Making short work of the long run

Rob Mechem explains the essentials of planning for a bulk annuity

I recently completed my first 100 mile run. Of course I didn't simply turn up without preparing and expect to run several marathons back-to-back! I followed a training plan; to improve my fitness, build my stamina and mentally prepare to run the South Downs Way 100 (which felt more up than down!).

Pounding the hills gave me plenty of thinking time. I was mentally ticking-off the milestones on my training plan when I started to consider what steps trustees can take to ensure the success of their first bulk annuity. So here's my trustee training plan.

1 – Align stakeholders behind a clear plan

With improved scheme funding levels and attractive insurer pricing, there's been unprecedented activity in the bulk annuity market. As a result, it's more important than ever for trustee boards and sponsors to be well aligned behind a clear plan to de-risk. This will signal you're serious about transacting and guarantees attention from advisers and insurers.

2 – Communication, communication and communication

Early and targeted communication will help secure and maintain this alignment between trustees, the sponsor and other stakeholders.

Do all stakeholders understand the benefits of a bulk annuity and the processes for selecting, transacting and implementing one? Bulk annuities are insurance contracts and benefit from the protection of the insurance regime with its solvency capital requirement and 100 per cent compensation of insured benefits through the FSCS in the unlikely event of the insurer failing.

Ask yourself what's generated the impetus for this bulk annuity? Has it been initiated by the trustee board, as part of a planned de-risking strategy agreed with your advisers – perhaps the next stage after an LDI strategy has been implemented and funding targets achieved? Has it come from your sponsoring employer, perhaps ahead of M&A activity?

This will help you plan how to communicate with stakeholders to build and maintain their alignment behind the bulk annuity transaction. Do they need to be educated, consulted or simply informed of any plans and decisions?

Once the transaction is complete, you may want to write to members to explain the protections you've secured.

3 – Do you need a specialist on board?

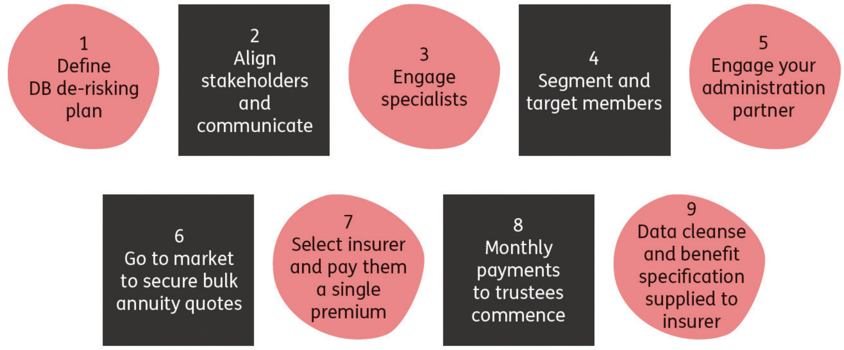
These are specialist transactions so you could benefit from the expertise of an independent trustee. Your advisers will have de-risking specialists, ensure they're engaged and supporting development of your plans.

4 – Start with the end point in mind and plan accordingly

For many schemes, the route to buyout

and wind-up is via a series of buy-ins to target specific tranches of liabilities. Sequential buy-ins enable you to de-risk in stages, by insuring the liabilities for tranches of your membership, perhaps as they become pensioners.

Less common are the ultra-marathons of the bulk annuity world; single transactions that target all liabilities of the scheme with a buyout.



5 – Which members should I insure first?

Assuming you're not going straight to buyout, when all members must be included, you should work with your adviser to select the tranche of members to insure. Selection has to be objective to avoid bias. So for example, you could select all current pensioners to be insured, or every third member of the scheme, or a 'top-slice', which is a group of members with the highest liabilities, often executives.

Such 'top-slices' can represent the most efficient use of scheme assets to de-risk. Liabilities are concentrated within the top-slice, so the impact of a few executives living longer than expected will be disproportionately costly to the scheme. By insuring them within a bulk annuity, you're transferring all this longevity risk to the insurer.

It's worth noting that big is not always beautiful for a bulk annuity. Pricing advantage can be delivered by medical underwriting, but it's only available for tranches of 300 members or fewer. Medical savings can be proportionately more significant for 'top-slices' of higher liability members where it only takes one or two to have a medical or lifestyle condition to deliver valuable savings compared to a standard transaction. Even large schemes can create a 'top-slice' to facilitate medical underwriting.

6 – Data, benefits and the role of your administration partner

Insurers will require accurate and comprehensive data for the members and dependants to be covered. The process of confirming this information is called a data cleanse and it can be undertaken by your administration partner post transaction.

Make sure they're on board with your plans. Tell them which members and dependants are going to be covered and empower them to start the data cleanse, complete any GMP reconciliation if applicable and support scheme lawyers to prepare documentation of the benefit schedule.

"It's more important than ever for trustee boards and sponsors to be well aligned behind a clear plan to de-risk"

In a competitive market, trustees who can show these processes are underway will be signalling their intent to transact and will be more likely to secure the attention of advisers and insurers. Like the London Marathon, only the elite, who are well prepared, can guarantee they'll be running.

Some administrators will be calculating benefits on a just-in-time basis. So they won't necessarily have comprehensive documentation of benefits due. Your administrator will have common data in place but conditional data that specifies benefits due may be incomplete, as you'll know from the TPR score you submitted for your scheme early in 2018 that rates the completeness and quality of this conditional data.

Having incomplete conditional data could mean that in time, as payments to deferred members and dependants commence, there will be a difference between the payments being funded by the insurer and liabilities due. It's something to be aware of, particularly if you're close to buyout, when your insurer will need to be certain the benefits for all pensioners, deferred members and dependants are fully and accurately defined so they know exactly what liabilities they're taking on.

7 – Your first bulk annuity

If everything I've outlined above is in place, you'll be more than ready to secure the attention of insurers. The planning will have paid off and the day of the race is upon you. But unlike my ultra-marathon, you won't be working alone. Once you've selected an insurer, they'll work closely with you and your administration partner to support the data cleanse and creation of a final benefit specification.

Complete an ultra-marathon and it's likely that as well as feeling virtuous, you'll have improved your longevity. If you're lucky enough to be the member of a DB scheme, this isn't something that'll please the scheme actuaries. Perhaps insurers should be checking whether members to be insured by a bulk annuity have recently completed a marathon? Now there's food for thought!

Written by Rob Mechem, head of DB business development, Just

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