



Update on buyout market

February 2021

This out of cycle bulletin from Aon's Risk Settlement Group covers recent developments in the buyout and wind-up of pension schemes. While this assumes a working knowledge, we would be very happy to explain anything in this article further.

Incoming buyout warning: the industry prepares

The record £43bn bulk annuity market of 2019 was driven mainly by an increase in substantial full scheme buyouts, with Asda, Telent and Rolls-Royce alone securing schemes totalling over £11bn.

Although the market held up well over 2020, it was inevitable that buyout volumes would temporarily slow from the COVID-19 disruption to normal business operation.

As a strong example of corporate support, the Asda transaction was supported by a £0.8bn contribution from the company. This was an example of the attractiveness of de-risking a business and making future corporate transactions easier. Decisions of this nature have inevitably become less common during the COVID-19 pandemic, until more normal trading conditions resume.

However, it is notable that 2021 will see the market finally reach the point where all providers can offer services to take on entire schemes, instead of only pensioners which have to date been the sole focus for several bulk annuity providers.

This reflects a period of significant investment in administration services from multiple insurers. However, it also reflects an acceptance that, post lockdowns, the long journey of final salary scheme de-risking will move up a gear, and a much wider range of schemes will seek to secure their remaining members as soon as affordable.

Scheme funding levels have generally held up well through the market disruption, reflecting the greater risk hedging and more diversified asset strategies taken by many schemes in recent years.

The recent annuity market growth has reflected higher capital injections from investors, and a supportive and competitive reinsurance market. To keep pricing at acceptable levels, there has also been significant diversification of annuity assets further into wider classes than traded bonds, as annuity funds get larger and can then justify more substantial investment resources. Annuity funds currently range in size from £20bn-£80bn across the various insurers in the market.

These trends, to support a larger annuity market, are continuing over 2020-21. They provide the backbone for future buyouts as we return to normality.



Brexit: Keep calm and carry on

The Brexit deal agreed in December did not resolve the future provision of financial services between the UK and Europe. By the end of March, a memorandum of understanding is expected to be agreed, but full resolution is expected to take time, certainly beyond 2021.

This leaves some unresolved questions for providing annuities to members of UK schemes that have retired to Spain or other European countries.

It is not clear whether annuity providers are now fully authorised to issue or service these policies from a UK entity.

UK annuity providers are left with little choice but to carry on operating annuities paid overseas in the expectation that no government would actually want to disrupt pension provision for a member in practice.

Hopefully this issue will be resolved sensibly in the near future – but it is worth for now being aware of the context.

There is also a question over coverage of the Financial Services Compensation Scheme for an annuity policy issued to an overseas address. However, there is an increasingly accepted solution to this through the issue of individual annuities to a UK based trustee.

Communication strategies

The wind-up of a scheme is only possible after navigating various aged and, in some cases, impractical regulations over information provision and related timings.

In the past these requirements have driven the content of communications to members. The members may well have struggled to grasp the changes happening to their scheme, which they would have been last to know about – as annuity transactions are arranged confidentially.

Increasingly though, communications have taken a less formulaic format, with clearer language, complimentary design and support from a website and from meetings.

This has become increasingly important as ongoing pension schemes have developed more evolved support systems for members. These can extend to quite sophisticated at-retirement options for drawing benefits, a significant library of supporting information and paid-for access to an independent financial adviser that has been well briefed in advance on the scheme.

Unfortunately, this support cannot be fully maintained on buyout. It is true that insurance administration has steadily developed with the most evolved services having a significant focus on member education and focus.

But the change in services on buyout can now be substantial for those members that have not yet retired, and careful communication planning to allow members to adapt to this change has become a new focus.

Steering your scheme through buyout and wind-up



Our team of experts have many years of experience in guiding schemes through the complexities of truly completing the buyout and wind-up of a scheme.

If would like any further information, please visit our [Risk Settlement homepage](#), or contact our buyout and wind-up specialists:

Dominic Grimley
Principal Consultant

+44 (0)121 262 5094
dominic.grimley@aon.com

Stephen Purves
Partner

+44 (0)113 394 3510
stephen.purves@aon.com

Phil Curtis
Senior Consultant

+44 (0)20 7522 8276
phil.curtis@aon.com

Ben Harris
Senior Consultant

+44 (0)121 230 6828
ben.harris.2@aon.com



Buyouts challenge GMP equalisation thinking

Schemes attaining buyout first tend to be the trend-setters on some of the more challenging issues impacting the pension industry. From the viewpoint of current buyout cases, a key current issue – GMP equalisation – may be viewed differently to common prevailing thinking.

Here are some common pre-conceptions about buyouts and GMP Equalisation:

1. Conversion has become the default equalisation approach

Conversion at retirement emerged as a popular low-impact approach to GMP equalisation over 2020. But this is less practical to implement in the bulk annuity market – keeping extra retirement options beyond buyout presents a range of problems e.g. it challenges reserving, reinsurance and administration services of insurers.

Conversion in bulk before buyout removes the problem from an insurer viewpoint. But this does leave some tax issues to consider for deferred members.

So the path of GMP equalisation post buyout hasn't settled down yet – the notable trend is a shift towards dual records as simplified approaches to administering them post buyout emerged. While only a few of the larger schemes are close to putting this actually in place, this solution is expected to be available from an increasing number of providers gradually over 2021-2022.

2. Unlike conversion, where you need to redesign the benefits, dual records at least is just a mechanical process

For several current buyout cases, dual records have been built by the scheme for implementation by the annuity provider. This has brought out several practical aspects to consider, for example:

- How to work around data issues to construct past histories of records;
- How exactly this construction is done; and
- How are dual records actually implemented – does this give new adjustments every month or just once a year for simplicity.
- Are pensions allowed to reduce, which can happen under the default version of dual records (known as 'method C2')?

3. We will wind-up the scheme when all relevant past transfers have been topped up

Schemes need to consider adjusting transfer values paid since 1990 for GMP equalisation, following the Lloyds 2020 court case.

This presents a large number of practical issues and is unlikely to prove possible in a significant number of cases. The court case did not specify de minimis or other limits, beyond noting that problems could arise and would need to be considered.

In practice we think limits will be needed on the efforts made to trace past members and schemes, and an alternative form of compensation identified, to avoid extending a wind-up by years rather than months. In many cases the extra funds to spend on a top-up benefit will be under £1,000.



4. We need to deal with transfers that came into the scheme for GMP equalisation. So we just include the transferred-in GMP in the calculation?

Unfortunately, this is unlikely to truly address GMP equalisation. To do that, we would need to know how much higher the member's benefits would be if the source scheme paid a transfer top-up. At present there is no full solution to this issue and careful consideration will need to be given as to how to equalise the transferred-in benefits within the scheme.

5. Can we just contact the schemes where the transfers came from and get the top-ups?

The scheme may be well advanced in its wind-up and hence GMP equalisation planning. But other schemes won't be – and unfortunately many will take some years to resolve the issues fully if under no real time pressure.

Consider residual risks early

It is important that the journey to scheme wind-up ends up with peace of mind that risks have been resolved.

At the end of a scheme's life, trustees commonly secure trustee indemnity insurance (TII) from an insurance company, to protect against future claims. This can avoid a later need to reconstitute a trustee company in response to a claim, while acknowledging that such claims have in practice been rare so far.

The market for this cover shrunk in 2020 as several general insurers were more pre-occupied with other lines of business, for example dealing with a significant volume of COVID-19 driven business interruption claims.

Despite the high profile buyouts of 2019, demand for TII cover on wind-up did not jump up. This apparent anomaly is however simply a question of timing – schemes had various actions – including new tax and equality issues - to grapple with to get from their transaction to scheme wind-up, and the actual cover purchase is usually one of the last acts in wind-up.

Hence, demand for such cover is set to rise notably from the second half of 2021.

6. At least we can agree on one thing - The Lloyds 2020 case is about GMP equalisation

Well kind of but... it has implications for most data cleanse projects. Even for a scheme with no GMPs, the case is a potential reference point on how far to revisit past transfers in correcting for other cleanse issues.

It is important to consider the layers of protection that may be available for the trustees early on in the process to plan scheme buyout. This cover may come partly from the annuity provider and the scheme sponsor, as well as TII cover.

Different forms of protection achieve different results, and unfortunately insurance markets are not currently well set-up to cover every potential cover gap – something that broking firms like Aon are seeking to improve as we enter more normal times.

We suggest seeking to understand the overall scope of protection options before securing the first part of your cover, which might for example be residual data risk cover from the annuity provider. Early engagement with the TII broker also helps them to consider when to build interest in providing your cover in the market.

Contact Information

John Baines

Partner

+44 (0)121 262 6944
john.baines@aon.com

Dave Barratt

Senior Consultant

+44 (0)1727 888 265
dave.barratt@aon.com

Martin Bird

Head of Risk Settlement

+44 (0)121 335 3727
martin.bird@aon.com

Hannah Brinton

Principal Consultant

+44 (0)20 7086 8115
hannah.x.cook@aon.com

Andrew Cooper

Senior Consultant

+44 (0)20 7086 9057
andrew.cooper.2@aon.com

Phil Curtis

Senior Consultant

+44 (0)20 7522 8276
phil.curtis@aon.com

Mike Edwards

Partner

+44 (0)20 7086 0437
mike.edwards@aon.com

Karen Gainsford

Principal Consultant

+44 (0)20 7086 9071
karen.gainsford@aon.com

Tim Gordon

Partner

+44 (0)7956 324415
tim.gordon@aon.com

Dominic Grimley

Principal Consultant

+44 (0)121 262 5094
dominic.grimley@aon.com

Ben Harris

Senior Consultant

+44 (0)121 230 6828
ben.harris.2@aon.com

Joe Hathaway

Senior Consultant

+44 (0)121 262 6986
joe.hathaway@aon.com

Stephen Purves

Partner

+44 (0)113 394 3510
stephen.purves@aon.com

Tom Scott

Principal Consultant

+44 (0)121 262 5073
thomas.scott@aon.com

Michael Walker

Principal Consultant

+44 (0)1372 733027
michael.walker.3@aon.com

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

Copyright © 2021 Aon Solutions UK Limited. All rights reserved. aon.com. Aon Solutions UK Limited is authorised and regulated by the Financial Conduct Authority. Registered in England & Wales No. 4396810. Registered office: The Aon Centre | The Leadenhall Building | 122 Leadenhall Street | London | EC3V 4AN. This document and any enclosures or attachments are prepared on the understanding that they are solely for the benefit of the addressee(s). Unless we provide express prior written consent no part of this document should be reproduced, distributed or communicated to anyone else and, in providing this document, we do not accept or assume any responsibility for any other purpose or to anyone other than the addressee(s) of this document. In this context, "we" includes any Aon Scheme Actuary appointed by you. To protect the confidential and proprietary information included in this document, it may not be disclosed or provided to any third parties without the prior written consent of Aon Solutions UK Limited.

