Kelvin Wilson

PRT: Making the best decisions in changing times

Pensions Age **speaks to Heywood director of pension risk transfer (PRT), Kelvin Wilson, about the changing nature of the de-risking market and how this affects DB schemes' choices**

Due to changing market conditions over the past couple of years, some DB schemes are finding themselves with improved funding levels and ready to implement a PRT sooner than expected. However, their data quality might not be at that same insurer-ready level. How can a scheme assess their data quality, and make any improvements required?
Important areas schemes should focus on are conducting data risk assessments/enrichments, engaging with the scheme membership, documenting administration practices and utilising an independent data specialist.

A data risk assessment (DRA) and enrichment will review, validate and improve the presence and accuracy of key member data items. Such reports also provide sample or full calculation audit of members' benefits, the scheme's experience data (where relevant) and a summary of the equally important asset considerations scheme must understand.

Use of independent data specialists can help trustees gather marital and spousal predictor data. Together with names, addresses and mortality tracing, such information will make member and policyholder communication strategies more efficient.

Finally, it is important that schemes document and evidence the data audit and validation work they do, including independent review of GMP reconciliation, rectification and equalisation.

Buyouts, buy-ins, longevity swaps etc.; there are many different PRT options for DB schemes. How can a scheme be confident that it is getting the right type of insurance deal for its needs?
The value of any insurance product will depend on the quantum of risk covered, the premium paid for cover and the term/length of the insurance policy. Bulk purchase annuities (BPAs), commercial consolidation superfund and insurance structured longevity swaps are whole of life, so the key value assessment trustees and scheme sponsors make relate to risks they wish to offload/run and the associated cost/reward.

BPA and commercial consolidation superfund transactions remove five important risks faced by pension schemes: Interest rate, inflation, investment, longevity and sponsor covenant risks. Bespoke longevity swaps can be structured to offer inflation protection against but its primary (and singular) protection against longevity risk make it absolutely, but not necessarily relatively, cheaper than BPAs and superfunds.

Combining longevity swaps with inflation and interest rate swaps within an LDI strategy might offer a synthetic solution that is comparable to BPAs and superfunds. In turn, superfunds can appear economically more affordable than BPAs for schemes that do not have 'strong or tending to strong' sponsor covenants. PRT solutions should be assessed on the cost/benefit of risks they hedge/remove as well as how they help scheme trustees and sponsors honour members' benefit promises.

Having implemented a PRT, are there any residual risks that remain the scheme's responsibility?
BPA insurance is rightly seen as the optimal way for sponsors (if they can afford it) to settle, and trustees to secure, the pension liabilities and benefits of scheme members. However, a BPA, like all insurance, will only cover the members and policyholders set out in the schedule. If entitled members and beneficiaries are overlooked, special promised benefits are erroneously excluded and/or unexpected changes in the law mean benefits should change, these risks (collectively known as residual risk) will not be covered by the standard BPA contract.

Residual risk has traditionally been mitigated by trustee indemnity insurance and run-off cover. However, cover is limited by term (fewer than 15 years) and subject to a liability cap.

As new entrants emerge and competition increases, more BPA insurers are including residual risk cover as part of their BPA offering, with unlimited terms and uncapped liability coverage, for a price of between 0.5 per cent to 1 per cent additional to the BPA premium. Innovation continues to be a feature of BPAs and the PRT market.

Wilson oversees Heywood's development and growth strategy in the PRT market, including Heywood's tech-based PRT solution, Heywood Passport.

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