 By Tony Baily and Lucy Barron

Playing to win: how to prepare for the endgame

AT A GLANCE

Keen buyout pricing has kept the bulk annuity market buoyant throughout the pandemic

Partial buy-ins can help to reduce risk ahead of the endgame and make a scheme more attractive to an insurer

Fiduciary management has also proven its resilience through nimble and decisive action

The endgame is in sight for many schemes now. Many are targeting buyout; Aon's *Global Pension Risk Survey* in 2019 showed that for many this destination is less than ten years away.

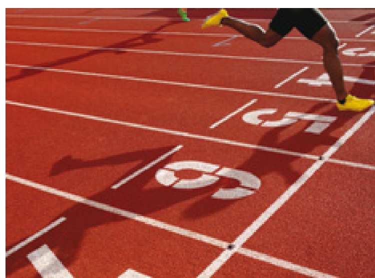
Despite challenging market conditions resulting from the Covid-19 outbreak, the bulk annuities market has remained buoyant and, with buyout pricing particularly attractive during this time, over £12bn of transactions was written in the first half of 2020. Schemes that were suitably prepared – well-hedged with access to low-risk investments and with strong governance in place – could act quickly and access the pricing opportunities. Planning and preparing are key to ensuring schemes are well-placed to transact.

TRICKY TRADE-OFF

However, schemes targeting buyout using investments alone face a tricky trade-off. Getting to buyout quickly requires higher investment returns, which typically means more investment risk. Conversely, a slower journey has less risk but comes at the expense of returns. Using the full pensions toolkit (rather than focusing on investment in isolation) can improve this trade-off and bridge the gap to buyout.

As buyout pricing varies over time and between insurers, closely monitoring and negotiating both pricing and terms with insurers significantly improves the price paid. This helps schemes to reach their targets sooner, without needing to increase investment return or risk.

One way of accessing this when annuity pricing is attractive and for schemes with modest return requirements would be to carry out a partial buy-in. This not only provides a better match for cashflows but also reduces longevity risk, meaning



schemes can reach buyout quicker and with more certainty.

Other tools to help make buyouts more affordable include member options and liability management exercises. For example, transfer value exercises and pension increase exchanges help accelerate the de-risking journey, although the combined impact of these actions will depend on the profile and maturity of each scheme. In some cases, actions such as this have reduced buyout time by over a third, while also reducing the overall level of risk – giving trustees a more stable journey.

MANAGING INVESTMENTS IS KEY

Regardless of the timeframe for reaching their endgame, trustees should think about the most efficient investment strategy to get them there. There are several investment options to consider that give schemes the best opportunities. Ensuring liabilities are fully protected against movements in interest rates and inflation helps reduce the risk of assets moving in a different direction. Holding credit also provides some protection against insurer pricing moves, as this is often an attractive asset for insurers. Trustees will want a portfolio that is well-diversified, to generate the returns needed with the least risk possible, and which offers sufficient flexibility and liquidity to capture opportunities should these arise earlier.

Schemes should also consider simplifying their assets, by reducing allocations to illiquids and any complex derivatives within their liability-driven investment portfolio. This can reduce the overall premium paid to insurers and reduces the risks associated with selling or transitioning assets as part of any deal.

ENHANCING GOVERNANCE

Using the full range of options available helps schemes reach buyout sooner and with less risk. However, from a governance perspective, there is much for schemes to do to achieve this. A fiduciary management approach can help by enhancing governance. Once trustees set their strategy, the fiduciary manager can implement it efficiently – freeing up trustee time to focus on the actions needed to secure buyout.

A fiduciary management approach can also enhance investment implementation by utilising the full investment toolkit – proactively managing a highly diversified portfolio of best-in-class strategies, rather than having to relying on market returns alone. As recent market volatility showed, reacting quickly and being nimble is vital for portfolio protection. A fiduciary manager can transact quickly and efficiently, meaning trustees are not missing out on opportunities to lock-in gains (or to de-risk).

Managing costs and achieving value for money are also important components when planning for the endgame. The synergies created by a fiduciary manager and a risk settlement team working together to manage and execute buyouts can result in significant cost savings – while also making the journey smoother and shorter.

Tony Baily and Lucy Barron are partners in Aon's investment practice