This is not just any buy-in deal; it's an M&S buy-in deal…

Theo Andrew talks to head of Marks & Spencer Pension Trust and chief investment officer, Simon Lee, to get the low down on their recent £1.4 billion buy-in deal, it was approached, what the benefit will be for its members, and what it plans to do moving forward

Please could you give an overview of the M&S defined benefit scheme and its current position?

The M&S Pension Scheme is a defined benefit scheme that closed to new members in April 2002 and to future accrual in April 2017. Established in 1938 as a benevolent trust, the pension scheme today has almost 112,000 members with around 51,000 pensioners and 61,000 deferred members.

The scheme, which has assets in excess of £10 billion, is significantly hedged against real interest rate risks and at the last actuarial valuation, as at 31 March 2015, was 102 per cent funded on technical provisions, with a surplus of £204 million.

What were the main reasons for the buy-in, and who helped with the deal?

The scheme's financial health and strong funding position has allowed the trustee to follow a strategy of reducing risk by aligning investments more closely with the pension benefits it will need to pay to members. This has been jointly managed by the trustee and M&S (as the sponsoring employer) through the consideration of a range of de-risking opportunities as part of this strategy. Longevity risk is a material risk to the scheme and a joint working group was established to consider how this might be addressed.

LCP led the advice to the trustee on the buy-in transactions, having been appointed to advise the trustee on its strategy to reduce the scheme's longevity risk. Linklaters provided legal advice to the trustee in preparing for and executing the transactions. The trustee was supported by the scheme actuary and its investment adviser, Willis Towers Watson. M&S is advised by Hymans Robertson. The trustee established clear roles for each adviser to ensure that the process was undertaken effectively and efficiently.

The purchase of buy-ins has allowed the scheme to better match future benefit cashflows and remove longevity risk for a portion of the pensioner population within the security of regulated insurance policies, all at an attractive price.

Was the buy-in the only pathway that was considered?

The trustee and M&S took detailed professional advice, completed a thorough review of the longevity risk market and ran a competitive selection process before deciding to purchase the bulk annuity policies.

How long had it been in the pipeline and why has the deal happened now?

Longevity risk management has been on the trustee's radar over the past few years and its relative importance has increased with the hedging of other risks and the de-risking of the scheme's investment strategy. The trustee has followed the development of the longevity risk market both in size and sophistication.

Last year, the longevity risk market had experienced a quiet summer period, which meant that when we first approached the market, insurers and re-insurers had high levels of capacity. With significant competitive tension, we were able to benefit from insurers adjusting their pricing models to reflect; recent heavier mortality experience, greater reinsurance capacity and the quality of our member data. The approach to market saw a lot of interest in the scheme's pensioner demographic, which is largely female and part-time and hence a good diversifier for insurers who have previously written buy-ins for male, full-time, blue-collar pension liabilities. 2018 is already seeing an increase in buy-in and longevity swap transactions across the DB pensions space.

What were the main challenges when completing the deal?

The timing of the transaction was crucial in benefitting from favourable pricing, which naturally presented a challenge in executing the deals under a relatively short timescale.

This was ultimately achieved through thorough preparation by the trustee and simultaneous engagement with both buy-in providers and longevity reinsurers in a transparent and efficient process led by LCP.

The trustee established a Longevity Transaction Committee to manage the detailed execution and with support from its advisers, was able to move quickly and ensure that the deal agreed was in the best interests of its members.

The effective collaboration between the trustee and M&S, demonstrated the importance of working together effectively to achieve positive outcomes for both scheme members and the sponsoring employer.

What will it mean for the members of the scheme? How have you communicated with them?

The two buy-in transactions, totalling £1.4 billion, cover one-third of the pensioner liabilities, around 17,000 members. The benefits that these policies cover are not affected by this investment and all pensions will continue to be paid from the scheme. The trustee retains the liability for these benefits and the fiduciary duty to the members.

These buy-in policies help protect the scheme against risks such as poor economic conditions and paying pensions for longer than currently expected. It makes the future cost of paying those benefits easier to predict, which improves the financial security for all members' benefits.

In an environment where pension schemes funding difficulties have been widely reported and where in the past, the nature of buy-in transactions have been mis-reported as a transfer of all responsibilities, it was important for the trustee to update all members about the investment. It chose to do this through its newsletter and information available on the scheme website, which was published before the announcements were made externally.

Do you have any plans moving forward to cover the remaining two-thirds of pensioner liabilities not included in the deal?

The trustee will continue to pursue opportunities that further protect the security of benefits as part of its strategy to effectively manage the risks to the scheme. The buy-in policies that were transacted were done so within framework documentation that would allow further buy-in transactions to be executed, but the trustee will consider all options to reduce longevity risk over time. The trustee will take such steps if it believes it is in members' interests to do so based on professional advice and taking account of market conditions and insurance pricing at the time.

Written by Theo Andrew

About the M&S Pension Trust buy-in deal

Last month saw Marks and Spencer complete a £1.4 billion buy-in with Aviva and Phoenix Life, covering around a third of its scheme's pensioner liabilities.

The £1.4 billion deal comprised of a £470 million bulk purchase annuity with Phoenix Life and £925 million bulk purchase annuity with Aviva, the insurer's largest bulk annuity deal to date. The deal is Phoenix Group's first external BPA transaction, less than a year after it entered the market.

The deals with both insurers were under umbrella master agreements and transaction schedules, which allows the trustee to complete further buy-ins with either of the two insurers or other market participants in future.

M&S's deal signifies the retailer's continued effort to reduce the risks in its £10bn DB pension scheme, following the closure of the scheme in 2017.

Editorial credit: patat / Shutterstock.com