Practice makes perfect

The Co-operative Pension Scheme, Pace, has completed four buy-ins in 2020, totalling almost £3 billion. At the PLSA's latest Annual Conference, Co-operative pension investment and risk manager, James Giles, explained the benefits of multiple transactions, and how the scheme was able to take advantage of attractive pricing

2020 has seen a number of trends emerging in the bulk annuity and consolidation markets, with more schemes than ever looking to de-risk amid the pandemic and an increasing level innovation in structures expected. One such trend that is emerging is that of multiple de-risking transactions, such as the four buy-ins completed by The Co-operative pension scheme, Pace, in 2020.

Speaking at the Pensions and Lifetime Savings Association (PLSA) Annual Conference 2020, The Co-operative (Co-op) pension investment and risk manager, James Giles, discussed the recent transactions undertaken by the scheme this year, the challenges it faced, and the benefits of an umbrella contract.

This follows the first ever buy-in for the Co-operative and its Somerfield Pension Scheme, in 2019 *[see PA October 2019 for more details]*, when the sponsor insured £425 million of liabilities with the Pensions Insurance Corporation (PIC), learning lessons that would support the sponsor in de-risking its core pension scheme, Pace.

Pace, which has around £4 billion in assets, has been in existence for almost 100 years, and was the main pension provision for everyone working in Co-op stores, funeral homes, Co-op insurance and the Co-operative bank, before closing to accrual in 2018. Speaking at the PLSA conference, Giles explained that the scheme was well funded, with longevity being the main residual risk for the company to focus on, in order to reduce this over time.

Setting a goal

He added: "Once we had decided on that as a target, we looked at the options and concluded that a pensioner buy-in was the best option for meeting our objectives. Our longer-term objective is to make sure that we can continue to pay pensioner benefits as they fall due and run off the scheme in as low a risk way as possible to members, but also to the employers, but making sure we're not doing anything along that journey that would make a future full risk transfer or a full scheme buyout more challenging."

Giles also clarified that whilst the scheme has considered other options, including a full scheme buyout, they had felt more comfortable with multiple buy-ins; firstly as the buyout would have required a significant cash injection that wasn't available, but also because a pensioner buy-in was more straightforward.

"Looking at deferreds is obviously harder because the benefits haven't crystalised so the data also needs a bit more work, and a full risk transfer with residual risk cover would have required greater due diligence from our perspective," he said.

However, he added that there were areas that needed greater consideration to avoid causing potential issues securing future bulk annuities. For instance, he noted considerations in terms of what section of the scheme to include in the buy-in, adding that it can be harder to insure populations with a larger deferred component, which meant that the scheme had to ensure that it did not skew the residual population to deferred members, making future transactions harder.

Giles also highlighted considerations in terms of how the transactions were to be communicated with members, stressing that all scheme communications were clear that the deal wasn't singling out any pension scheme members, but rather improving everyone's security.

"Really, we treated it as just a regular investment decision, so we communicated it through the reporting accounts, the member updates… but we've not made a huge deal of it," he said. Giles also noted however, that where the scheme did have member engagement was amid the spousal existence exercise undertaken prior, highlighting the importance of ensuring communications are genuine and credible, particularly in the current environment.

The scheme has now completed four buy-ins in 2020, with two £1 billion buy-ins with Aviva and PIC announced in January and February. This was subsequently followed by two

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transactions, which were completed amid market volatility stemming from the Covid-19 pandemic and saw £350 million of liabilities and £400 million of liabilities insured with Aviva and PIC, respectively.

Lessons learnt

Through these transactions, key strengths of the scheme and sponsor have begun to emerge, with ongoing flexibility aspect of this.

For instance, Giles explained that whilst the Co-op issued requests for quotes in 2019, when the market was "pretty busy from transactions", feedback from insurers was clear that the scheme would be able to secure better pricing if the actual implementation of transactions was deferred until early 2020, which the scheme agreed to. Furthermore, he added that, amid the large transactions in 2019, there was not much appetite for a £2 billion transaction, which led to two smaller £1 billion transactions with separate insurers.

"We weighed that up and were comfortable I think, given that the pricing we were offered worked in terms of our objectives, that we would rather proceed on that basis, than delay and run the risk that pricing movies away from us," he stated. Having an umbrella contract in place meant the scheme could move very quickly, he adds, noting that discussions with the insurer also allowed for bonds that were already held to be used, again speeding up the process.

It was not just the umbrella contract structure that allowed the scheme to move quickly however, with Giles also noting engagement from both the trustees and sponsors as making the scheme more credible, in turn allowing it to be particularly flexible in timings and move quickly when needed. He highlighted this governance structure as one of the key processes applied from the previous smaller scheme transaction completed in 2019.

"Putting a formal joint working group in place between the trustees and the sponsors, with delegated decision-making authority, allowed us to be confident that we knew exactly what decisions we would need to make and that we could go to market happy that we would be able to transact if we hit certain targets around price or scale," he explained.

Of course, this is not the only lesson learned from previous transactions, with Giles stating, for instance, that the scheme had not previously appreciated how much more complex using bonds and credit, as well as gilts, would be. "It worked very well and we got an attractive price from it," he clarified, "but I would definitely engage our asset managers earlier on in the process, and make sure that we have them on board, anything we can do with them to help facilitate the process would be helpful".

Furthermore, he emphasised the importance of ensuring capacity and sufficient bandwidth when approaching the market with transactions in close succession.

"In an ideal world, I don't think we would have done two transactions at one time", he explains, noting that this left the legal teams a huge amount of work to do in a compressed period. However, he acknowledged that it had to be done in order to take advantage of the pricing, stressing the importance of having advisers that can cope with processes running in parallel.

Getting the right relationship

Multiple transactions have also seen the scheme and sponsor establish strong relationships with providers in the market, in turn allowing them to take advantage of attractive, and fast moving, pricing opportunities. In the scheme's third transaction for instance, Giles noted that pricing wasn't quite as attractive as seen previously. He explained however, that as the scheme had all the processes in place and wanted to transact, it agreed to set a soft price target with PIC, in order to move as quickly as possible once that was hit.

He explained: "When we got into the lockdown period in early March and there was market volatility, pricing improved slightly and we could hit that transaction, as long as we transact very quickly, given the volatility. Given we had all the documentation in place for the other section, it was a much more straightforward process."

Furthermore, the scheme was proactively approached by Aviva in April for a potential £35 million pensioner buy-in, assuming the scheme could transact quickly. Giles explained that as the funding position had improved, the scheme was confident it could move quickly under the umbrella contract, with around a four-week period from the initial conversation the transaction.

Written by Sophie Smith