Pension De-risking

Part 2 of 3

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How do you understand the relevant options for your scheme?

pwc

Pensions de-risking options

If you are a trustee or a sponsor considering the endgame of your defined benefit pension scheme, you're likely to secure better outcomes for your members by understanding the full range of options available.

Today, there are eight active insurers in the bulk annuity market, over ten providers offering reinsurance or longevity solutions, and more than five alternative capital providers. All with varying appetite and preferred deal size.

PwC's three-part pension de-risking series covers:
Part 1: Can the market insure £1 trillion of DB liability over the next decade?
Part 2: How do you understand the relevant options for your scheme?
Part 3: How to select and implement the right option for your situation.

Increased market innovation and provider appetite, combined with high demand for bulk insurance in a market of finite resource, means an improved range of de-risking options has become available.

Bulk insurance

- Buy-in and ultimate buy-out remain a key objective for most schemes, with two-thirds of schemes surveyed by PwC targeting a 'buy-out' level of funding, so plan to be able to afford such a transaction.
- The bulk insurance market is well established with around £30bn of annual deal volume over the last few years. However, the option is unaffordable for many schemes in the short term. Future affordability lacks certainty due to the dependence on insurance regulation and financial markets.
- There are also challenges beyond affordability - capacity is likely to become an issue as Part 1 of our series highlights.

Structured insurance

- This covers a broad range of solutions including longevity de-risking, captive insurance and other solutions where only selective risks are insured.
- For example, a pension scheme might implement a structure to remove only investment risk, if market volatility was a particular concern.
- Alternatively, longevity risk can be reduced with innovative structures like collapsible swaps and stop-loss insurance, among others.

Capital backed

- A capital provider (typically an asset manager) uses its own capital to underwrite a journey plan to a long-term funding objective within a certain timeframe, e.g. full buy-out in 10 years. Capital set aside by the provider reduces reliance on the sponsor covenant.
- In addition to greater journey plan certainty, the scheme also benefits from the provider's asset sourcing capability.
- Currently multiple asset managers are offering this option for schemes of varying sizes.

Fiduciary investing

- Fiduciary management involves the delegation of some, or all, of the day-to-day investment decision-making and implementation to a suitable counterparty. The trustees retain responsibility for setting overall strategy with the support of an investment adviser (who could also be the fiduciary manager).
- We estimate the current DB assets under fiduciary management to be £200bn+ and there are 1000+ schemes using a fiduciary model. Around 20 fiduciary managers are currently active in the market including benefit consultancies and asset managers.

Run-off

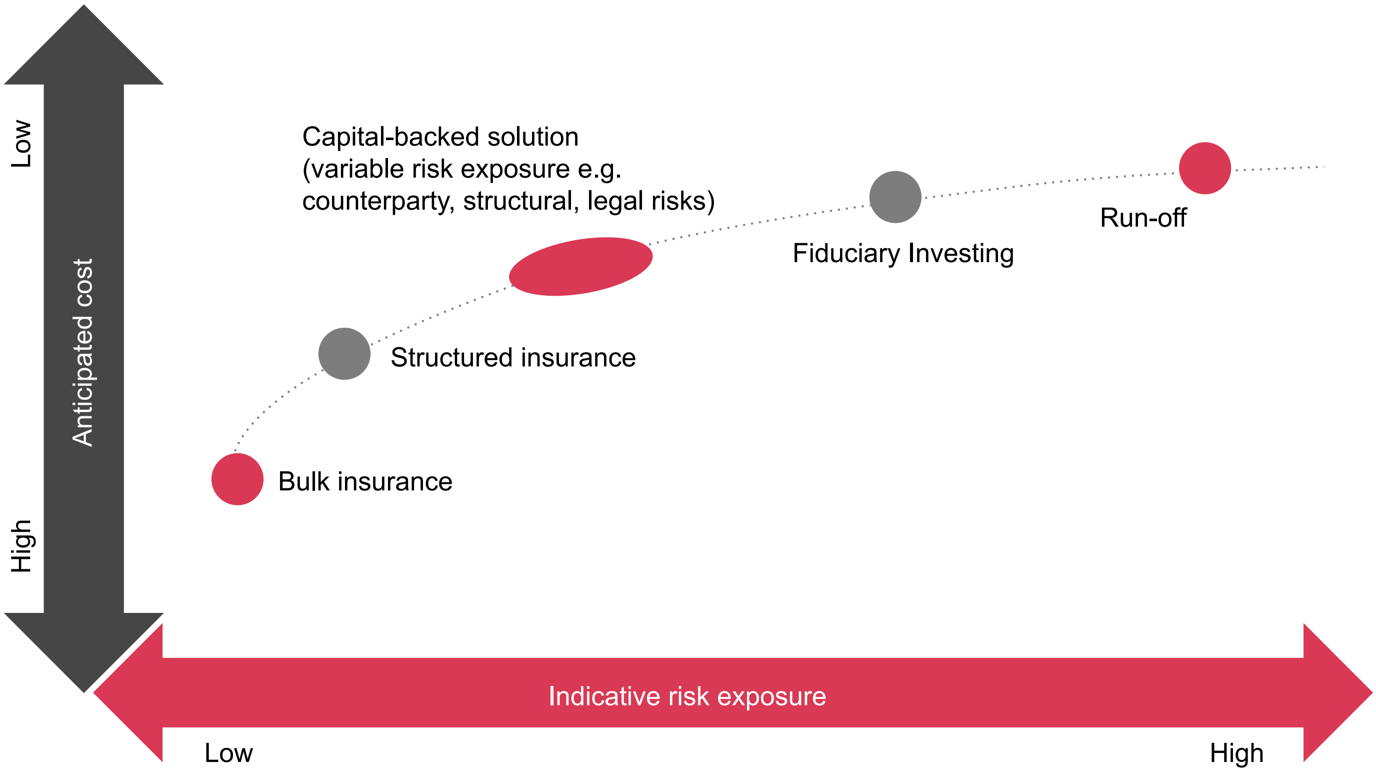
- According to PwC's funding survey, over half of schemes continue to target full funding on a low-risk basis of Gilts + 0.25% to Gilts + 0.5%. To reach this milestone, returns from growth assets remain a key component of the investment strategy.
- Supporting this, the same survey found that over 40% of schemes plan to reach their long-term funding target using asset returns alone. Some schemes will rely in part on sponsor contributions, but long-term sponsor covenant remains fundamental.

Selecting the de-risking option that fits

Selecting relevant options from a range of solutions should be driven by a number of key factors, including:

- **Affordability** and market capacity
- **Risk** exposure addressed by the selected option
- **Timeframe** to achieve target endgame
- Strength of and dependency on **sponsor covenant** in the interim.

Pension schemes could consider a combination of options (e.g. one for pensioner members and another for deferred members) instead of looking to force a single option to fit across the entire scheme.



Checklist for assessing the range of options:

1. How does the chosen de-risking strategy enable the trustee to fulfill their fiduciary obligation?
2. Is the corporate sponsor supportive?
3. Is this solution affordable? Does it mitigate the key risks of greatest impact and concern?
4. Does it deliver the best value for money versus improvement in benefit security?
5. Would the solution fit within the pension regulatory framework and how does it impact PPF eligibility?
6. Do trustees and sponsors understand the solution and its risks? Is training required?
7. Does the pension scheme have the appetite to implement newer solutions where suitable?
8. Are all stakeholders comfortable with the counterparty risk?
9. Who keeps control of the investment strategy and retains associated risks?
10. How does it impact ongoing administration and member communication?

Trustees and corporate sponsors must take the time to consider and understand the questions.
Inadequate understanding or due diligence could lead to suboptimal decision-making and member outcomes

Key features from some of our past deals

Asda Walmart

£3.8bn buy-out

Full scheme buy-out to unlock the M&A transaction

Successful transition of £500m illiquid assets

British Airways

£4.4bn buy-in

Transaction terms executed within just five weeks of exclusivity

Included novation of the two longevity hedges

IMI

Several buy-ins covering £1.7bn

Includes deferred heavy tranches

Member option exercises implemented in parallel

Led to accelerated journey to full buy-out

Lehman Brothers

£700m buy-out

Implemented as part of a large, high-profile corporate insolvency

Secured full benefits for members previously restricted in the PPF

TRW

£2.5bn buy-out

Pension increase exchange pre buy-out

One of the largest partial buy-outs through a scheme demerger mechanism

Barratt Developments

£675m buy-out

Completed buy-out within 12 months of buy-in

Involved transfer of DC section in competitive process to allow full scheme wind-up

William Hill

£300m buy-in

Full scheme buy-in to unlock the M&A transaction

Cashflow pricing approach used to validate deal in order to meet tight deadlines

ITV

£600m buy-out

Joint setup (combining corporate and trustee) to drive negotiations in fast-changing markets

Indexation switch to streamline liability profile

AIB

£250m synthetic buy-in

One of the early deals using synthetic insurance solution

Insured risks offering best value for money

Project Elm

£90m buy-in

Full scheme buy-in with 80% plus deferred population

Pricing obtained from multiple insurers within three weeks to enable timely execution, deploying PwC Insure platform

Project Bonaparte

£1.7bn longevity hedge

Longevity hedged through a captive insurance vehicle

First pension scheme to transact directly with two reinsurers at the same time

Project Nova

Capital backed transaction

Maiden capital backed journey plan executed

Enabled the scheme to target accelerated buy-out with reduced interim risks

How PwC can help your de-risking plans

PwC's Pensions Risk Transfer team is a group of dedicated specialists. We focus on ensuring member benefits are secured optimally, while meeting overall trustee and sponsor objectives. We advise trustees and sponsors of schemes ranging from £20m to £90bn in size, with lead advisers experienced in particular segments of the market.

A leading deals advisory practice

We bring latest techniques and market understanding to the deal process.

Too many deals languish because stakeholders and advisers have not thought through all the issues. Witness the number of buy-ins which have not progressed to full buy-out yet because of data challenges, which could have been identified and solved earlier.

PwC has the UK's leading deals advisory practice, well networked across all the full range of market participants.

Skills and experience

We have the skills and experience required to secure the best deal for members, trustees and sponsors.

This includes FCA-approved insurance industry specialists who can give you comfort about the counterparty you are dealing with, as well as seasoned finance experts who can ensure a cost-effective deal which leads to better member benefits and outcomes.

We have one of the world's largest asset and wealth management practices with specialists who can optimise your asset strategy in the run-up to and during a transaction, including illiquid assets.

We act with pace

Some processes stall because incumbent advisers and administrators have a disincentive to act quickly.

We bring pace and progress to the deal process. We can also, if appropriate, structure our fees to reward timely completion.

We deploy best-in-class technology, such as PwC Insure, to accelerate timelines and manage costs.

Innovative solutions

We have a reputation for bringing innovative solutions to trustees and sponsors who need to find a different way to get their deal done.

This includes the market for consolidators, captives and solutions backed by third-party capital.

We are one of the PPF's panel of lead transaction advisers for PPF+ cases - they recognise the value in managing deals as a commercial process and not just an actuarial adviser led exercise.

Strategic advice

We are 'journey plan' and strategy advisers to a range of trustees, sponsors and joint working groups, across the whole client spectrum spanning schemes of various sizes.

This gives us the context and experience to know how a well-run strategy should incorporate a risk transaction.

Bespoke deals

We have a strong track record in tackling bespoke deals, particularly when there are special features involved.

Over the last year we completed several smaller 'deferred heavy' deals, with a large proportion of non-pensioner members - securing the whole liability in one go.

We also tackle special situations, for example where there are legal anomalies.

Independence

We are uniquely independent of market solutions such as fiduciary management, administration, master trust and insurance brokerage. Clients know they will get advice which is free of conflicts, and with their best interests always in mind, covering all market options without any limitation or blindspots.

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