HYMANS ROBERTSON

Buy-in monitoring service

Comprehensive analysis of the buy-in market - May 2019

Headlines

Early signs of pensioner buy-in pricing being impacted by business volumes
Following a record breaking 2018, the volume of buy-in and buy-out transactions completed over the first quarter of 2019 has remained high. Over this period, insurers have continued to deliver the level of pricing required by schemes. However, the signs of pricing starting to harden in some areas are appearing.

Over the past few years insurers have improved their ability to source bespoke, higher yielding assets and have increased their asset allocation to these in order to help deliver attractive pricing. However, as demand and transaction volumes grow, some insurers are starting to find that their pipeline of new business from pension schemes is bigger than their pipeline of investment opportunities. This puts upward pressure on their pricing and insurers will need to balance this with their desire to deliver pricing that is both competitive and attractive to pension schemes.

Trustees and sponsors will need to consider the drivers behind the quotations they receive
Some insurers that have written a large amount of business during the first quarter of the year will now be looking to build up their asset pipeline, focussing on bedding in the transactions completed over Q1 and thinking about their appetites for the rest of the year. With insurers being able to provide very attractive pricing on some but not all transactions, trustees and sponsors will need to be attuned to market dynamics in order to achieve the best outcome.

Part VII transfers and why pension schemes should care about them
A 'Part VII transfer' refers to the transfer of contracts from one legal entity to another as governed by Part VII (Control of Business Transfers) of the Financial Services and Markets Act 2000 (FSMA 2000). For a pension scheme that has an existing buy-in policy with an insurer, it is the only way that an insurer could move the policy to another legal entity. Trustees must therefore consider the insurance regime as a whole and the protections they have in place before entering into a buy-in policy. Further details on this, and what trustees should do if they are notified of a proposed transfer can be found in our **"Buy-in insights"** section.

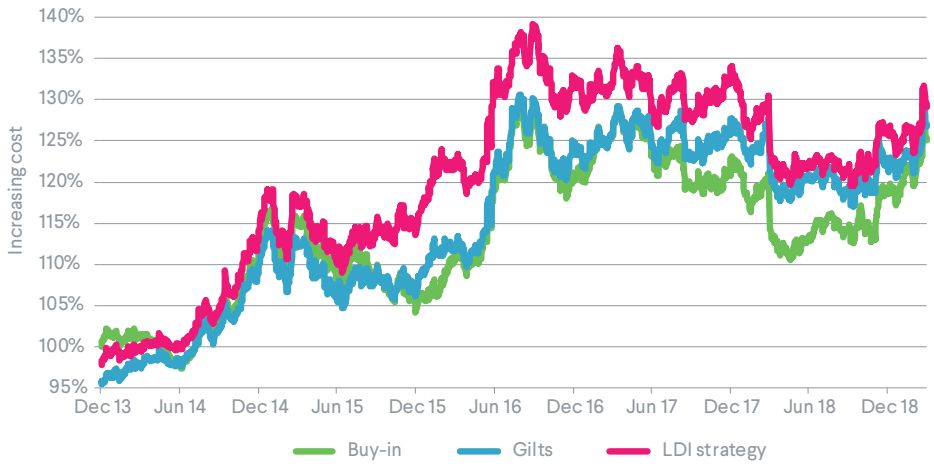
Buy-in pricing

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



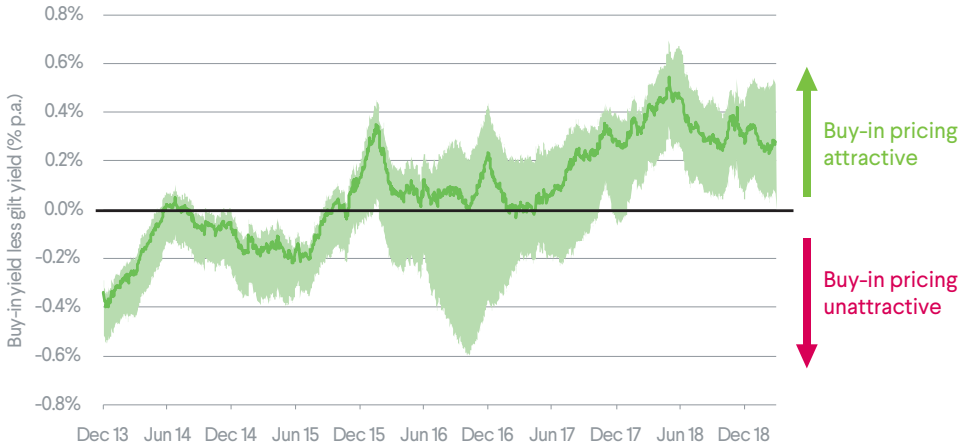
Pricing analysis

For those schemes able to secure competitive terms, average pricing remained broadly the same over the first quarter of 2019 and 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 above shows the yield locked into 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 green 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.

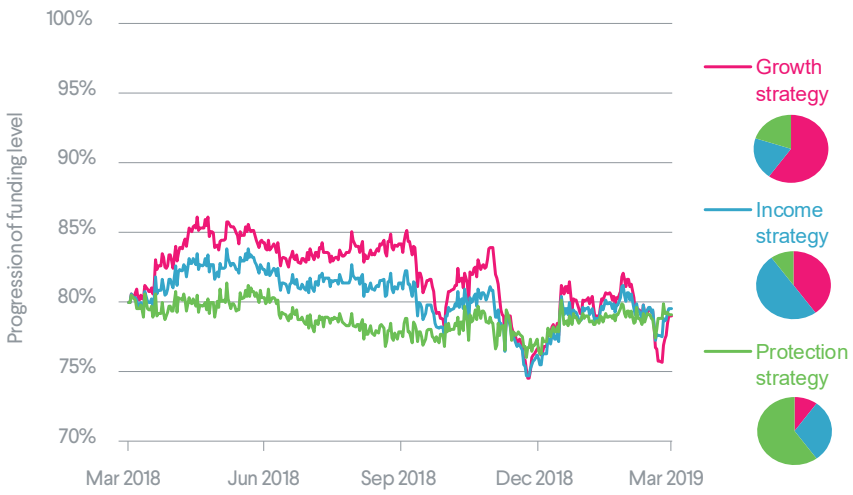
Average pricing, compared to gilt yields, continues to be attractive despite worsening slightly since the mid-year peak in pricing.

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 March, growth assets performed well on the whole 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 towards the end of 2018 if they didn't lock in these gains as equity markets fell significantly.

Buy-in insights

Part VII transfers: what are they are what is their relevance to pension schemes?

What is a Part VII transfer?

A 'Part VII transfer' refers to the transfer of contracts from one legal entity to another as governed by Part VII (Control of Business Transfers) of the Financial Services and Markets Act 2000 (FSMA 2000). For the purposes of a pension scheme, it is the only way that an insurer could move a buy-in policy to another legal entity. The most common use of these transfers is for internal business restructuring, i.e. moving from one legal entity to another within the same Group, but they can also be used by insurers to move business to a third party insurer. For example, the transfer of £12 billion of annuity business from Prudential to Rothesay Life last year will have required a Part VII transfer to complete the transaction.

How do they work?

Part VII transfers are highly regulated processes, as required by FSMA 2000. They ultimately require approval from the High Court, but there are a number of other protections for policyholders (including trustees), such as:

- insurers must appoint an independent expert to assess the impact on policyholders and the independent expert must be approved by the PRA;
- the PRA and FCA are entitled to be heard as part of the court proceedings, and will usually submit a written report to the court on the proposed transfer;
- the insurers must notify all policyholders of the proposed transfer; and
- policyholders are entitled to be heard by the court if they feel that they would be adversely affected.

The court then acts in the interest of policyholders in order to determine whether to approve a transfer or not and has extensive powers to amend the terms of the transfer.

What should trustees do if they are notified of a proposed transfer?

If trustees are notified of a proposed Part VII transfer, they will receive an information pack that they will need to digest. This will typically include a summary of the proposed transfer, a summary of the independent expert's report, and Q&A giving further details and issues for note by policyholders.

The main considerations for the trustees will be whether the transfer changes the security of the policy or the operation of the policy in any way. Trustees should also reflect on whether they have any additional contractual rights in respect of the proposed transfer.

For most schemes, the principal decisions will be whether or not to make representations to the court, and whether and how to communicate the change to the scheme members.

Trustees will generally perform due diligence on their chosen insurer at the point of buy-in or buy-out, in particular looking at the financial strength of the insurance company. The ability of the insurer to pass this business by Part VII transfer to another insurer means that trustees must also be comfortable with the insurance regime as a whole. For example, trustees should consider the capital requirements that apply to all insurers, the strength and effectiveness of the regulatory bodies, and the protections that are inherent in business transfers.

Buy-in contact

If you would like to discuss this quarterly update in more detail please contact your usual Hymans Robertson contact or:

James Mullins
Partner
Head of Risk Transfer Solutions
T 0121 210 4379
E james.mullins@hymans.co.uk

Richard Wellard
Partner
Risk Transfer Specialist
T 0121 210 4355
E richard.wellard@hymans.co.uk

Michael Abramson
Partner
Risk Transfer Specialist
T 020 7082 6155
E michael.abramson@hymans.co.uk

Alan Garbarino
Risk Transfer Specialist
T 0141 566 7664
E alan.garbarino@hymans.co.uk

Clive Fortes
Partner
Risk Transfer Specialist
T 020 7082 6235
E clive.fortes@hymans.co.uk

Christine Cumming
Risk Transfer Specialist
T 0141 566 7943
E christine.cumming@hymans.co.uk

Iain Pearce
Risk Transfer Specialist
T 0121 210 4358
E iain.pearce@hymans.co.uk

Freya Williams
Risk Transfer Specialist
T 0121 210 4346
E freya.williams@hymans.co.uk

Kieran Mistry
Risk Transfer Specialist
T 0121 210 4338
E kieran.mistry@hymans.co.uk

Baljit Khatra
Risk Transfer Specialist
T 0121 210 4344
E baljit.khatra@hymans.co.uk

Harry Allen
Risk Transfer Specialist
T0121 210 4365
E harry.allen@hymans.co.uk

Eloise Richer
Risk Transfer Specialist
T0121 210 4386
E eloise.richer@hymans.co.uk

Emma Horsfield
Risk Transfer Specialist
T 0121 210 4390
E emma.horsfield@hymans.co.uk

Thomas Hoare
Risk Transfer Specialist
T 0121 210 4372
E thomas.hoare@hymans.co.uk

Tim Wanstall
Risk Transfer Specialist
T 0207 082 6330
E tim.wanstall@hymans.co.uk

HYMANS ROBERTSON
CLUB VITA

London | Birmingham | Glasgow | Edinburgh T 020 7082 6000 | www.hymans.co.uk | www.clubvita.co.uk