Adapt to survive

Pension funds and providers are adapting to the changing landscape across both defined benefit and defined contribution provision. Matt Ritchie looks at some of the innovation taking place in the market

Summary

- Deficit reduction, de-risking, and at-retirement products have all seen new approaches emerge recently.
- Initiatives previously only available to large schemes are increasingly being taken up by smaller plans.
- Activity is expected to increase in the bulk annuity space, in particular at the smaller end where medically underwritten solutions are becoming more mainstream.
- The government's legislative agenda for the next year has created room for further innovation in the pensions space.

A huge amount has been written and said about the pace of change in the pensions industry in recent years. And as times change pension schemes and providers are adapting and innovating to find ways of succeeding in new environments.

It is not just new techniques that are being arrived at, there is also a drive to find ways to offer pension funds of all sizes solutions traditionally restricted to the largest schemes.

From closing funding gaps, to removing risk from sponsors' balance sheets or providing new ways for members to use their savings, the industry is not resting on its laurels.

ABCs

Asset backed contribution deals are one way schemes are using less conventional methods to achieve their objectives.

ABCs typically see the sponsor and scheme establish a Scottish Limited Partnership. The sponsor will transfer assets into the SLP, and the revenue stream accrues to the scheme as a funding contribution.

The deals have been around for almost a decade, but have traditionally been the preserve of larger schemes. This has now changed dramatically, with the overall number of deals increasing and much smaller transactions taking place.

A report from KPMG earlier this year showed 23 ABCs were made last year, up from seven in 2012.

The average transaction size has decreased considerably over time, the accountancy firm said. The average deal last year was valued at around £80 million, compared with about £320 million in 2009/10). Seven new ABCs of £25 million or less were implemented in 2012/13, compared with just three prior to that.

The size of ABCs is not the only thing undergoing change, as the sorts of assets used to fund contributions is also developing.

Property remained the most popular type of asset used in ABCs in KPMG's survey, with 66 per cent of the transactions using it. This was up from 61 per cent in previous surveys.

Intra-group loans have been a popular asset, used in 14 per cent of deals. Bonds, receivables, and commercial loan portfolios each featured in 5 per cent of deals in 2012/13, while 'other' assets also appeared in 5 per cent of transactions.

De-risking

While more schemes and sponsors are using ABCs to close deficits, the ultimate aim for many remains getting liabilities off the balance sheet altogether.

Aon Hewitt risk settlement consultant John Baines says in 2013 UK pension schemes completed "a record £7.8 billion of bulk annuity transactions", which was an increase of 65 per cent on £4.7 billion worth of deals in 2012.

"The market continues to grow at pace and schemes are understandably looking for more affordable ways to de-risk as they seek greater pensions stability. Medically underwritten annuities are an attractive and viable option that both small schemes and larger schemes with a concentration risk are now exploring."

UK schemes could save up to £50 million in transaction costs this year through underwriting bulk annuity deals with medical data of members, Aon Hewitt says.

Changes to the rules of defined contribution arrangements removing heavy tax charges for savers who do not use annuities are also expected to boost activity in the market, as insurers seek to replace business lost as a result of a dip in the market for individual annuities.

Towers Watson expects an increase in the capital available to write bulk annuity business over the long term, reducing the risk of a future capacity crunch.

The emergence of bulk annuity deals written by insurers that previously only offered individual annuities could see the market segmented by

transaction size, the consultancy says, with smaller deals executed on a medically underwritten basis.

JLT Employee Benefits recently advised on just such a deal, which took advantage of the multi-insurer broking process first used for a medically-underwritten buy-in for the British Arab Commercial Bank last year.

The new £8.5 million deal with Just Retirement covers all the non-insured pensioners of the DDD Limited Pension Fund.

JLT's process uses a third party to collect medical information from members on behalf of trustees through a short medical questionnaire. More detailed information is gathered from some members through telephone interviews and/or general practitioners reports.

The information gathered is then shared with all participating insurers to ensure the buy-in pricing is based on consistent information, resulting in accurate quotes and a competitive process.

JLT Employee Benefits senior consultant, buyout team Ruth Ward said the deal had to overcome some difficult issues, including the fact the transaction used most of the scheme's invested assets.

"Our whole of market broking process again achieved the client's desired result and we expect to see many more underwritten trades in the bulk annuity market going forward, particularly, but not exclusively, for smaller schemes, such as the DDD Limited Pension Fund, which have a high concentration of mortality risk in a relatively small number of individuals with a high liability," Ward said.

Individual annuities

The Budget this year completely changed the game for individual annuity providers, and many have responded swiftly with transitional offers to take advantage of the new environment.

As a result of the changes, from April 2015 anyone aged-55 or over will be able to take their entire pension pot as cash, paying only their marginal rate of tax on the whole value above the 25 per cent tax free lump sum.

Specialist enhanced annuity provider Partnership promptly launched its 'Enhanced Choice Annuity' in response, allowing retirees with health or lifestyle conditions to access their tax free cash and access a guaranteed income for life, but providing the option to cash in after 12 months.

Partnership's managing director of retirement Andrew Megson said many people facing retirement are unsure what to do in the new environment and the new product aims to help people "navigate this new landscape".

"The Enhanced Choice Annuity not only allows them immediate access to a predictable income and their tax-free lump sum but offers them the opportunity to continue to benefit from the security of a guaranteed income for life if they feel that this is the best option for them. However, if they decide there are more attractive options in a year then they can switch out."

Enhanced annuity specialist Just Retirement has launched a one-year fixed-term annuity in response to the changes, directed at those who need an income between now and April 2015.

"At times of uncertainty people like to keep their options open," the company's director of external affairs Stephen Lowe says. "Our one-year fixed-term annuity is a way people can start using their pension savings to fund their retirement now whilst giving intermediaries time to review their clients' position next year when the details of the new rules are known."

LV= launched a product on a one-year fixed term basis, offering clients their guaranteed maturity value and allowing customers to select any income from nil to 150 per cent GAD.

The future

The changes announced this year have sent providers scrambling to design new products to offer into the new-look marketplace post April next year. The nature of default funds is changing, and new at-retirement and drawdown products are emerging.

In the most recent major change the government announced the law would be changed to provide for collective defined contribution schemes to be offered to UK savers.

The plans received a mixed response, but a number of consultants welcomed the move and there is little doubt UK-tailored frameworks are currently under development to be shopped to workplaces across the country soon.

Whether in response to legislative or market changes, the pensions continues to evolve and adapt. Some initiatives will succeed where others will surely fail, but there is little doubt it will be a very different looking industry by the end of the decade.

Written by Matt Ritchie