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What makes a good buy-in/buyout transaction

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21 March 2014

Bulk annuities: some misconceptions?

- Scheme Actuary solvency estimate near 100%
- Near perfect data
- Ability to pay all the premium upfront
- Simple benefits
- Structure of transaction to be known at outset

Agenda

- Market update
 - Volume of business
 - Recent developments
 - Pricing
- What makes a successful transaction
 - Key considerations
 - Process
 - Framing the transaction
 - Benefits and data



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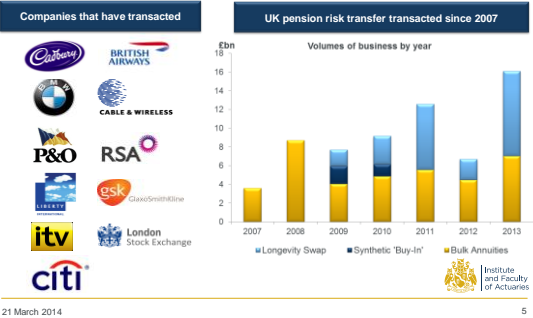
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Market update

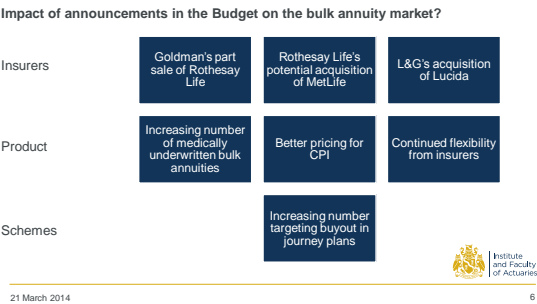
Enterprise
Mentorship
Thought Leadership
Progress
Community
Sessional Meetings
Education
Working parties
Volunteering
Research
Shaping the future
Networking
Professional support
Enterprise and risk
Learned society
Opportunity
International profile
Journals
Support

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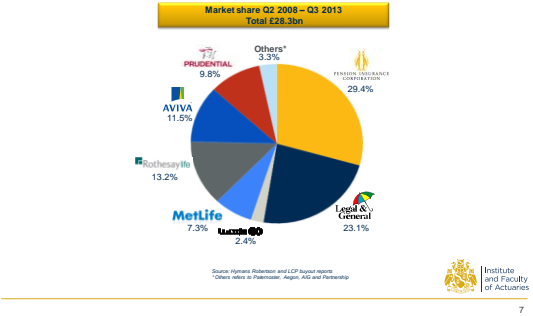
A busy 2013



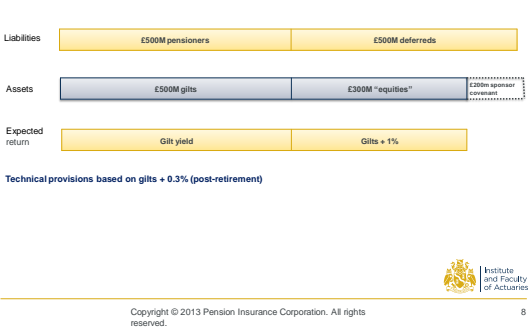
Recent developments



Market share by volume



Economics of a buy-in (1)



Economics of a buy-in (2) – Illustrative worked example

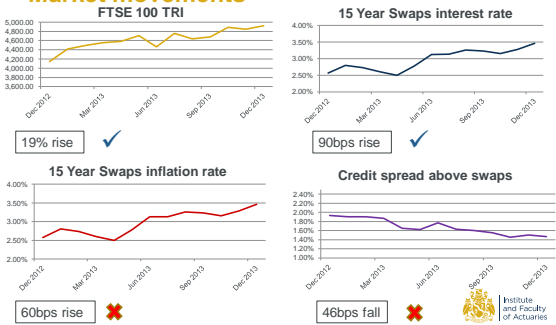
- Technical Provisions: £500m
- Cost of buy-in: £550m

Technical Provisions	£ m	Insurance Value	£ m
Pensioner Technical Provisions	500	Rebased Tech Provisions	543
Rebase to gilts discount rate (using full curve)	+20	Value of:	
Adjust mortality assumptions	+3	• Longevity cover ³	25
Capitalise expenses		• Other cover (e.g. proportion married)	10
• Investment ¹	+10	Value of deflation protection ⁴	30
• Future admin ²	+10		
Rebased Technical Provisions	543	Total value of pensioner buy-in	608

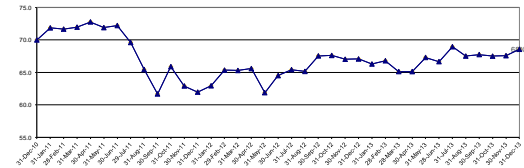
Notes:
1. Assumes investment expenses of 15 bps for gilts.
2. Assumes administration transferred to insurer after 10 years.
3. Based on typical cost of longevity only insurance.
4. Based on long duration inflation swaps with and without a floor of zero percent.



Market movements



Funding to buyout



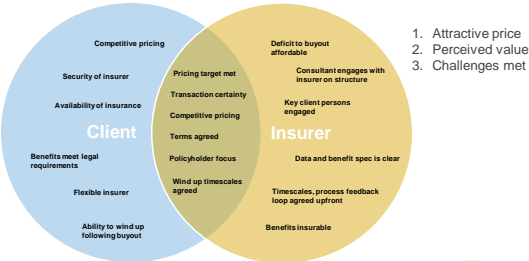
- Commentary:
- Typical scheme: Deferreds and pensioners: Say £100m buyout cost
 - Assets (£70m): 44% (£30.8m) equities, 28% (£19.6m) corporate bonds, 28% (£19.6m) gilts
 - Start funding level: 70%
 - End funding level: 68%



What makes a successful transaction

Partnership
Thought leadership
Community
Sessional Meetings
Education
Working parties
Volunteering
Research
Shaping the future
Networking
Professional support
Enterprise and risk
Learned society
Opportunity
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Desired outcomes



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Suboptimal Process 1

- Detailed quotes requested from several insurers
- 3 rounds of quotes, prices within Trustees target
- Structure of transaction agreed between insurer, Trustee and advisor
- Beauty parade, selection of insurer
- Following the 6 month process above, transaction fell away as when final signoff required from Sponsor this was not granted

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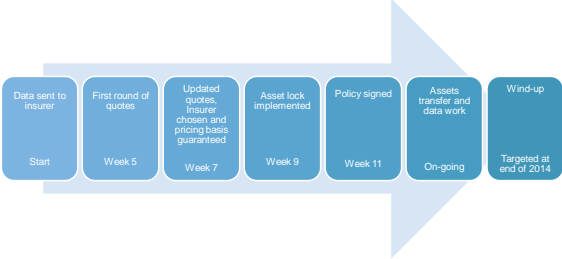
Suboptimal Process 2

- Quotes requested from Insurer
 - Pricing within target, no decision made
- Continual quotation requests over two and a half years
 - Scheme valuation delayed process
 - New data provided twice
- Quotations provided not always discussed at scheduled Trustee meetings
 - Decision delayed due to not all parties being engaged
 - Quotations become out of date

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Successful process



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Framing the transaction

Client perspective

- Clear idea of where they are heading, otherwise difficult to know when arrived
 - Objectives set up front on areas like:
 - Member treatment/perception
 - Acceptable pricing
 - Match benefits
 - Link with journey plan

Insurer perspective

- Wants to know the deal is 'real'
 - Limited capital and resources
 - Needs to decide which deals to target
 - Real costs incurred in quoting

Consultant's role

- Help client understand the important issues and make decisions on these
- What has been decided on price targets, timescales, data, benefits, assets, etc.
- Company and trustees working together, accounting impact been considered, any other potential show stoppers **to address at the start**
- Clearly communicate these to the insurers – negotiation effectively starts now
- Help drive the process from the client's side



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When to approach the market

- Speculative approaches are unhelpful to both scheme and insurer
- Insurers provide good indicative pricing information on a regular basis
- Monitor the position regularly and if you are close to a point where trustees and company agree a transaction is feasible
 - Agree objectives
 - Clarify data and benefit information to be passed to the market
 - Establish interest from the insurer market



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Benefit Considerations



- The benefits insured at the outset do not need to be in the final form
- Agreed changes can be put through during data verification



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Other Considerations

- CPI benefits
- Deferred premium
- Liability management – ETV, PIE etc
- Vesting arrangements
- Deflation
- Administration transfer
- Future top up cover
- Preference issues



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Data

- Needs to contain all items required: pension amounts, postcodes, salary data, GMPs etc
- If time is available some scheme's do collect additional data e.g. Marital status and spouse date of birth
- Collection of additional data is not usually essential. Additional premium can increase or decrease the premium.

Common myth is that having clean data gets a better premium

- As long as minimum data fields available that is all that is needed
- More accurate data will reduce the amount of the verification true up
- Any corrections for data can still be carried out after the contract is signed and that is expected
- Data work can be carried out in parallel to the annuity broking process

Data Risk vs. Market Movements

Data	Changes	Typical effect on premium to PIC's experience
Initial data insured	Data verified during verification and corrections made	±0.5%

Period	Market Movements	Approximate effect on premium
25 Feb. 2013 – 26 Feb. 2013 = 1 day	↓ 11 bps	+1.3%
15 Feb. 2013 – 1 March 2013 = 14 days	↓ 31 bps	+4.0%
2 April 2013 – 5 April 2013 = 3 days	↓ 18 bps	+2.1%
19 June 2013 – 20 June 2013 = 1 day	↑ 12 bps	-1.4%
19 June 2013 – 24 June 2013 = 5 days	↑ 34 bps	-4.1%

Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.