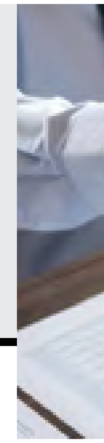

Summary
• Predictions for pension scheme bulk annuity deals for the year ahead have proposed a 'record year' following the past few years of steady growth. The market has now got to a level where it is securing £10-15 billion of pension liabilities each year, with this year set to be even higher.
• For schemes considering a bulk annuity deal, full preparation is necessary to gain insurers' attention.
• When deciding whether to embark on a risk hedging deal, schemes must be wholly certain that they are making the right decision and that the agreement is well suited to them.
• Stakeholders, scheme members and scheme sponsors must be provided with adequate information to be aware of the transaction taking place and how it will affect them.

Getting the right deal

With many insurers predicting and preparing for record bulk annuity transactions this year, Talya Misiri asks what has caused this upsurge and what interested schemes, trustees and sponsors should do to prepare

In a volatile market, most industries look to remove and protect themselves from all possible risks to ensure that they are not harmed. This is certainly no different for pension schemes in the UK.

With many insurers predicting record bulk annuity transactions with pension funds this year, trustees and sponsors are being encouraged to ensure that they are wholly prepared to secure a desirable deal.

Record year

Predictions for pension scheme bulk annuity deals for the year ahead have proposed a 'record year' following the last few years of steady growth. The market has now got to a level where it is securing £10-15 billion of pension liabilities each year and this year is set to be no different, or even higher.

"The fact that this volume of members' benefits is being secured in this way is a fantastic result for the pensions industry," says Legal & General head of strategic pension risk transfer Pretty Sagoo. At present, "many scheme trustees and scheme sponsors are within touching distance" to longevity transactions, Willis Towers Watson senior director of bulk annuity and longevity hedging Shelly Beard adds.

But like all market upsurges, it is important to ask what factors are expected to cause increased bulk annuity transactions in 2018?

On a large scale, improved equity markets has been a key motivator for growth in the bulk annuity market. Beard points out that "equity markets have done well" in the past year and to date, which has essentially led to the strengthening of pension schemes' funding positions.

Aggregate funding levels across all defined benefit schemes, as measured by the PPF, are over 16 per cent higher than they were in the period immediately after the UK's Brexit vote 18 months ago. Schemes are now 95 per cent funded compared to 78 per cent in June 2016.

"The main factor we anticipate increasing *[buy-in/buyout]* demand in 2018…is the increase in pension plan funding," says LCP partner Charlie Finch. In particular, it is expected that buyout transactions, as opposed to pensioner buy-ins, are due to increase as a result of improved funding, he adds.

With stronger funding levels and falling deficits, schemes are in optimal positions to secure a well-priced deal. "As deficits have reduced, the cost of transferring risk to an insurer through a buy-in or buyout has become more affordable for increasing numbers of pension schemes and sponsoring companies," Sagoo says.

Looking at the types of schemes that are likely to pursue these deals in 2018, Sagoo notes that there is demand "right across the market from small to large schemes". She explains that while schemes differ in size, assets and liabilities, "pension debt is risky, volatile and tricky to manage," therefore, "the underlying motivations for wanting to transfer risk to an insurer remain the same" across most schemes.

Nonetheless, better pricing as a result of Brexit has been cited as a reason for increased buyouts among multinational companies this year. Finch explains that the UK's departure from the European Union could lead to more multinationals seeking to buy out their pension plans. This is due to falls in the sterling following the referendum, which further reduced the cost of buyouts, as well as "if some multinationals seek to relocate from the UK due to Brexit then buying out their pension plan would be a natural step in that process", Finch says.

Preparation is key

With increased demand for bulk annuity transactions from all angles therefore, insurers are inadvertently awarded with greater power over interested clients. For schemes considering a bulk annuity deal, preparation is necessary as: with increased demand, insurers are able to be "picky", Beard emphasises.

When it comes to embarking on a bulk annuity deal, "preparation is key", she says.

Finch agrees that: "In terms of preparing for a transaction, we would advise schemes to draw up a plan identifying and prioritising the work required."

In order to be fully ready for a de-risking transaction, key bases must be covered by schemes and their trustees, Beard outlines. To achieve good pricing from the insurer, trustees and the scheme sponsor must agree on the objectives of the deal, she highlights.

In addition, both Finch and Beard advise that member data must be organised to a sufficient level. "Data does not need to be perfect but almost all schemes should be able to identify key priority areas where it is worth spending time upfront before approaching the market," Finch says.

Beard adds that member data must be in order and trustees should have an exact idea of which benefits need to be insured. Further to this, schemes are encouraged to allocate some time to work with lawyers to draw up benefit specifications and "codify how any discretionary benefits should be applied", Finch notes.

It is also encouraged that undertaking a feasibility exercise before approaching the market is beneficial to present stakeholders with a clear view of what the deal aims to achieve.

Ultimately, the potential for increased strains on insurer capacity emphasises that schemes must be fully prepared to approach the market.

Making the right decision

When deciding whether to embark on a risk hedging deal, schemes must be wholly certain that they are making the right decision and that the agreement is well suited to them. The "due diligence" must be completed to "make sure it's the right decision for the scheme," Beard notes.

"Even if a scheme is not yet in a position to buy out, insurance does not have to be an all-or-nothing decision. We are increasingly seeing schemes de-risk gradually through a series of buy-ins, each making the scheme more secure and less reliant on the sponsor," Sagoo explains.

Alternatively, in recent years insurers have witnessed collective de-risking deals come to the market. One example involves collective deals whereby multiple schemes under the same sponsor work together to achieve a combined bulk annuity deal.

By taking this route, Beard comments that a collective effort is likely to lead to better pricing, a more desirable deal and more insurer interest. Sagoo adds that pension schemes are encouraged to "engage early and collaboratively in order to get the best result from insurers".

"Insurers are more likely to allocate resources, assets and capital to schemes that are willing to provide a pricing target and a commitment to transact at that target."

Clarity and communication

Stakeholders, scheme members and scheme sponsors must be provided with adequate information to be aware of the transaction taking place and how it will affect them. Gowling director Suzanne Mortimer explains that the level of communication expected of trustees with members is dependent on whether it is a buy-in or full buyout.

"If it is the former then members do not need to be told anything about the transaction as the buy-in is just another scheme investment. If however it is a full buyout, members will need to be told about the transaction," she says.

While members are generally informed after the deal has been agreed, trustees should inform members that they will receive an individual annuity in due course and that their pension payments will switch from trustees to the insurer.

"Some members may be concerned about what the buyout means for them so reassuring words that their pension will not change are helpful; trustees will also be keen to make sure that a consistent message is given to members from the insurer," Mortimer adds.

"Insurers also invest in really good communications", to maintain a clear understanding of the deal for all involved parties, Beard comments.

Ultimately, "planning and preparation *[in all areas]* remain the keys to success" when it comes to bulk annuity deals, Sagoo explains. Schemes must work from the deal's inception to prepare their scheme, its data, members and stakeholders for the transaction in order to gain insurer attention.

Sagoo concludes: "In a year where demand in the market is high, showing commitment in the early stages may prove to be vital."

Written by Talya Misiri