LET'S TALK

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SMALL SCHEME BUY-INS AND BUYOUTS

Are smaller schemes being squeezed out of the bulk annuity market?

ARE SMALLER SCHEMES BEING SQUEEZED OUT OF THE BULK ANNUITY MARKET?

Larger bulk annuity transactions inevitably grab the headlines. Market analysis, however, shows that historically transactions of under £100m have typically accounted for over 90% of the deals completed in any year, with a significant amount of these being sub £10m. Recent commentary has suggested that smaller schemes are struggling to get any insurer to quote for them – we assess the situation and what these schemes can do to increase their chances of closing a satisfactory deal.

ARE SMALLER SCHEMES OBTAINING QUOTATIONS?

It is true that a number of insurers concentrate on the larger transactions – if an insurer can get the same return on a £100m transaction compared with five £20m deals, then surely the larger transaction is more attractive? It isn't that straightforward though – insurers also have to factor in the likelihood of transacting, how many other insurers are providing a quotation, how complex the transaction is, how long it will take to get it over the line, and so on. For a number of insurers, smaller transactions form a key part of their bulk annuity strategy.

JLT's Buyout Team has brokered a significant number of smaller transactions and are confident there remains a market to do so. For example, in early 2016 we took a c£4m pensioner buy-in to market, which attracted quotations from three insurers – a competitive broking exercise followed, with the scheme achieving a price close to their Technical Provisions. The key for smaller schemes is to ensure they are as attractive as possible to insurers.

HOW DO SMALLER SCHEMES COMMAND THE ATTENTION OF INSURERS?

There are two questions that matter most for insurers – how likely is a transaction to proceed, and how complex will it be? All schemes, but particularly smaller schemes, should consider these when deciding whether to go to market.

Commitment – Demonstrating commitment and affordability is vital – insurers like to know that if they hit the trustees' / sponsor's price target then a transaction will go ahead. Quotes take time and money to produce and inevitably insurers' resources will be focussed where they have the best chance of success. It therefore follows that trustees' and sponsor's objectives should be aligned.

Data quality – Resolving significant member data and benefit definition issues in advance saves insurers lengthy post-deal implementation exercises – schemes considering approaching the market, even for a buy-in, should be taking steps to get "buyout ready". Trustees should speak to their buyout adviser about the significance of any issues identified – whilst final data is highly desirable, there may be minor points it is not worth holding up a transaction for.

As ever, working with an adviser with tried and tested broking processes, a high deal conversion rate and strong insurer relationships will also help.

WHAT ABOUT VERY SMALL SCHEMES?

Some insurers will have a minimum premium they will accept; however in our experience even the very smallest schemes are currently still able to obtain quotations from the market. One insurer confirmed they completed transactions for schemes of under £1m during 2015 and will continue to provide quotations where transactions remain appealing and cost-effective. JLT has placed 20 trades of below £5m in the last two years.

ABOUT US

JLT Employee Benefits is one of the UK's leading employee benefit providers offering a wide range of benefit and pension services, including administration, actuarial and pension consultancy, investment, Self Invested Personal Pensions (SIPPs) and Small Self Administered Schemes (SSASs) administration, flexible benefits, healthcare, benefit communication and financial education.

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Buyout solutions are available for the very smallest schemes; albeit insurers may only be prepared to provide a quote on an exclusive basis with the expectation all data queries are resolved prior to transacting. Even if only one insurer provides a quotation, affordability can be measured against a target price and a transaction should proceed when the trustees and sponsor can remove liabilities at an acceptable price.

WOULD AGGREGATING SMALLER SCHEMES HELP?

If we work on the premise that insurers are more attracted to larger transactions, then could we increase traction by aggregating smaller schemes before taking them to market, e.g. if five £20m schemes were taken to market as one £100m scheme?

Potentially this may increase the interest of insurers – more insurers would normally quote for a £100m scheme than would quote for a £20m scheme. The overall price for the aggregated liabilities may also decrease due to the increased size of the total transaction and also through the aggregation of the fixed elements of the price. However, it is unlikely that the same insurer would have offered the best individual price for each scheme unless the demographics and benefits of the schemes are very similar – as such some schemes may pay a higher premium under this type of structure. Complexities are added if different trustees and sponsors are involved as this can add to the transaction timescales and also affect the likelihood of a trade – what happens if one or more parties decide not to proceed?

We believe better aggregation structures exist that can get around some of these challenges and are actively investigating one such structure - watch this space!

CAN SMALLER SCHEMES GET A COMPETITIVE PRICE?

Recent pricing suggests so. Any scheme, whether big or small, should have in mind at what price a transaction is affordable, setting realistic triggers for this. Beware – schemes can spend a long time chasing the "best price" and never quite getting there. Consequently, if an insurer delivers a suitable price that hits the agreed trigger then, unless circumstances have changed, a transaction should proceed.

WILL THIS CHANGE?

Currently there are opportunities for trustees and sponsors of smaller schemes. In the short term we expect this to continue – new insurers are likely to enter the market, some of whom will be active at the smaller end. Whilst there is a limit to the amount of bulk annuity business insurers can write, we believe it is resource rather than capital restrictions that could affect this in the sort term. As more and more larger schemes seek bulk annuity solutions, inevitably insurers' interest will move towards these opportunities.

In the meantime, smaller schemes shouldn't delay – the cost of running these schemes is relatively high and competitive buy-in and buyout quotations are available.