QUANTUM ADVISORY
WORKING IN PARTNERSHIP WITH YOU

RISK TRANSFER JOURNEY PLANNER

Q2 | 2024

Buy-out and other endgame options

Welcome to Quantum Advisory's Q2 2024 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. 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).

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 2024 were fairly stable, but gilt yields rose by about 0.25% during the quarter while market implied inflation rose by about 0.1%. The net impact was lower insurer pricing for most benefits.

On the asset side, equities generally ended the quarter at a higher level to where they started, with equity prices up 5% and bond prices down 5%. The impact on individual schemes will depend on their asset allocation.

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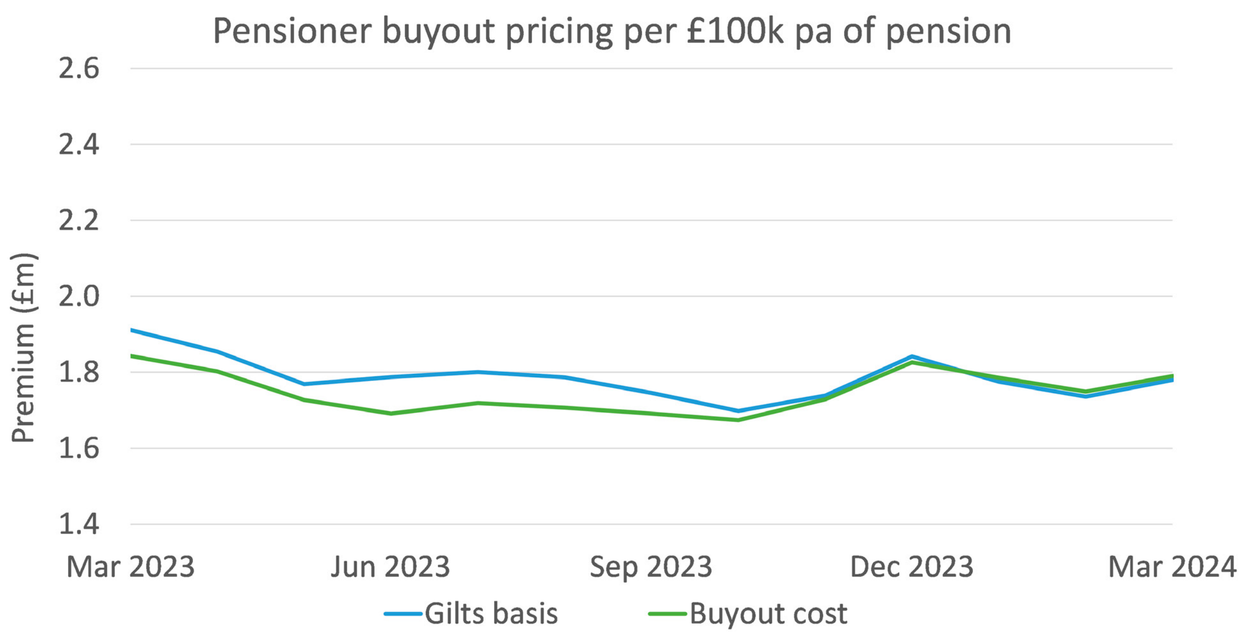
The chart below that buy-ins for pensioners are becoming more expensive and now roughly equal the cost of funding the same benefits with a portfolio of gilts (shown by the green line being at the same level as the blue line).

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.

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.

Quantum Advisory case study - Investment client

Enabling the Trustee of a £10m pension scheme to secure a buy-in through successful teamwork, specialist advice, careful planning and project management.

The client: A UK-based company with a c.£10m DB pension scheme

Background

The higher interest rate environment we find ourselves in today has led to a marked improvement in many defined benefit (DB) pension scheme funding levels.

Following the rise in UK government bond yields and significant improvement in our Client's funding level, we approached the Client during November 2022 to recommend that they capitalise on the fortunate position they found themselves in. We recommended an immediate reduction in investment risk through a sale of their higher risk growth assets. This was followed by a restructure of their liability matching portfolio. We worked closely with the Trustee and their Scheme Actuary (an external adviser) to conclude that a buy-in was a feasible short-term goal.

The Trustee decided to continue their partnership with Quantum Advisory as their Investment Advisor during the risk transfer project, given the proven track record Quantum Advisory has in assisting to secure members' benefits with insurers, particularly at this smaller end of the market.

Initial modelling

As a buy-in became possible for the Client, we initially recommended some further pragmatic changes to their investment strategy to increase the allocation to corporate credit in a bid to increase the correlation with insurers' buy-in pricing. The Client opted to retain their global diversified bond holding and introduced an allocation to UK credit. This marked a strong step towards a buy-in friendly portfolio.

Our in-house risk transfer and modelling teams research insurers' investment portfolios and buy-in pricing models to determine the desired credit exposure. We undertook an asset-liability modelling exercise to ensure the hedge provided an adequate match for the pension scheme's liabilities. After implementing the necessary changes to the Client's investment strategy, we worked with their external advisers to track the movements in assets and liabilities to ensure that they moved broadly in tandem.

A modelling and transition specialist were assigned to the client team and worked closely with the Trustee and their external advisers over the months that followed to ensure the project was moving forwards. We attended frequent meetings with the Client and their advisers ensuring all necessary stakeholders received timely information regarding the Client's assets when required.

Specialist modelling advice

Once the Client identified an insurer to undertake the buy-in, our specialist modelling team were in touch with the insurer to gain as much information as they could regarding their buy-in pricing model. We recommended that they implemented a price-lock portfolio to ensure further correlation with the insurer's buy-in pricing model. Some price lock portfolios are dictated by the insurer, often with specific gilts required to be purchased. However, this was implemented based on the interest rate, inflation and credit spread sensitivity of the quoted price. Our specialist team were able to construct three potential price-lock portfolios which carefully matched the insurer's pricing model with varying degrees of complexity and matching sensitivity. After carefully weighing up the options with the Trustee, they chose to implement our recommended portfolio, which offered a high level of matching without over complicating the solution or delaying implementation. Only one new fund was required for the purpose of implementing the price lock portfolio.

Quantum Advisory case study - Investment client buy-in

Price Lock Implementation

It was vital that the price-lock was implemented in a timely manner, ensuring that the deviation between the investment strategy and the quoted price did not diverge over time. Our specialist transition team were involved in carefully planning and managing the transition to ensure both a timely implementation and to manage out of market risk. To ensure timely implementation, it was decided to move all assets in one tranche. A large number of assets were therefore moved on a single day and the use of a pre-investment facility was key to ensure that assets were bought and sold on the same day with no impact on hedge ratios during the implementation process. The implementation of this portfolio was instrumental in ensuring assets correlated with the insurers price, until the date of transaction.

Price Lock Monitoring

The insurer provided three updates on the premium price between the implementation of the price lock and the risk-transfer date. Our modelling team ran checks on the insurer's roll forward mechanism to ensure it was in line with our expectations. We provided asset updates at the same dates, matching the different underling pricing points of the different funds to the price update dates. As the risk-transfer date arrived, it was clear that the price-lock portfolio had been closely aligned with the insurer's pricing model.

Final Disinvestment

We carefully set the fund disinvestment dates considering weekly dealing cycles and fund pricing points. We organised the divestment of all invested assets across two different days to ensure all pricing points matched the agreed risk-transfer date. Notice was then agreed with the insurer to transfer 95% of the premium to them a few days later. We ensured that sufficient time was built in to account for the settlement of funds, including contingency for any potential late settlement. While a surplus was expected, as the final amount transferred is unknown until the point of sale, the Employer was also on standby to make good any shortfall.

All assets were transferred to the Client's nominated bank account on the agreed date. Fund manager accounts were closed and it was confirmed that all outstanding fees to managers had been paid. At this time, it was confirmed that there was a surplus of assets above the set insurance premium. The premium was then paid from the Trustee bank account to the insurer undertaking the buy-in. The remaining surplus was held in the Client's bank account and will be used to pay expenses and advisor fees until the scheme is able to fully wind up.

Key takeaways

As with any buy-in project, dedicated planning and project management were key to its success. We cultivated close working relationships with all external stakeholders to ensure we had a comprehensive understanding of all areas of the project at any given time. As the investment adviser to the Client, we planned ahead to ensure we were always ready to progress the next stage of the project when required and without delay.

Buy-ins and Buy-outs – insurer activity during 2023

Last year was a record-breaking year for the UK pension risk transfer market, with aggregate deal sizes totalling a staggering £49.1bn. 2023 saw a significant increase in the number of giant transactions, with 11 buy-outs/buy-ins totalling over £1bn. This included the UK's largest full buy-in by premium size, completed by **L&G** with the **Boots Pension Scheme**.

Despite these giant transactions, insurers across the market continued transacting in the small pension scheme market, which made up a large proportion of their total transactions. **Aviva**, **Legal & General** and **Just** continued to write the most deals for smaller schemes in 2023.

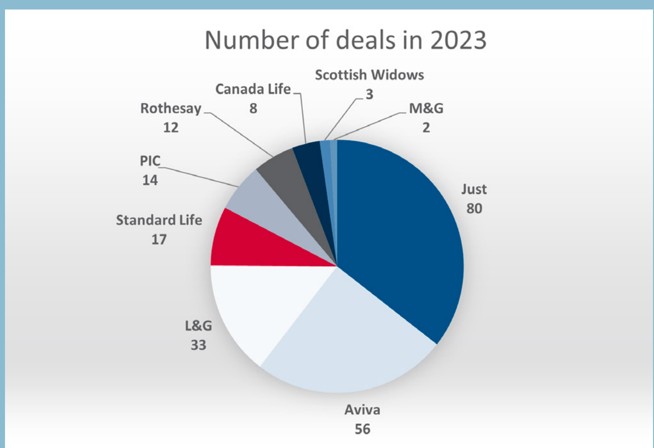
Source: Insurers' own reporting

Aviva carried out a pilot phase in 2023 for their new **Aviva Clarity** product, offering a streamlined Bulk Purchase Annuity service aimed at smaller schemes with assets of less than £100m. **Aviva** formally launched the product in 2024 and has transacted more than 20 schemes through the service.

Despite **L&G's** giant buy in of the Boots Pension Scheme, two-thirds of their total transactions in 2023 were for premiums of less than £100m with their smallest transaction being just c£3m. **L&G** believe working with small schemes is key to their whole market approach, and are enhancing their Flow offering in 2024 to continue to support schemes under £150m in size.

Just increased the number of completed transactions compared to 2022 by 40%, resulting in a total of 80 transactions. Half of these transactions were for schemes with fewer than 100 members. Not only did Just complete their largest ever deal in 2023 of £513m, they also completed their smallest ever deal of just £0.6m.

PIC are known for their large scheme deals but have increasingly been transacting within the smaller scheme market. 13 of their 14 transactions in the last year were below £200m, whilst also completing their largest ever deal at £6.2bn. For 2024, they have launched a streamlined service for smaller schemes called **Mosaic**, aimed at schemes with assets under £100m.



Source: Insurers' own reporting

The outlook for smaller deals for 2024 is looking very positive, with many insurers streamlining their quotation process and focusing their efforts on increasing efficiency for smaller transactions. With new entrants into the market in 2023, such as **Canada Life,** and multiple new entrants expected in 2024, smaller schemes can expect to have more choice of insurer than ever before.

This quarter's newsletter was prepared by Simon Hubbard. Simon sits on 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, Cardiff and London. Give us a call to see how we can help with your risk transfer, pension and employee benefit challenges.

Simon Hubbard, Principal Consultant
Cypress House
Pascal Close, St Mellons
Cardiff CF3 0LW
029 2083 7968
simon.hubbard@qallp.co.uk

Amanda Burdge, Partner
Cypress House
Pascal Close, St Mellons
Cardiff CF3 0LW
029 2083 7910
amanda.burdge@qallp.co.uk

Stefano Carnevale, Investment Consultant
Cypress House
Pascal Close, St Mellons
Cardiff CF3 0LW
029 2083 7941
stefano.carnevale@qallp.co.uk

Chris Mason, Senior Consultant & Actuary
Orega Old Bailey
20 Old Bailey
London, EC4M 7AN
020 3427 5093
chris.mason@qallp.co.uk

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