Summary
• Smaller DB pension schemes are finding that more and more insurers' doors are open to them when it comes to de-risking, due to the recent attention on the significant number of small DB schemes in existence.
• Small schemes are looking to de-risk as they still struggle to have the same investment opportunities as larger schemes.
• Many small schemes are looking to offload responsibility for their retirees by negotiating a bulk annuity deal with an insurer. Innovation in the marketplace has made bulk annuities more achievable for small schemes to obtain.
• In order to conduct a de-risking transaction, schemes are recommended to undertake a data cleansing exercise.
• Fiduciary management as a solution for smaller schemes can also help to reduce risk, as does consolidation of DB schemes.

Small and secure

Louise Farrand explores the growing number of options available for small-sized DB schemes looking to de-risk

Small is beautiful. At least, that's what insurers increasingly think. Smaller defined benefit (DB) pension schemes are finding that more and more insurers' doors are open to them when it comes to de-risking.

"The landscape has turned more towards looking at smaller schemes," explains Independent Trustee Services (ITS) managing director Chris Martin. He points to the Pensions and Lifetime Savings Association (PLSA)'s DB Taskforce *Interim Report*, published in October 2016. The report identified the fact that there are a small number of schemes with large numbers of assets and members, but there are very many small schemes. In fact, the PLSA found that the average scheme (by mean) has only 1,845 members and £217 million of assets under management.

"The research really drew the attention to the fact that actually, by bulk of numbers, *[schemes are]* down at that small end. Therefore, the market is turning its attention in that direction," explains Martin.

Martin's comments are echoed by Willis Towers Watson senior consultant Gemma Millington. "Across the board, not only among small schemes, we have had a busy start to the year. We have seen a lot of schemes approach the market and move on to transacting."

European legislation slowed the market down in early 2016, as pension schemes waited to see whether insurers' pricing would be affected by Solvency II legislation. "That slow start to 2016 resulted in the pick up we are now seeing," explains Millington. "Solvency II didn't have an adverse effect on pricing, so schemes that were sitting back and playing a waiting game have now moved towards a transaction."

Most insurers target a specific scheme size. Legal & General are unusual in the sense that they have always dealt with schemes of every size. "We have done transactions with a value of below £10 million this year, says Legal & General head of pension risk transfer Costas Yiasoumi. "As a scheme of a larger size you will be given more quotes and at a smaller size you will probably get smaller numbers. My experience is that every transaction is different and insurers are keen to transact."

It's no wonder that small schemes are looking to de-risk. While Martin believes it is now easier for them to access well-priced investment advice, they still lack the buying power of large schemes when it comes to investment. "You still have to get the quality investment advice, and that can be disproportionate, plus you have to monitor all the managers. That starts looking quite expensive for a scheme with £4 million, £5 million, or even £20

million of assets. Add to that the fact they need to monitor the covenant, and the costs of running a scheme can get quite high."

Bulk buying

Many small schemes are looking to offload responsibility for their retirees by negotiating a bulk annuity deal with an insurer.

"Bulk annuities are very efficient because it is straightforward to add extra liabilities into an already very large fund," says Yiasoumi. "The small end of the market is always very active. The very big transactions are few and far in between, but when they happen they tend to get a lot of publicity."

Millington reports that bulk annuity deals are more attainable than ever for small schemes, thanks to innovation in the market. "Particularly over the last 12 to 18 months, we have seen streamlining in bulk annuity and longevity hedging markets, which have opened up opportunities for schemes to carry out transactions on attractive terms."

Specifically, insurers are standardising the wording and terms in their contracts, which helps to make the process more efficient, she explains. That way, schemes can take advantage of pre-negotiated terms, which saves time all round, leading to cost savings.

Standardisation is also a trend Pension Insurance Corporation's head of business origination, Jay Shah, is seeing.

He reports: "By and large, bulk annuity contracts have been standardised across the market. Most insurers have relatively similar terms in their contracts, which helps. Once you have reached a commercial agreement with the trustees, putting terms in place is relatively streamlined, which helps manage the process for smaller schemes."

Shah adds: "If, as part of a process, an insurer is having to provide two, three or four rounds of quotations before a trustee is able to select their insurer, that is quite an overhead. It is more difficult to make it economical for a smaller scheme. Standardised contracts take out the costly aspects of the transaction."

New ideas

Innovation is also happening elsewhere in the de-risking market. "Fiduciary management as a solution for smaller schemes is something we are seeing quite a lot, and we absolutely support that. It is a way of helping trustee boards that may not have much of a governance budget to spend on running their investment strategy," explains Martin.

The PLSA published *DB Taskforce: The Case for Consolidation*, in March 2017. The report argues that the UK's proliferation of small schemes creates problems for sponsors, trustees and regulators and that pensioners would be better served by consolidating assets and achieving economies of scale in investment, administration and governance.

Several defined benefit master trusts have come to market recently, seeking to achieve similar economies of scale, Martin observes. "Especially in DB schemes, which are genuinely legacy – when they relate to former employees

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and there is no interest in running it in house, it makes sense to delegate,” he says. “But will they all survive? They all need critical mass.”

Making the case

Small schemes that are looking to embark on a de-risking project like a bulk annuity transaction should choose their advisers carefully. Independent trustees who have been through the process numerous times can carry weight with insurers, says Martin. “Generally, when we have been appointed to lead a transaction we make it happen. Insurers are generally more confident committing their time and capital to a discussion. We also get more airtime because we deal with big and small schemes.”

Schemes should be sure that their advisers have good relationships with insurers, says Millington. Insurers tend to specialise in a particular size of scheme, and a good adviser will know the whole market and be able to play matchmaker. “Before you approach the market, it is important to work with your advisers to work out what the best option is for you. Both before and during transactions, it is really important that *[advisers]* know the market, know what they are looking for and are able to position the opportunity to insurers in the right way in order to get those best terms.”

Shah suggests that trustees should work closely with their advisers to get a clear understanding of the market and what would constitute attractive terms for them. “We have had a few opportunities where trustees have said, ‘we have a pretty good view on where insurance companies are pricing, we know what would be a great deal for us and what would be a great deal for you, and if you can get to this pricing level and these terms, we can transact pretty quickly.’ “That is attractive from an insurance company’s perspective. It avoids a lot of iterations of refining a proposal because you know what the clients wants and you are able to assess whether you are able to deliver that or not.”

Getting your data in good order is also vital to getting attractive de-risking terms. Yiasoumi advises: “The schemes that just want a rough price tend to be the ones who have not spent the time going through and cleaning up the data. Sometimes things like cleaning data is driven by trustees, so if they are not willing to make that investment until they have a bulk annuity price, it gets a bit chicken and egg. I would always say that given you ultimately need clean data anyway, it is an expense you need to incur sooner rather than later.”

He adds: “Small schemes should make themselves as attractive as possible. Have clean data and know your benefits, demonstrate you are ready to transact and have a target price. Advisers should be able to give small schemes guidance on what price they should be willing to transact at. All those things help an insurer prioritise what cases they should focus on.”

Written by Louise Farrand, a freelance journalist