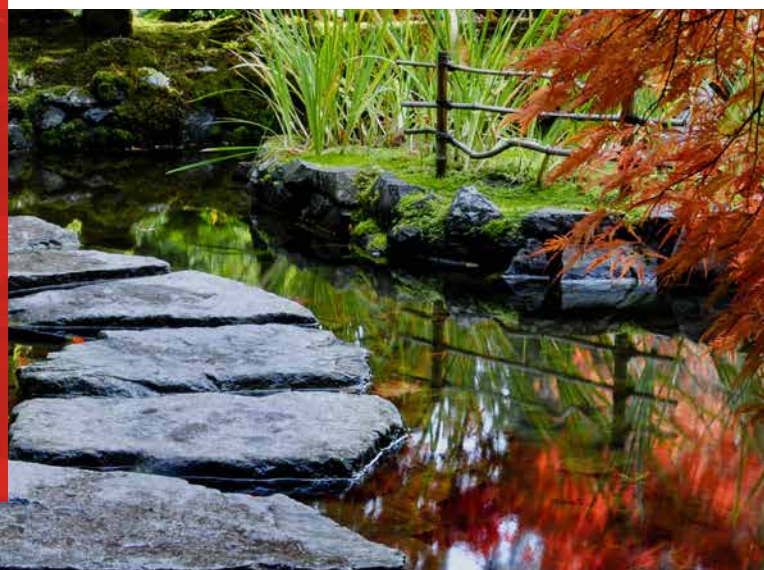
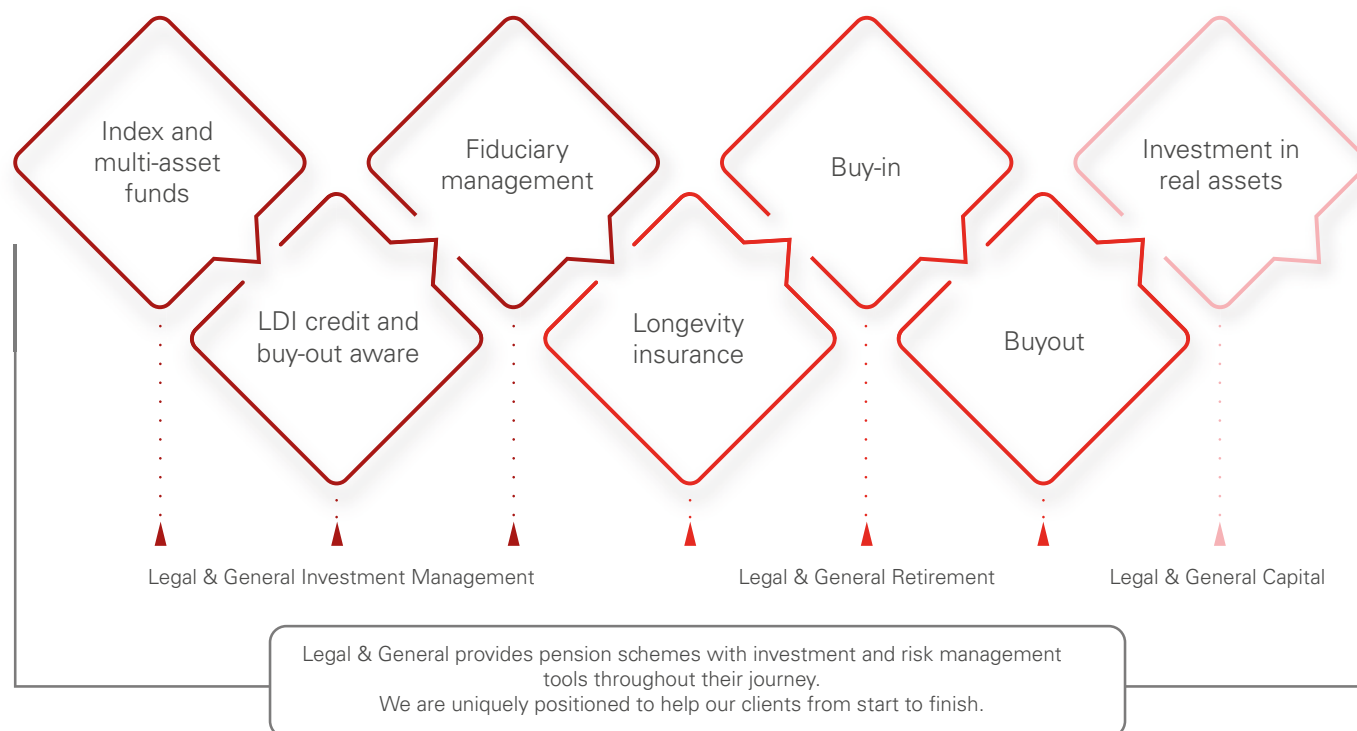


Stepping stones to the endgame – Buyout case study

We can offer the full range of endgame solutions for our clients drawing on our experience of managing both investment and longevity risks. This paper focuses on how we have supported our fiduciary management clients to buyout.



Legal & General is there for your entire journey



More and more pension schemes are approaching the endgame, which for all but the very largest is likely to be buyout with an insurance company. The LGIM fiduciary management team work closely with L&G's buy-in / buyout specialists to provide dynamic endgame-focused investment strategies for pension schemes targeting buyout. This enables our fiduciary clients to efficiently manage their risks whilst also capturing opportunities along the way.

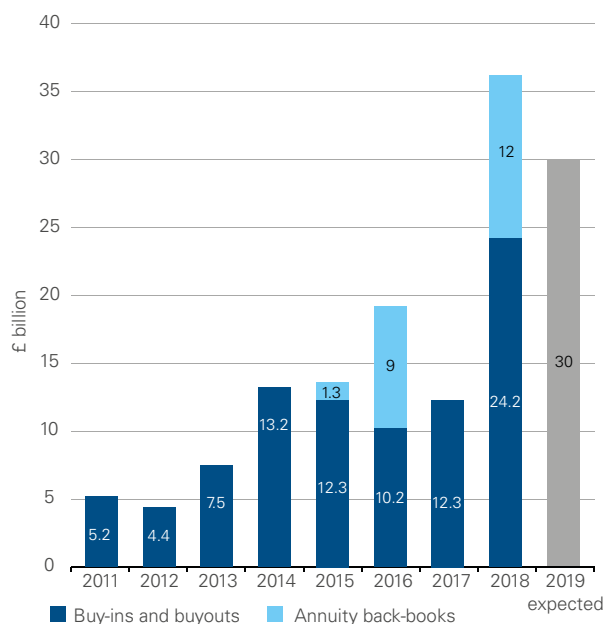
The value of an investment and any income taken from it is not guaranteed and can go down as well as up; you may not get back the amount you originally invested

Current market environment

We believe buyout is a very attractive option for trustees who wish to safeguard their members' benefits in the most secure framework possible. This is due to the regulatory framework that insurers operate within, the substantial capital they hold to back liabilities, and their ability to pool risks.

2018 was a record year for pension scheme bulk annuity transactions, with £24.2bn of deals. This trend has continued into 2019, with total transactions expected to exceed £30bn. This creates a challenge for pension schemes as the demand for bulk annuities begins to outstrip supply and insurers become more selective in providing quotations. Utilising the L&G Group's expertise in fiduciary management and buyout allows trustees to meet this challenge and be at the front of the queue to transact quickly and efficiently when the time is right. This is a unique offering not available elsewhere in the market.

Market activity: Buy-in, buyout and annuity back book volumes



Source: LCP Pensions de-risking report 2019

Factors affecting buy-in / buyout pricing

Insurance companies operate in a complex regulatory environment where achieving the best price isn't always a simple function of competitive supply and demand dynamics.

Insurers hold capital to back the business they write and Solvency II means the asset types they hold to back their bulk annuity contracts has a material impact on the price they can offer. The higher yielding these assets are the better the price. So giving an insurance company time to source those higher yielding assets can get you a better price.

There are other factors to consider too, such as financial year-end targets, other business volumes, reinsurance pricing and market dynamics which can all affect pricing.

As a result, choosing an insurer to partner with and agreeing a price target for the insurer to hit will often lead to a much better outcome than a traditional process where each insurer is asked to quote on a given day based simply on the asset backing opportunities and reinsurance facilities they have available on that day.

Pensioner buy-in price versus gilts – yield difference (higher values are cheaper)



Source: WTW bulk annuity and longevity market update, March 2019

Case study

In the second half of 2018, a small scheme (whose name we are not disclosing in this document) began the process of selecting and appointing a fiduciary manager, and as part of this process the trustees started looking in more detail at its long-term strategic objectives. The sponsoring parent company was keen to buyout, with the funding gap to be met through a combination of sponsor contributions and asset returns.

For our fiduciary management clients we can provide and monitor actual, transactable buyout pricing to assist in the formulation of strategy, even though an actual transaction may be some years away. A scheme's journey plan can then be structured to target that pricing, and the return target set to close any residual funding gap. Our fiduciary management clients also get exclusive access to L&G's buyout specialists, who can provide valuable help with the practical aspects of completing a buyout.

As part of the strategy design process for the scheme in question, we were able to deliver an actual buyout price quotation. This was lower than the scheme actuary's estimate of the buyout liabilities, and the trustees and the sponsor were then keen to accelerate the buyout process and avoid missing out on the opportunity to secure a buyout at an affordable price.

To assist with this, L&G was able to lock the buyout price to the value of the assets held within the fiduciary management portfolio. This meant that the buyout price moved exactly in line with the scheme's investments for a number of weeks, creating increased certainty around the affordability of buyout whilst the finer details were agreed. This was made possible through the trustees' use of the combined expertise of the L&G Group to quickly implement a buyout-ready investment portfolio and also lock the buyout price to that portfolio.

On completion of the buyout the assets in the investment portfolio were then transferred across to the insurer directly, which minimised the transaction costs the trustees incurred.

It is important to note that whilst in this example, the scheme decided to go to buyout with L&G, there was no requirement for them to do so. A joined-up approach offers clear advantages for our clients, but we are equally able to help our fiduciary management clients secure buyout with an alternative insurer, and indeed have already done so.



Conclusions and next steps

As pension schemes continue to mature and funding levels improve we expect to see more and more schemes approach the buyout market. Whilst some schemes will be able to jump straight to the option of buyout with the support of their sponsor, many will pursue de-risking strategies, liability management exercises and buy-ins along the way.

A flexible approach to managing the journey to a scheme's low-risk run-off phase is therefore vitally important. All schemes' situations are different and will require a bespoke approach to prepare for buy-in or buyout.

If buy-in and/or buyout are part of your long-term objectives then please get in touch to discuss how our fiduciary management team can help you position your portfolio and put in place the governance to achieve your goals.

When our affiliate Legal & General Retirement (LGR) is providing a quote for bulk annuity buyout they will do so on their own commercial terms as at the point when the buyout is secured. All buyout aware clients are encouraged to seek competitive open market quotes and should be aware that if a competitor's quote is more favourable than LGR's, then additional transition costs are likely to be incurred when moving scheme assets to that competitor. An investment into the Buyout Aware fund range does not constitute a guarantee from Legal & General Retirement to provide a quote for a bulk annuity buyout.

Contact us

For further information about LGIM, please visit [lgim.com](https://www.lgim.com) or contact your usual LGIM sales representative.

Alternatively please email FiduciaryManagement@lgim.com or visit <https://www.lgim.com/uk/en/capabilities/defined-benefit/fiduciary-management/>



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Legal & General Investment Management Ltd, One Coleman Street, London, EC2R 5AA

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