# Alternatives to Traditional Buyout

**Paul Jayson**
**Barnett Waddingham LLP**

## The buy-out market

- Before 2005: Duopoly
  - Legal & General and Prudential
- Now: 20 plus providers
  - More competition
  - Greater flexibility
  - Lower prices
    - Risk adjusted corporate bond/swap yields
  - Alternatives to buy-out

## Drivers

***For insurers:***

- Over £1.2 trillion to be won (Source: Prudential)

***For employers:***

- Greater focus on risks and costs
  - Increased life expectancy assumptions
  - Low gilt yields
  - Regulator funding requirements
  - FRS17/IAS19 requirements
- Volatile contribution rates
- Effect on corporate activity

## The Snowball Effect

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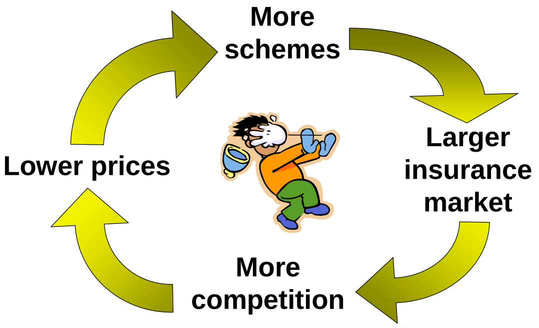


## 2007 – buy-out market

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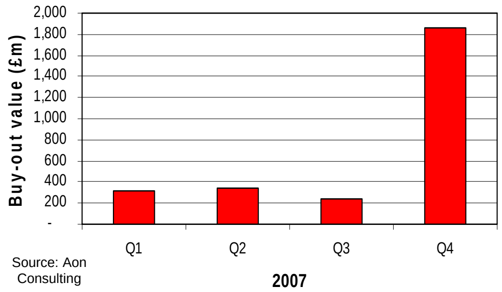


Source: Aon Consulting

## New buy-out ideas

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- Phased buy-outs
- Investment roadmap to full buy-out
- Insuring active members
- Profit-sharing
- Quick buy-outs
- Becoming the sponsoring employer

## Phased buy-outs

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- Buying out sections of the scheme over an agreed period
- Buying out pensioners as they retire?
- Prices based on fixed terms
- Allows cash injection by employer to be delayed
- Higher premium?
- Strict penalties for failure to complete?

## Investment roadmap to full buy-out

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- Combined product from insurer and investment manager
- Investment manager aims to make scheme fully funded on a buy-out basis after a set period
- Insurer buys out sections of scheme as funding targets reached
- Buy-out basis agreed in advance
- Can have investment roadmap without the buy-out option

## Annuity purchase roadmap

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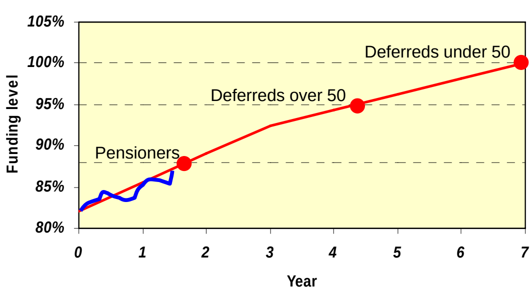

## Insuring active members

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- Actual benefits can be bought in the short-term
- “Notional benefits” bought out for long-term
  - Based on estimated salary increases and withdrawal assumptions
  - Policy may over or under-insure in practice

## Profit-sharing

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- Agree a refund for good experience
  - Mortality?
  - Transfer values?
  - Entire basis?
- Extra premium - is it worth it?

## Quick buy-outs

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- Buy-out completed in a rush...
- ...before winding-up period begins?
- Insurer becomes sponsoring employer?
- Data risk could be taken on in advance
- Data cleaned at a later date
- Premium will increase
- Useful if M&A activity expected

## Corporate solution

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Why?

1. Paternoster/Emap – to enable quick buy-out
2. To run-off and keep the surplus
3. To buy the company, reduce the deficit and sell for a profit

Features:

- No FSA capital requirements for non-insurers
- Premium is less than buy-out?

Set up a shell company to act as employer?

Need to satisfy membership and trustees

## Insurer quality

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- Greater competition leads to better service
  - Increased reliance on indicative quotes
  - Willingness to discuss options
  - Face-to face meetings with trustees
  - Improved documentation?
  - Administration?
    - Can be outsourced
- Market in 5 years?
- Due diligence

## Buy-out auctions

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- Used for final negotiations
- Forward planning required
- Can be effective in reducing premium quickly
- Knowledge of auction theory?
- Need to guard against anti-competitive practices

## Buy-out auctions 2

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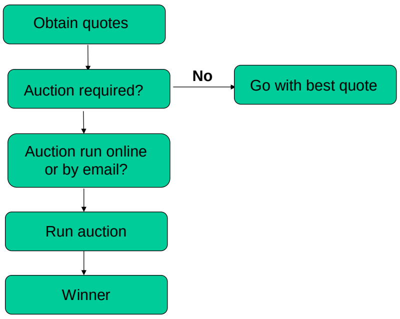


## Buy-out auctions 3

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- Advantages:
  - Leaves an audit trail
  - Treats all insurers fairly
  - Avoids last minute haggling
  - Quick
  - Usually results in lower prices
- Disadvantages:
  - Requires time spent planning the rules and procedure
  - Risk of fees outweighing saving
  - Prioritises price

## Alternatives to buy-out

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- Insolvency insurance
- Matching funding level for a fixed period
- Mortality swaps
- *Liability-driven investment*
- *Transfer inducement exercises*

## Insolvency insurance

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- Agreement to take over liabilities of scheme if insurer becomes insolvent
- Premium based on FRS17/IAS19 liabilities
- Flexibility still allowed:
  - Scheme can remain open
  - Investment strategy
  - Advisor appointments
  - Sponsor's corporate strategies
- Power to annuitise if scheme/employer breaks contract?
- Reduction in PPF levy in pipeline?
- "Cherry-picking" from the PPF?

## Matching funding level for a fixed period

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- Promise to maintain funding level based on agreed liabilities for a fixed period
- Cashflow insurance
- Can make allowances for additional contributions
- Useful for maintaining FRS17/IAS19 position
- Use of derivatives/creation of longevity swaps

## Matching funding level for a fixed period 2

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- Which basis?
  - FRS17/IAS19?
  - Buy-out?
- What if basis changes?
  - Does the policy stay on the old basis?
  - Does it move to the new basis?
  - New longevity assumptions?
  - New accounting regulations?
- What happens after the end of the policy?

## Mortality swaps

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- Emerging market
- The next speaker...

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