What makes a good buy-in/buyout transaction
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Jay Shah/Uzma Nazir – Pension Insurance Corporation

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

Market update
Recent developments

Impact of announcements in the Budget on the bulk annuity market?

Insurers
- Goldman’s part-sale of Rothesay Life
- Rothesay UK’s potential acquisition of MetLife
- L&G’s acquisition of Longmore

Product
- Increasing number of medically underwritten bulk annuities
- Better pricing for CPI
- Continued flexibility from insurers

Schemes
- Increasing number targeting buyout in journey plans

Market share by volume

Economics of a buy-in (1)

Liabilities
- £500M deferreds
- £500M gilts

Assets
- £200m sponsor
covenant
- £300M “equities”

Expected return
- Gilt yield
- Gilt yield + 1%

Technical provisions based on g = 5.2% (post-retirement)

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

**Technical Provisions:** £500m

**Cost of buy-in:** £550m

<table>
<thead>
<tr>
<th>Technical/Provisions</th>
<th>£m</th>
<th>Insurance Value</th>
<th>£m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Precedent Technical Provisions</td>
<td>500</td>
<td>Reserves from Provisions</td>
<td>500</td>
</tr>
<tr>
<td>Rebase to gilts discount rate (using full curve)</td>
<td>+20</td>
<td>Value of</td>
<td>20</td>
</tr>
<tr>
<td>Adjust mortality assumptions</td>
<td>+3</td>
<td>Other returns (e.g., proportion married)</td>
<td>+3</td>
</tr>
<tr>
<td>Capitalise expenses</td>
<td>+10</td>
<td>Value of deflation protection</td>
<td>+10</td>
</tr>
</tbody>
</table>

**Rebased Technical Provisions:** £543

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

### Market movements

**FTSE 100 TRI**

<table>
<thead>
<tr>
<th>Market movements</th>
<th>19% rise</th>
<th>90bps rise</th>
<th>60bps rise</th>
<th>46bps fall</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>15 Year Swaps interest rate</strong></td>
<td>3,600.00</td>
<td>3,800.00</td>
<td>4,000.00</td>
<td>4,200.00</td>
</tr>
<tr>
<td>15 Year Swaps inflation rate</td>
<td>2.00%</td>
<td>2.50%</td>
<td>3.00%</td>
<td>3.50%</td>
</tr>
</tbody>
</table>

**Credit spread above swaps**

<table>
<thead>
<tr>
<th>Credit spread above swaps</th>
<th>150bps rise</th>
<th>90bps rise</th>
</tr>
</thead>
<tbody>
<tr>
<td>150bps rise</td>
<td>2.00%</td>
<td>2.50%</td>
</tr>
</tbody>
</table>

### Funding to buyout

**Commentary:**
- Typical scheme: Deferred and permissive: Buy £1bn buyout cost
- Assets: 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

- Start funding level: 70%
- End funding level: 68%
### Desired outcomes

- Attractive price
- Perceived value
- Challenges met

### 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

### 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

### Successful process

**Data sent to Insurer**

**First round of quotes**

**Valuation done, decision on insurer and guardrails**

**Asset lock implementation**

**Policy signed**

**Assets transferred, data work**

**Wind up**

Targeted at end of 2014
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

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

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

Other Considerations

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

- Needs to contain all items required: pension amounts, postcodes, salary data, GMFs etc
- If time is available some schemes 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

<table>
<thead>
<tr>
<th>Date</th>
<th>Change</th>
<th>Approximate effect on premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial data insured</td>
<td>+/−0.5%</td>
<td></td>
</tr>
<tr>
<td>Data verified during verification and corrections made</td>
<td>+1.3%</td>
<td></td>
</tr>
<tr>
<td>Period</td>
<td>Market Movements</td>
<td>Approximate effect on premium</td>
</tr>
<tr>
<td>28 Feb 2013 – 28 Mar 2013</td>
<td>11 bps</td>
<td>+0.6%</td>
</tr>
<tr>
<td>15 Feb 2013 – 1 Mar 2013</td>
<td>31 bps</td>
<td>+4.0%</td>
</tr>
<tr>
<td>2 Apr 2013 – 5 Apr 2013</td>
<td>14 bps</td>
<td>+0.9%</td>
</tr>
<tr>
<td>19 June 2013 – 26 June 2013</td>
<td>12 bps</td>
<td>−1.4%</td>
</tr>
<tr>
<td>19 June 2013 – 24 June 2013</td>
<td>24 bps</td>
<td>−0.1%</td>
</tr>
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The views expressed in this presentation are those of the presenter.