QUANTUM ADVISORY
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# RISK TRANSFER JOURNEY PLANNER

Q1 | 2025

## Buy-out and other endgame options

Welcome to Quantum Advisory's Q1 2025 Journey Plan newsletter. Each quarter, our risk transfer team will bring you details of market pricing as well as sharing useful tips and experience to ensure that your risk transfer journey is as smooth as possible.

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

After another record year for buy-in transactions in the UK, we take a look at the current 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 Q4 2024 were fairly stable, but gilt yields increased by about 0.6% during the quarter while market implied inflation also rose by about 0.1%. The net impact was lower insurer pricing for most benefits.

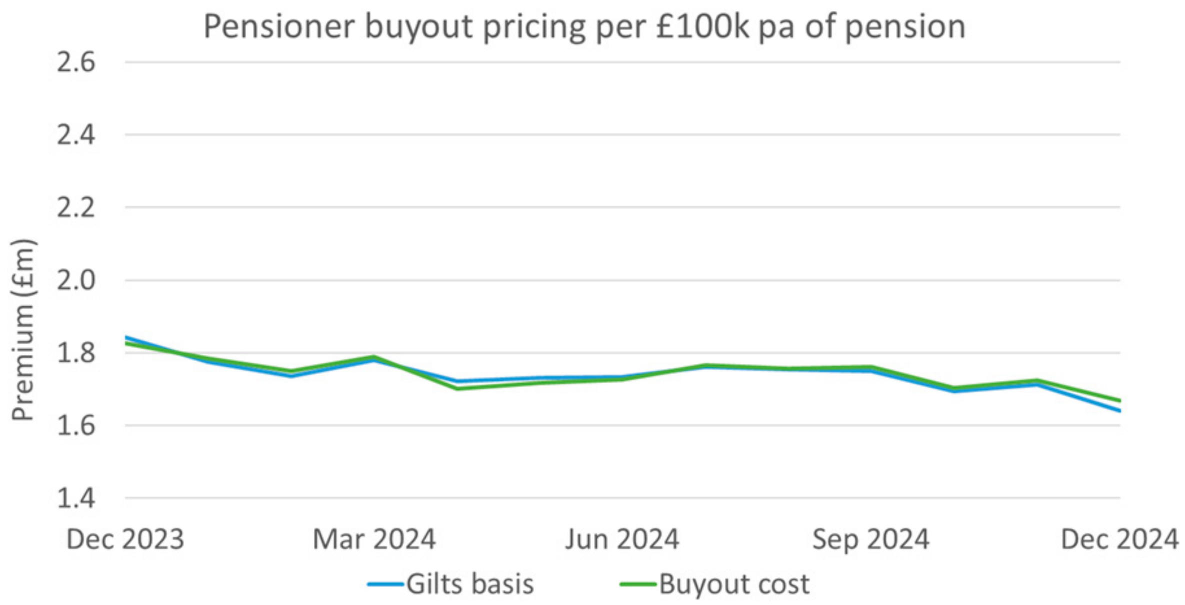
On the asset side, equities generally ended the quarter at a higher level to where they started, with bond prices down by around 5%. The impact on individual schemes will depend on their asset allocation.

### Pricing update and de-risking opportunities

The chart below shows 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 pricing similar to a year ago, with little movement in absolute terms. However, pricing relative to gilts has increased to the point where a buyout might have a similar cost to holding a portfolio of gilts. Pricing will vary by scheme though and there will sometimes be opportunities to transact at more attractive prices.

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

Despite pricing hardening amongst insurers, many schemes have found opportunities to secure their benefits with an insurer, with 2024 seeing a record number of transactions. We remain poised for another busy year, but with recent legislative changes proposed by the Government, there is also an opportunity for schemes to pause and consider whether run-off or run-on is the most appropriate option for them.

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 Case Study

## Helping the sponsoring employer and Trustees to navigate challenges incurred in securing a buy-in

Quantum Advisory has recently completed a £25m buy-in transaction for a long-standing Defined Benefit client securing the benefits for around 250 deferred and pensioner members.

The Trustees and Employer have always worked openly and collaboratively with each other which enabled the challenges that were faced as part of the transaction to be easily and swiftly resolved.

Prior to 2022, the Scheme was already in a strong funding position with a surplus on the ongoing technical provisions basis. As with many other defined benefit pension schemes, the market movements over 2022 led to a further improved funding position. Although the Scheme was estimated to have a deficit on a solvency basis, this had significantly reduced and the Employer was keen to work with the Trustees towards securing a buy-in policy for the benefits. In light of this, the Employer and Trustees decided that the Employer would continue to pay contributions into the Scheme to reduce the gap further.

### Preparation work

Prior to approaching the insurers, Quantum ensured that the membership data, including data in respect of spouses, was of high quality and also worked with the Trustees' legal advisers to agree a detailed benefit specification. This legal review highlighted a small number of areas where the administration of the Scheme differed from legal documentation. Having assessed the impact on the Scheme's benefits, Quantum worked with the other parties to achieve a pragmatic way forward for the Employer and Trustees.

### Approaching the market

Quantum approached the insurance market on behalf of the Trustees and Employer.

A number of years ago, another advisor had carried out a benefit modification exercise for the Trustees with the intention of improving the funding position of the Scheme. In the exceptionally busy buy-in market in 2024 however, the additional complexity in the Scheme benefits, with some members having opted to modify their benefits whilst leaving the spouse's benefits unchanged, worked against us.

The preference for this client was to run a competitive process with multiple insurers. Having discussed the transaction with the market Quantum lined up two insurers who were willing to quote on this basis, and who met the Trustees' wider selection criteria.

However, whilst one of the insurers was carrying out a more detailed review of the benefits as part of their work on preparing the quotation they had to withdraw from the process due the complexity of the benefits not matching their administration system's capabilities.

Following this set back we quickly accelerated the process with the other insurer who was happy to step in and swiftly proceed to provide a transactable quotation. Having already considered indicative pricing for the Scheme, the Trustees were assured that the price was both affordable and competitive.

# Quantum Case Study

### De-risking and allowance for liquidity

As the funding position further improved the Trustees' fiduciary manager de-risked the Scheme assets in line with the improved position.

Unfortunately, given the pace of improvement in funding, a significant portion of the assets were in illiquid funds which meant that these assets would not be available to purchase the buy-in.

Quantum worked closely with the fiduciary manager to understand and monitor the impact of this as well as engaged with the Employer to explore whether any additional funding could be provided to the Scheme in case there was a shortfall in liquid funds. Quantum monitored the position closely receiving regular pricing indications so that the transaction could be made at an opportune time, minimising the need for additional support to cover the need for liquidity.

### Factors and finding a compromise

Prior to transacting, the Scheme Actuary advised the Trustees on whether the insurer's standard factors were suitable to be adopted for the Scheme. The cash commutation factors were the primary concern to the Trustees as these provided a lower value to members than the Scheme's current factors.

Considering the available assets, things were tight from an affordability perspective. Working with the insurer to negotiate a higher level of cash commutation factors, whilst still keeping an eye on the pressures around asset liquidity, we managed to find a satisfactory uplift for the Trustees, that ultimately only placed the transaction with a very slight deficit. However, the Employer was happy to help meet the short term cashflow requirements of the Scheme to ensure that the Scheme could transact.

## Summary

Even for well prepared schemes such as this one, challenges can arise during a buy-in transaction in a number of areas. With our experience in the market, we were able to overcome these in an efficient and pragmatic manner to achieve an excellent outcome for both the Trustees and the Employer and, most importantly, the members.

# How to manage illiquid assets ahead of a buy-in transaction

For the majority of smaller schemes, risk reduction via an insurance transaction requires the full sale and liquidation of invested assets to fund the ‘liability’ or premium.  Following the rise in gilt yields over the last few years, many trustees have found themselves in a position where they are able to transact with an insurer sooner than they may have expected.

For a transaction to occur as smoothly as possible, assets should be redeemed and/or transferred to the insurer as quickly as possible (whether that be via cash or via a portfolio of specified assets such as gilts).

Ideally, of course, the investor wants to maximise the value of their investments before selling. However, this may not always be possible and a transaction may be hindered if the trustees are unable to sell some of their assets because they are ‘illiquid’. This essentially means that the asset cannot easily and readily be sold or exchanged for cash, or if it is then a substantial loss in value has occurred in order to generate the sale as quickly as possible.

The pricing of an illiquid asset is often quoted in terms of Net Asset Value (“NAV”) and will generally be based on models and unobservable inputs, given their illiquid nature. Property investments are a prime example, but illiquid investments (”Illiquids”) come in many forms such as infrastructure, timberland, private markets etc and these investments can be structured in the form of equity or debt and can be direct or pooled investments.

The inability to sell an asset as quickly as the trustees would like can have a significant impact on the insurance transaction:

1. **The asset is sold at a reduced NAV** (sometimes significantly so). This could mean that the total value of assets is no longer sufficient to fund the insurance transaction and an additional contribution from the sponsor may be required to fund the deficit.

2. **The insurer may accept a deferred payment of the premium,** allowing time for the illiquid asset to be sold, although this will incur additional costs and exposes the scheme to some risk post transaction folio for c£6bn.

3. In extremis, and if there is a significant proportion of the portfolio invested in illiquids, **the transaction may be delayed** until the sale occurs, by which time the premium may have increased and a buy-in is no longer affordable.

# How to manage illiquid assets ahead of a buy-in transaction

So, the question for a trustee becomes, what can be done? Trustees who find themselves in such a position may take comfort in the fact that they are not alone, according to the '2024 PPF Purple Book' on average schemes have a c.15% allocation to investments that could be interpreted as illiquid, and with risk transfer the 'end game' solution for the vast majority of schemes, the scenario set out above has been (and will likely continue to be) a common occurrence. Which is why, the industry has developed some potential solutions:

1. **In specie transfer to the insurer.** Some insurers may be willing to accept the asset as part of an in-specie asset transfer, the asset is essentially assigned to the insurer. This can avoid the requirement to sell at a materially discounted NAV. This solution has to date been reserved for much larger schemes.

2. **Secondary markets & platforms.** The role of a secondary market within the illiquids space is growing and platforms are now available which allow sellers and willing buyers of illiquid assets to transact. Whilst this will help facilitate the sale of assets, often this will occur at a considerable discounted NAV.

3. **Deferred premium.** Insurers may be willing to offer a deferred premium when they have visibility over a scheme's illiquid allocation. Most of the initial premium is paid 'upfront' (funded by the sale of liquid assets for example) whilst a smaller portion of the premium is paid later (once the sale of the illiquid asset occurs), often interest is applied over the deferral period subject to specific terms agreed with the insurer.

4. **Sponsor support.** Trustees should engage with the sponsor so that they are aware of their illiquid investments. The sponsor may be willing to 'loan' the scheme the required amount whilst waiting for the orderly sale of the illiquid asset, essentially the sponsor frontloads funding and uses the proceeds realised post transaction to fund expenses. If a scheme is in surplus, the illiquid sale proceeds are added to the remaining surplus and may be refunded to the sponsor, therefore the trustees and sponsor may need to wait longer than expected to wind-up the scheme.

**Conclusion**

- If buy-out is the sole focus for your scheme and you currently hold illquids, speak with your investment consultant. Early planning is essential to achieve the best outcome for your illiquid assets and should minimise any unwanted surprises further down the line.
- Review your investment strategy and increase liquidity over time, moving towards a 'buy-out ready' strategy as funding improves.
- If you reach your endgame and have not yet disposed of your illiquids, engage with insurers as early as possible to discuss any innovative solutions which may help.

# 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, buy-outs and the potential use of consolidation vehicles. Our experience has been built up over many years, so there are few issues we have not collectively encountered and overcome.

This quarter we launched our risk transfer videos, which aim to keep you informed of current issues and matters to consider. You can access our video content here.

## This quarter's newsletter is brought to you 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 is the recipient of the Professional Pensions Woman of the Year Award 2024 and is Vice Chair of Trustees for the Wales Air Ambulance Charity.

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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