Small, but packing a mighty punch

One year on from the launch of Just's DB Choice bulk annuity product, *Pensions Age* considers how medically underwriting members post transaction enables small pension schemes to easily and cost-effectively remove significant liabilities

The UK bulk annuity market is charging towards a record-breaking year and is well on track to exceed £18 billion of transactions. Over the past 12 months it has been the larger of these deals grabbing headlines, such as the £4.4 billion pensioner buy-in for British Airways and Siemens' £1.3 billion buy-in. Seeing this, small schemes may be forgiven for thinking that this growing market is not for them. However, the bulk annuity market cannot be this vibrant without innovation occurring across the entire sector.

Take DB Choice from Just. Launched in November 2017 for bulk annuity deals of 300 members or fewer, it has turned medical underwriting on its head by providing a guaranteed price ahead of the transaction and then collecting medical and lifestyle data after the transaction has completed.

Previously in typical, medically-underwritten 'top-slicing' deals, where only a proportion of a scheme's members, those with the highest liabilities, are insured, medical underwriting would take place pre-transaction. This would sometimes make completing the deal too slow a process for pension schemes, compared to undertaking a bulk annuity transaction without medical underwriting.

This proved to be too convoluted a process for many schemes, Just head of DB business development Rob Mechem explains, as they would have to make a 'judgement call' as to whether they would get a reduction in cost following medical underwriting, and if so, by how much.

The solution to this is DB Choice. It provides a guaranteed transaction price before the medical underwriting occurs – the cost stays the same no matter the result of the underwriting. This enables quick and easy comparisons with other tenders.

"The proposition was developed in response to trustees saying they needed to compare our pricing with competitive standard quotes," Mechem says. "To make that possible we calculated the average reduction in premium we anticipated achieving over the longer term by medical underwriting and applied this to our DB Choice medical pricing, which is guaranteed and therefore can be compared with standard competitor quotes."

The comparison can be very attractive, as DB Choice offers the pricing advantages that can come with longevity assumptions calculated using medical data, to deliver a lower price than a conventional quote that just uses postcode and lifestyle factors as its pricing basis.

Just's extensive experience in medically underwritten annuities – they are the only provider active in the bulk annuity market to offer this – allows them to confidently price in the expected savings medical underwriting will provide to its quote.

The company's experience and expertise in medical underwriting means it makes the process of collecting medical and lifestyle data as easy as possible for the trustees and members, with minimal intrusion. As the medical underwriting takes place after the transaction, DB Choice transactions can be completed within the same timescales as standard transactions, enabling trustees to secure favourable market conditions, Mechem says.

The medical underwriting process begins with the selected members being sent a letter from the pension scheme (a Just templated letter can be used to assist the scheme with this) explaining that Just will be writing to them and why.

Just manager DB underwriting Jill Harvey says that on average, they normally only write to about 60 per cent of the members and dependants to be covered, focused on the highest liabilities then working downwards – so not everybody needs to supply data.

These members are then sent a form from Just asking some simple questions regarding their health and medical history – all of which is confidential and seen only by Just. In the vast majority of cases – 75 per cent of the time, Harvey says – the questionnaire is all that is needed for Just to make estimates about the participant's life expectancy.

If the member has expressly given permission to do so, a quick phone call for clarification is needed for just 20 per cent of those who return the form and rarely, in 5 per cent of occasions, Just may write to the member's doctor – if permitted. This is in cases where it may be insensitive to quiz the member further, such as in a diagnosis of dementia, Harvey explains.

A few trustees can be reluctant to medically underwrite as they're concerned some members may be unwilling to disclose sensitive medical information. However, Just prides itself on the 'kid glove' approach it takes, for instance by providing a guidebook for members answering frequently-asked questions, which provides reassurance both for trustees – by ensuring they fully understand the process – and for members by ensuring they understand that the information they supply will never be shared with their employer or the trustees of their scheme and will not impact the value of their pension.

The results speak for themselves. Just has underwritten over 4,000 people this way without member complaint or incident, Harvey says. She finds that on average, 65 per cent of members sent the medical underwriting form by Just return it – which, considering that key to the process is making sure the member understands that they are under no obligation to respond, and that they receive no personal benefit for doing so – is particularly impressive.

But it is not just the members themselves that respect and see the benefits of the medical underwriting process. Just enjoys strong support from the employee benefit consultancies (EBCs) that have implemented DB Choice, to the extent that some have gone on to recommend the process to other pension trustee clients.

Since its launch just 12 months ago, Just has worked with four EBCs to complete seven DB Choice transactions for six schemes, worth over £180 million.

Large bulk annuity deals may have grabbed most attention over the past year. But this unique DB Choice proposition has ensured that smaller transactions enjoy the benefits of this buoyant market – making this an amazing year for the bulk annuity sector in more ways than one.

NG Bailey

NG Bailey wanted to manage a common risk facing many pension schemes – having a relatively few people with large DB benefits greatly impacting upon the liabilities of the company's pension scheme.

NG Bailey is a fourth-generation, family-owned construction and facilities management business in Yorkshire.

"Like a lot of businesses of that type it has got a significant DB pension scheme, with over £300 million of assets," independent trustee for the scheme Jon Sharp says.

It also has around 3,000 members. "One area of risk was that some of these members have much larger pension promises than others and therefore if they happen to live longer than expected, that can have a disproportionate impact on the funding of the scheme," Sharp says.

So when the pension scheme's investments were in a "good place", it was decided to insure these member risks through the medical 'top-slicing' process.

The scheme and sponsor agreed that £50 million would be allocated for this deal to see how many of the highest-liability members could be insured for this amount.

"That is where DB Choice and this flavour of medical underwriting process becomes quite powerful," Sharp says. "It allows you to insure longevity, inflation and investment risks at a good price."

Just simply provided their best price, making it very straightforward and easy to compare with other providers, he explains. "They were below the next best quote we had." None of the other quotes featured medical underwriting.

Just was able to insure 100 NG Bailey pensioners for the £50 million.

The process of completing the transaction took just two months, with the medical underwriting process taking place for a few months after the transaction had been completed.

In this instance, the NG Bailey pension scheme sent the questionnaire to members, as opposed to being sent by Just, as the scheme was very keen to ensure that members would not feel obligated to respond.

"We wanted to have that partnership approach in the way it was communicated to members. We wanted to make sure it was appropriate and that no one felt under pressure," Sharp explains.

The pension scheme received just one member query, checking that their pension amount was not changing.

"Most members positively received it," Sharp says. "For a lot of businesses and especially family-owned ones like NG Bailey, there is a warmth between the pensioner, former employer and trustees. So many members were pleased with the idea that if they provided some details it may help the pension scheme to be run better."

The sponsor was also very happy with the use of DB Choice. "We were pleased with the buy-in process, which is a positive step in helping us manage our pension scheme to the benefit of scheme members, employees, customers and shareholders," NG Bailey CFO Mike Porter says.

With the success of DB Choice, more deals may well occur in the future for NG Bailey.

Summary
- De-risking sales has had a bumper year in 2018. Can this be sustained into 2019?
- Insurers are hunting for diversifying assets in a crowded market.
- The emergence of DB consolidators is stirring up the status quo.

Pension de-risking: The only way is up?

The pensions de-risking market is enjoying a record year and the sector is expected to stay buoyant despite potential competition from DB consolidators

As 2018 draws to a close, the pensions de-risking sector can look back on a bumper year of activity.

With a record-breaking £7.7 billion of buy-in and buyout activity transacted in the first six months of the year – just £4.5 billion shy of the 2017 total, according to data from LCP – the rapid pace has not yet slowed. Experts predict pension funds to offload liabilities worth almost double the H1 amount by the end of the December, as several large deals have completed since mid-summer.

But with storm clouds gathering over major financial markets and global politics looking unsettled, might the good times be drawing to a close? Add into the mix a new breed of pension consolidation firms, keen on mopping up pensions desperate to de-risk, and suddenly the outlook might not be as rosy as it once appeared.

To look to the market's long-term future, it is worth examining why the market has had such a good run thus far.

In 2018, the pension de-risking sector found customers lining up to offload their assets and liabilities. These customers, UK defined benefit schemes, had entered a purple patch themselves, and wanted to make hay while the sun shone.

Since September 2016, schemes have clambered back towards full-funding, according to the Pension Protection Fund's figures. From just under an aggregate 80 per cent funding ratio in September 2016, a year later the figure was above 90 per cent and climbing, leading many to seek insurance against it falling again.

In June 2018, Mercer's annual *Asset Allocation Survey* found 17 per cent of UK DB funds were actively considering buyouts, with another 18 per cent looking at a buy-in. The survey found the proportion of DB plans that were targeting a buyout with an insurer had increased to 24 per cent from 17 per cent a year earlier.

Just Group director, defined benefit solutions, Tim Coulson, says: "There is no incentive for schemes to wait, most are closed to new members and/or future accrual. If schemes can afford it, they are doing it."

On the other side of the equation, these schemes found no shortage of potential suiters, with prices at a level they often could not refuse.

One significant factor in this price drop was that longevity assumptions, which had been steadily rising, levelling off. Meanwhile while more players in the reinsurance market decided to take on the risk, meaning offloading it came with a lower price tag.

Rothesay Life co-head of business development Sammy Cooper-Smith says it had declined to quote on several schemes that had come to the market this year, citing some providers offering prices the company was not inclined to try and beat.

Sellers' market

However, despite the de-risking option becoming more affordable for schemes, the great numbers looking to transact has begun to work against them.

"Insurers are becoming fussy about what they quote on," says consulting firm LCP partner Charlie Finch. "They are becoming more tentative about what they put their best pricing out for."

Coulson says his team was picking over the requests to tender that arrived each week and was certainly not pitching for all of them.

Legal & General effectively shut up shop after announcing a £4.4 billion pensioner buy-in with BA in September, followed by a £2.4 billion buyout with Nortel, according to XPS head of de-risking solutions Colette Christiansen.

It took the insurer's volume for the year to around £8 billion – more than had been transacted in the whole market in 2016.

"The market is putting the brakes on quotes," says Christiansen. "When these companies set out what they can do at the start of the year, they have to be ready for this situation."

Large deals take up huge amounts of manhours, time and capital, according to Finch, and the volume the market brought this year has soaked much of it up.

This means that rather than a flurry of deals happening in the final quarter of the year, as has been the pattern since de-risking took off, most of the transactions have already been done, says Coulson.

"Corporates want to get things done before the year end," he adds.

But these large deals, along with soaking up corporate time and money, have also meant insurers have had to be innovative in their investment strategies.

While the majority of their asset pools are still made up with corporate bonds and gilts, insurers have been hunting assets that produce good returns, along with matching liabilities, now that they are fully au fait with Solvency II capital requirements.

Finch says each insurer had followed its own distinct path since the regulation was introduced in 2016, depending on the type of deal they favour.

L&G have gone headlong into direct investments, Scottish Widows have favoured shorter-dated securities, while Just Group has taken a keen interest in mortgages, he adds.

"There are only so many specialist assets out there," he explains, adding no insurer wanted to dilute the potency of an asset's returns by overbuying and bulking up on them.

Rothesay Life has cast its net widely to increase its chances of finding suitable investments. Cooper-Smith says the insurer had opened offices in New York and Australia to scout for assets to buy.

The company took on a £12 billion annuity book from Prudential in the first half of the year.

"Insurers are having to look deeper and further afield," says Cooper-Smith. "But there is not a finite pool."

A crowded trade?

This pool may have to go deeper and wider, however, as new players are joining the game.

In the past year, DB pension fund consolidation firms have appeared on the de-risking landscape.

These firms do not offer a true de-risking solution but will take on assets and liabilities for a fee and manage them as part of a larger portfolio. Although not formally approved by the regulator, there have been signs that both it and the Department for Work and Pensions see consolidation as something positive for the sector.

The Pension Superfund, founded by the brainchild of de-risking specialist Pension Insurance Corporation Edi Truell, intends to take on multiple schemes and manage them through to wind-up. Any shortfall will be covered by the superfund's backers – who will mop up any surplus, too.

Clara takes a similar approach, bringing on board multiple schemes, but rather than manage them to their final payment, the firm intends to be a 'bridge to buyout', according to its founders. They will do this through a process of cleaning up data and positioning the scheme's overall set up to be attractive to a range of insurers.

While only schemes at full-funding – or those happy to hand over the cash to make up the difference – will be admitted, these consolidators need to hold assets to match or even make good the liabilities they take on. But much of the groundwork has been done for them.

Mercer's survey showed UK DB schemes have retreated from equities to bonds – the ideal choice for de-riskers and consolidators – over the past decade. In 2007, the average UK DB scheme held 61 per cent of its portfolio in equities, with just 36 per cent in bonds. At the start of 2018, half of UK DB pension assets were in bonds, with the remainder split between equities and diversifying alternatives.

Plenty of room at the inn

If approved, few are concerned that Clara, the Pension Superfund, or any other consolidator will take market share from the ultimate de-risking market.

"The Pension Superfund stands on its own, but insurers will be happy to work with Clara," says Christiansen. "They will not see it as competition for clients or assets – if anything it will be easier for them to have one point of contact and a standard way of working."

The direct market looks in rude health, too. Cooper-Smith says Rothesay Life's pipeline, like the rest of the sector's, looked healthy going into 2019, and Coulson is just as confident about Just Group's future plans.

"The pipeline is strong, and while these deals do not happen overnight, £20 billion a year is the new normal," Coulson states.

Written by Elizabeth Pfeuti, a freelance journalist

In association with JUST.