

# Bulk Annuity Contracts

Over the last decade, the risks associated with final salary schemes have come sharply into focus with ever increasing improvements in life expectancy and highly volatile financial markets creating challenges for trustees and financial headaches for scheme sponsors. As a result, stakeholders are increasingly looking for solutions to help them manage the risks in their pension scheme.

In the last few years, bulk annuity contracts have become a popular means of managing both longevity and investment risks. In 2008, several established insurers entered this area of the market and other specialist companies opened for business. Some have been more successful than others but the increased competition in the market has forced annuity prices down.

As pricing has become more competitive, insurers have looked to differentiate themselves by offering innovative variations to a standard bulk annuity policy. As examples, insurers may agree to deals being completed in stages based on guaranteed terms, to take on the risk of data errors and omissions or to offer additional security offering protection in the event of their future insolvency.

The purchase of a bulk annuity policy is not always straightforward, particularly in the current climate where volatile financial markets can make the affordability of a policy look attractive one week but not the next. Having an efficient process for obtaining quotes and being able to make informed decisions quickly is vital – delays can mean that opportunities are missed.



## TWO TERMS RELEVANT TO BULK ANNUITY CONTRACTS ARE “BUY-OUT” AND “BUY-IN”

A buy-out refers to a transaction where the liabilities are transferred to an insurer and the transferring scheme is left with no further obligations to the members insured. This will require the insurance policy to exactly match the scheme's obligations transferred. Data and benefits must be defined precisely, which can be a long, protracted process. A buy-out normally precedes a wind-up of the scheme and involves the entire scheme membership being transferred. A partial buy-out is unlikely as the scheme could be seen to be favouring one group of members (i.e. those covered by the bulk annuity policy) over the remaining members if their benefits are fully secured.

The majority of recent bulk annuity transactions have been structured as a “buy-in”. Under this structure, the policy remains an asset of the scheme. As a result, the scheme can purchase an annuity policy that covers part of the scheme's liabilities but, as the policy can potentially be reallocated if necessary, it does not reduce the security of the members whose benefits are not notionally backed by the policy. The policy does not impact directly on members but acts as a hedge against risks such as interest rates, inflation and longevity for the scheme. In many cases, a transaction can take place without the company having to provide additional funding immediately.

Under a buy-in policy, payments are made by the insurer to the scheme that has an obligation to pay benefits to the members. This means that there can be some mismatch/simplification between the scheme's obligations and the benefits insured and thus a buy-in may be quicker to complete. Members may not even be aware of the transaction and the detailed communication required with a buy-out may be avoided. A buy-in policy can eventually be converted into a buy-out policy and is therefore often part of a wider de-risking strategy to ultimately wind-up the scheme.

Many companies are relying on scheme asset performance to provide sufficient investment returns to keep the company's contribution rate at an affordable level. Hence, a bulk annuity policy, which does not expose the scheme's assets to the potential for such performance, may not be attractive. As a result, longevity swaps are receiving a lot of interest at the moment. A longevity swap manages a scheme's longevity risk. This is a new and developing market for pension schemes and both the swap providers and scheme stakeholders are getting to grips with the complexities involved. Barnett Waddingham can advise on how they work and help you decide whether this is a route worth considering based on a scheme's specific circumstances. We can, if appropriate, assess the pricing basis and potential value offered by the swap and negotiate terms with providers.

Barnett Waddingham has considerable experience in completing buy-out and buy-in processes and has also advised on a significant longevity swap transaction. We can provide in-depth knowledge of the latest risk management products and services on offer. We can provide advice on whether a buy-out or buy-in is appropriate for a scheme based on both employer and trustee objectives (which we can help formulate) and how to decide if it is the right time to transact. We can also obtain quotations, negotiate the price, agree the terms with insurers and finalise the deal.

In addition, Barnett Waddingham have agreed an innovative deal with MetLife that facilitates quotations for smaller deals quickly and efficiently and thereby aids decision making. Smaller schemes are sometimes given low priority by insurers interested in larger, more lucrative deals and our arrangement has been acknowledged as much needed by trustees and sponsors alike.



## For further information

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail.

Alternatively, please email:

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