

Bulk annuity briefing, Quarter 4 2021

With the first superfund, Clara-Pensions, having successfully completed the assessment process of The Pensions Regulator (TPR), it's a good time to look at broader issues around DB superfunds.

In this briefing, we also discuss the latest prices in the First Actuarial Bulk Annuity Index, which monitors pricing trends in bulk annuity transactions relative to self-sufficiency liabilities.

How do superfunds work?

Under the superfunds model, all the existing assets and liabilities of a Defined Benefit (DB) pension scheme are transferred into a new DB scheme which is backed by additional capital from the sponsoring employer and external investors.

Some sponsoring employers are likely to find superfunds attractive as they offer potential for a clean break from their DB scheme at a lower cost than securing a buy-out policy from an insurance company.

The saving depends on scheme maturity but could be up to 10% for a scheme with mainly deferred members.

How does Clara-Pensions work?

Under the Clara-Pensions model, the traditional sponsor covenant is replaced with a well-funded capital buffer, funded by external investors and a one-off contribution from the outgoing sponsor.

Each incoming scheme contributes its assets, liabilities and supporting capital buffer to a new separate section of the Clara-Pension scheme. Clara-Pensions then manages the scheme to pay benefits to members as they fall due.

Once member benefits can be secured in full with an insurance company (which on average is expected to take between seven and 10 years), the excess assets and profit within the relevant section are returned by Clara-Pensions to their investors.

Clara-Pensions can therefore be considered to be a bridge to buy-out.

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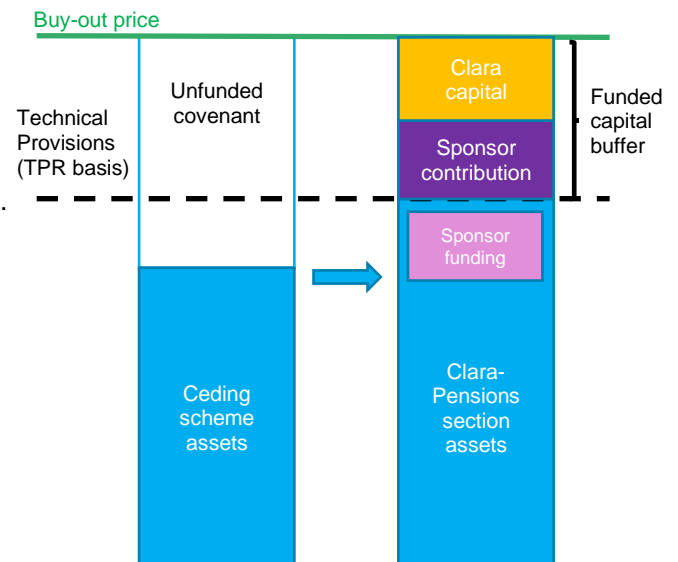
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The Clara-Pensions model



Interim regulatory regime

Clara-Pensions is the first pension scheme to be assessed by TPR under its interim regulatory regime.

Under this interim regulatory regime, sponsoring employers will need to apply to TPR when planning to transfer from their scheme to a superfund.

The three 'gateway principles'

TPR will expect trustees to state why they believe transferring to a superfund is in the best interest of members, and demonstrate that the three 'gateway principles' have been met:

- The scheme cannot afford to buy-out now
- The scheme has no realistic prospect of buy-out in the foreseeable future, given potential employer contributions and the insolvency risk of the employer
- The transfer improves the likelihood of members receiving full benefits.

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First Actuarial Bulk Annuity Index

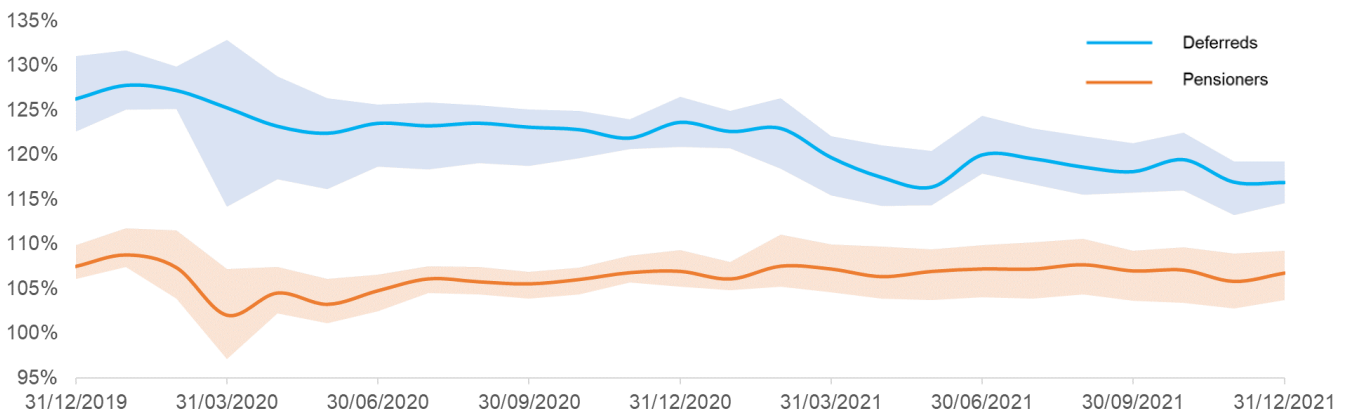
The chart below shows the average price of a £50 million bulk annuity transaction (with a mixture of fixed and inflation-linked liabilities) as a percentage of the liabilities measured on a self-sufficiency basis, using a discount rate of 0.5% pa above gilt yields.

The solid lines represent our estimate of the average price relative to self-sufficiency liabilities. The shaded area shows the range of sample pricing submitted by various insurers.

Insurers charge a higher premium for deferred members than for pensioners of the same age. This is because it's harder to predict the benefit outlay, as deferred members are entitled to exercise options around when to retire and whether to take part of their benefits as a tax-free cash lump sum.

For many schemes, the cost of a full buy-out can be prohibitive. But generally, as schemes mature and approach a self-sufficiency target, the extra funding required to reach buy-out decreases.

First Actuarial Bulk Annuity Index (£50 million transaction) – pricing relative to self-sufficiency liabilities



Pricing has generally been attractive over the last 24 months. Schemes that were 'buy-out ready' were able to obtain extremely attractive pricing from late March to early May 2020, on the back of the market shock caused by Covid-19.

As at 31 December 2021, we estimate that the average price of a bulk annuity covering pensioners would be 7% higher than the equivalent self-sufficiency liabilities. In other words, for a scheme that was 100% funded on a typical self-sufficiency basis, we estimate that for every £10 million of liabilities, an additional £0.7m of funding would be required. However, for every £10 million of deferred liabilities, we estimate an additional £1.7m of funding would be required.

Further information

Find out more about [First Actuarial's buy-in and buy-out services](#).

To discuss bulk annuities, please contact your usual consultant or email enquire.buyout@firstactuarial.co.uk.