How smaller schemes achieve good value in the bulk annuity market

Gavin Smith of Legal & General's Bulk Annuities and Longevity Insurance team explains why now might be a good time for smaller schemes to settle their liabilities and how to get the most out of a bulk annuity transaction

Many smaller schemes are coming to the conclusion that the natural place for their liabilities is with an insurance scheme rather than sitting on the company's balance sheet. One of the main reasons is the additional return insurance companies expect to achieve by investing in long-term illiquid assets that would be very hard for a small scheme to access alone. Insurance companies also benefit from significant economies of scale and have large dedicated teams solely tasked with managing risks.

During the last 18 months Legal & General has written over 70 policies for transactions under £100 million and we believe that this end of the market is only set to grow.

Following the 2014 Budget changes several new providers have entered or will shortly be entering the market with the majority of these expected to target smaller schemes. This increased competition can only be positive for schemes, leading to increased innovation and better pricing.

Given Legal & General's significant experience of helping smaller schemes achieve their de-risking goals, I will now share our top five tips for approaching a transaction.

1. Robust governance – having the correct team in place to approach the market is fundamental. I believe a joint trustee and sponsor approach increases the chance of a successful transaction. Engaging the right adviser is also important – many consultancies have specialist teams to run such processes and have specific, streamlined, small scheme offerings that look to reduce costs. This is a hotly contested area so shop around for the best advisers for you.

2. Feasibility – understand your objectives as well as the affordability constraints and probability of meeting them – there is no point in spending money obtaining insurance quotations if the transaction is not currently affordable. Again the right adviser can help you with this and look into alternatives or ways to increase affordability. Also be aware that scheme actuary buyout estimates prepared for statutory purposes are typically more prudent than actual costs due to competition in the market.

3. Ensuring data and legal quality – most schemes believe they have good quality data and legal documentation in place and this is true when it comes to managing a scheme on an ongoing basis. However when it comes to approaching the insurance market many lack the detailed information required to achieve best pricing. These include data items such as postcodes, marital status and spouses dates of birth, any outstanding legal issues and a thorough understanding of all the defined benefits offered. A thorough review of all data and legal documents is therefore highly recommended. The money spent could save you much more on the final insurance premium.

4. Approaching the market – whilst there is lots of appetite from insurers, they are limited by resources. Given the work required to produce a quote, many will need to select which quotes to proceed with based on the likelihood of success. Evidence of the completion of the three steps above will help in demonstrating to insurers that there is a transaction to be done. You should also consider how many insurers to approach – sometimes the additional cost of approaching the whole market can outweigh any additional price reductions you might get compared with only approaching a targeted two or three.

5. Timing – bulk annuity prices move around with market conditions and in the current financial climate we have seen movements of around 4-5 per cent in a relatively short timeframe. To avoid a transaction moving out of reach you may wish to consider ensuring your assets are aligned to move broadly in line with insurer pricing. High level regular monitoring of the funding position need also not be an expensive option and could result in significant savings.

Bulk annuities can be a cost effective and efficient way of de-risking, with careful planning upfront and the right advice you can achieve success whatever the size of your scheme. If you would like to find out more please contact me on 020 3124 2271 or email gavin.smith@landg.com*.

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