactions.

With the funding position of the scheme protected and the preparatory work in place we were able to approach the market and ultimately secure a buy-in for the Trustee with Legal & General.

Darren Wateridge, Senior Consultant and Actuary at Quantum Advisory commented:

"It has very much been a pleasure working with the Trustees, Mills & Reeve and Legal & General to secure the buy-in policy for this scheme".

Fiona Jaffray, Pricing and Strategy Actuary at Legal & General said:

"Our streamlined approach for smaller schemes, including novation of the scheme's LGIM assets as premium payment, coupled with the straightforward and collaborative process run by Quantum Advisory led to the smooth and highly efficient completion of the transaction. We're pleased to have supported the Trustees and its advisers in securing the benefits of the scheme's members."

Quantum Client Engagement

Rising yields driven by political and global economic events have fed through to scheme's funding positions giving opportunities to think about de-risking investment portfolios and the next step of moving a pension scheme towards a more secure funding basis. Bulk annuity pricing, as a result, has become more attractive over the past circa 18 months.

As a result, Quantum's risk transfer team has been working with a range of existing clients from across the firm's service lines –actuarial, administration and investment – enabling them to transact with insurance companies and secure a buy-in.



We are proud to announce that seven of Quantum's clients have recently transacted with an insurance company and are currently in the processes of completing a buy-out. Furthermore, the team is currently working with several other clients to broker a deal with an insurance company over the next six months, with more in the pipeline initiating risk transfer projects with us. The journey for many of these Scheme's started long before the point of transaction



with the insurer. From an investment perspective, Trustees already had in place de-risking journey plans, taking the decision to incrementally de-risk the scheme's investment strategy as funding positions improved. From an actuarial perspective, Trustees understood the importance of setting long term funding objectives (i.e. funding on a more prudent basis) and ensuring that Scheme's membership data is in good shape. All of which meant, that when it was time to "pull the trigger" and transact with the insurer, the Schemes were in a favourable place.

About our Clients

The clients range in size, trustee boards, membership profiles and investment strategies. However, all have the common aim of securing members' benefits. Many trustee boards and sponsors have always planned for the "end game" to be buy-out; few, however, would have thought that this could be possible just a short time ago. Having a team of dedicated risk transfer consultants to advise and act efficiently in this buoyant market has been crucial to helping our clients achieve their objective sooner than expected.

This quarter's newsletter was prepared by Stefano Carnevale

Stefano joined Quantum in 2017 and works across a number of Quantum's clients (both Defined Benefit and Defined Contribution schemes).

He has experience working on a range of clients of different sizes and complexities. Recent work has included cashflow driven investments, de-risking strategies and preparing clients for buy-out. He's also part of the investment teams modelling capabilities providing statistical modelling of efficient investment strategies for clients; his specialist area. He plays a key role in developing junior members of the team.

Stefano is a CFA charter holder and received his First-Class honours BSc in Finance and Investment Banking from the Henley Business School, University of Reading in 2013. Prior to joining Quantum, Stefano worked as a derivatives trader, building the foundations of his investment knowledge.

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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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A list of all members is available for inspection at our registered office.



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