HYMANS ROBERTSON

Buy-in monitoring service

Comprehensive analysis of the buy-in market - November 2018

Headlines

Pensioner buy-in pricing dips from mid-year peak
Buy-in pricing remains attractive with prices in many cases 3-5% lower than the equivalent gilt liabilities. Average pricing has deteriorated slightly compared to pricing seen in the middle of the year, primarily due to the record levels of business already written by insurers during the first half of the year. High business volumes in the first half of the year has reduced the appetite of some insurers for the remainder of 2018 and, not surprisingly, insurers are being more selective over which transactions they compete for. However, schemes prepared to be patient and understanding the changing market dynamics will continue to be able to secure attractive buy-in pricing. **See our "Buy-in pricing" section for more details.**

Well prepared and informed schemes benefit as insurers manage large volumes
The surge in demand from pension schemes provides both opportunities and new challenges for insurers. Insurers are having to carefully manage their own resources and will not be able to provide their best pricing on every transaction. Well prepared schemes with a clear strategy, straightforward approach and realistic target price are likely to be favoured by insurers. For some years insurers have turned away or minimised effort in responding to speculative quotation requests. What we are now seeing is the start of the next step change in the supply-demand dynamics. A phase where insurers' are able to deliver the attractive pricing required by schemes, but are limited in volume by the investment opportunities they can source. Understanding insurers' investment processes and what they are looking for in a transaction will allow trustees to get to the top of insurer lists and achieve better outcomes from their transactions. **See our blog on this topic here.**

Completing the journey to buy-out
This surge in demand from pension schemes has been driven primarily by improved funding levels and attractive insurer pricing. The slowing down of longevity improvements together with higher numbers of members transferring their benefits out of DB schemes has led to an acceleration in schemes' journey plans, with many finding that buy-out is closer than they may have anticipated. While buy-out is the long term objective for many trustees and sponsors, winding up a scheme and completing the journey is new territory for many trustees. **See our "Buy-in insights" section for more details on the key steps trustees and sponsors can do to ensure a smooth wind-up process.**

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Buy-in pricing

A buy-in policy insures against all risks associated with a subset of pensioner liabilities. When considering whether to undertake a buy-in, pricing is best assessed against returns on other very low risk assets.

Pensioner buy-in pricing

The chart below plots the relative cost of hedging pensioner liabilities with a buy-in policy, a portfolio of gilts, or a swaps and cash based LDI strategy.

Pensioner scheme buy-in vs gilts and LDI strategies

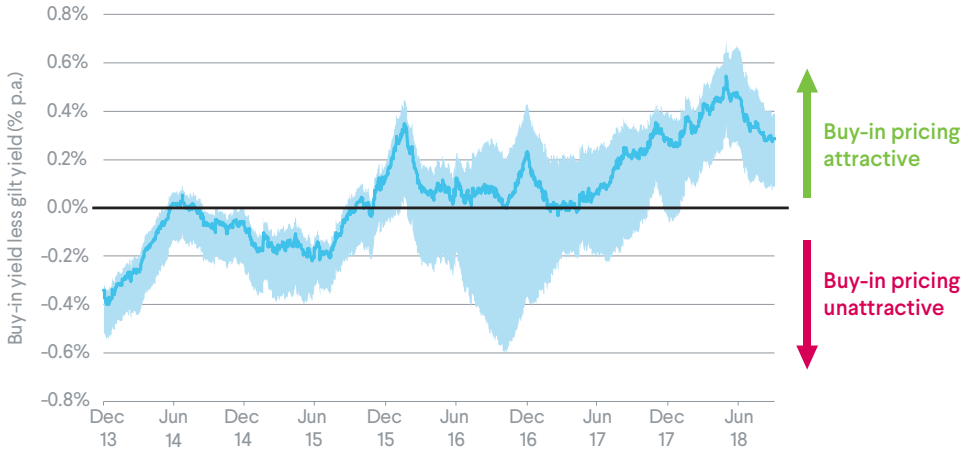
Pricing analysis

Average pricing got slightly more expensive over the third quarter of 2018, however still remains materially cheaper than the value of gilts needed to match the same liabilities (the green line is below the blue line in the above chart). This means that schemes can exchange gilts for a buy-in policy, maintaining or improving the return on the overall asset portfolio, obtaining a better cashflow matching asset and addressing demographic risks.

Buy-in yield analysis

Although tailored to meet the benefits of a subset of members, a buy-in contract remains an asset of the scheme. In assessing the attractiveness of a buy-in, it is useful to understand the investment return (yield) implied by the price.

Buy-in yield relative to gilt yields



The chart on the previous page shows the yield locked in to based on typical buy-in pricing. This analysis varies depending on the schemes' characteristics and views over members' life expectancies; this variation is reflected on the chart, with the solid blue line the position for the "typical" scheme.

A buy-in yield of 0.1% p.a. to 0.2% p.a. below gilt yields might be viewed as a "fair" price to pay, given the reduction in longevity risk, other demographic risks and level of cashflow matching achieved.

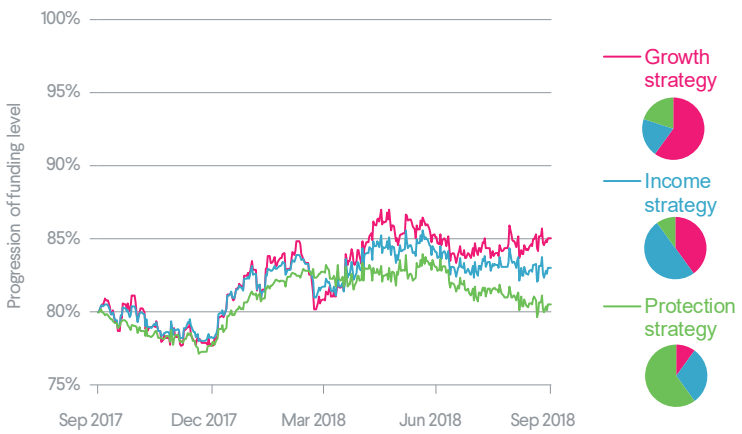
Average pricing, compared to gilt yields, continues to be attractive despite worsening slightly since the mid-year peak in pricing.

Hyman Robertson's online 3D Analytics tools allow trustees and sponsors to track buy-in pricing and yield analysis tailored specifically to their individual scheme population

Buy-out affordability

The chart below shows progress towards full buy-out funding for pension schemes at different stages in their de-risking journey.

Buy-out affordability for different investment strategies



Affordability analysis

Most schemes will find that buy-out is more affordable than it was a year ago. Through a combination of strong returns, attractive buy-out pricing and member transfer activity, a lot of schemes will be closer to buy-out than previously thought.

Over the 12 months to September, growth assets performed well and schemes with a higher allocation to equities will have fared particularly well. However, these same schemes are likely to have suffered falls in funding level over October if they didn't lock in these gains as equity markets fell significantly.

Buy-in insights

An increasing number of schemes are already in a position to secure all members' benefits, as funding levels continue to improve and buy out pricing has become increasingly competitive. **Our research** shows that c3% of schemes sponsored by FTSE350 companies are in a position to buy-out their liabilities today and c13% could be in a position to buy-out with less than 1 months' earnings.

Completing the DB journey

While this is what trustees and sponsors have been working towards, actually securing all members' benefits with an insurer and winding up a scheme is likely to be a new experience for many trustees and pension managers. There are potential pitfalls and historical cases where schemes have taken years to wind up. The costs involved are material and the risks of previously unknown issues arising (like additional members or previously undocumented benefits) need to be carefully managed to avoid unnecessary delays and additional costs.

Travelling this part of the journey requires careful planning and management. Key steps that need to be navigated include:

Planning, governance and communication strategy. Completing a wind up can take 2 years or more so careful planning is essential. Trustees and sponsors should not underestimate the importance of keeping members informed at every step of the way – a good communication strategy will save both time and cost.

Data cleanse. This is the last opportunity for trustees to ensure that they are securing the right benefits for the right members.

Member options. Offering members choice does add complexity to the wind up, but can often generate a better outcome for members and a lower cost of buy-out. Options might include winding up lump sums, transfers out or reshaping pensions to make them more efficient to insure. **(For further details see our article on member options in our 2018 Risk Transfer Report here)**

Securing benefits. Trustees may have already entered into a series of buy-ins prior to moving to a buy-out and winding up the scheme. It will be necessary to ensure that all members' benefits have been covered and that any features that might have been excluded from a previous buy-in policy are included in the final buy-out.

Completing the wind up. At some stage along the process it will be necessary to formally trigger the wind up. This will initiate a number of statutory steps, including issuing statutory notices, and culminate in the completion of the final scheme accounts. Only then is the job complete.

To ensure a smooth process, trustees should consider the team and support needed to guide them through wind-up. We have found that the best approaches tend to use a specialist technical expert to lead the wind-up process, supported by a dedicated project manager. The wind-up specialist, working alongside the trustees' existing advisers and administrator, leads and directs the process. Identifying the "unknown unknowns", adopting best practise approaches and controlling costs and risks.

After successfully navigating the scheme along its journey, crossing the finishing line shouldn't be the hardest part.

Buy-in contact

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