TECHNICAL SUPPLEMENT

For pensions trustees and their advisers

Aiming for buy-out

Pensions Management Institute

CHARLES STANLEY
Fiduciary Management

Welcome

In our recent Fiduciary Management Survey (see page 3), we found a significant increase in the number of schemes focusing on buy-out as a Long Term Funding Target (LTFT).

This shift has been driven in part by improvements to scheme funding positions as a result of increases in gilt yields across 2022. Regulatory pressures are also playing a role, and a buoyant insurer market is also helping to make buy-out look more attractive.

This guide explores how trustees can work with a fiduciary manager to help them plan and transact a buy-out, from thinking about investment strategies and taking an independent view on potential buy-out insurers, to ensuring that transactions run smoothly both at the time of buy-out and immediately afterwards.

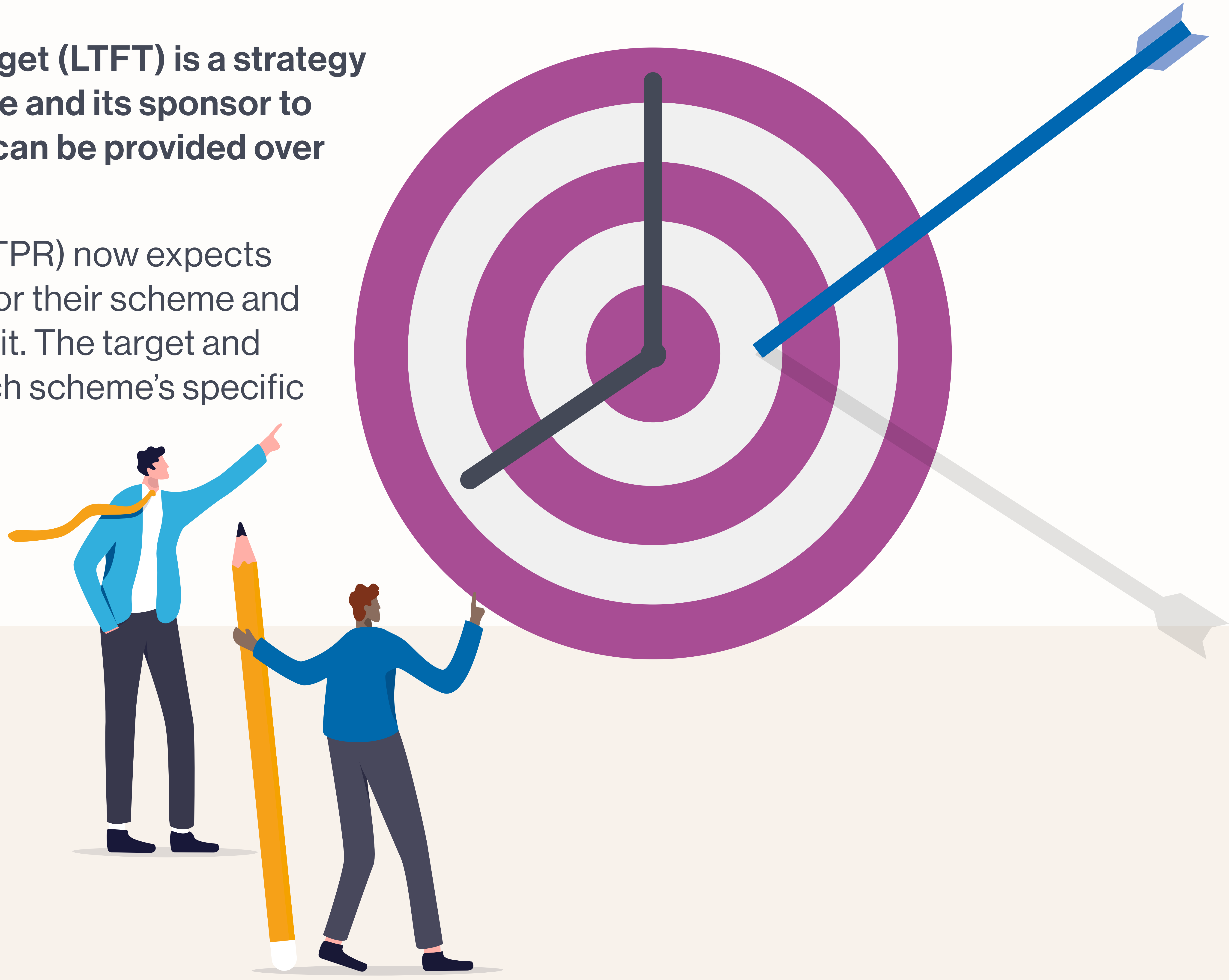
I hope you find it valuable and practical.

Bob Campion, CFA,
Head of Fiduciary Management,
Charles Stanley
Fiduciary Management

What is a Long-Term Funding Target (LTFT)?

A Long-Term Funding Target (LTFT) is a strategy agreed between a scheme and its sponsor to ensure pension benefits can be provided over the long term.

The Pensions Regulator (TPR) now expects all trustees to set a LTFT for their scheme and plan how they will achieve it. The target and the plan should reflect each scheme's specific circumstances.



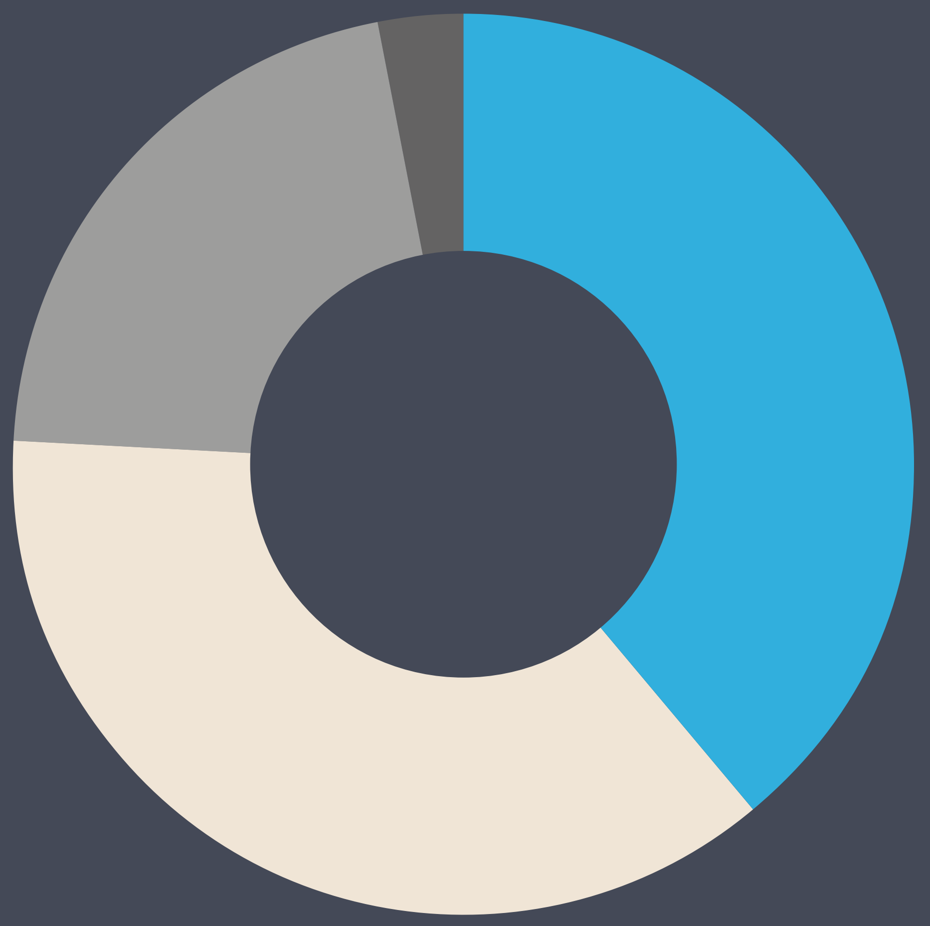
Most schemes' LTFT is likely to be one of the following:

- Low dependency on the sponsor (sometimes called 'self-sufficiency')
- Carrying out a buy-out with an insurer
- Consolidation, such as througha superfund.

Long-Term Funding Targets in numbers

In Q3 2023, Charles Stanley surveyed 67 professional pension trustees of UK DB schemes, to find out about their LTFT and future plans.

Have schemes set long term funding targets?



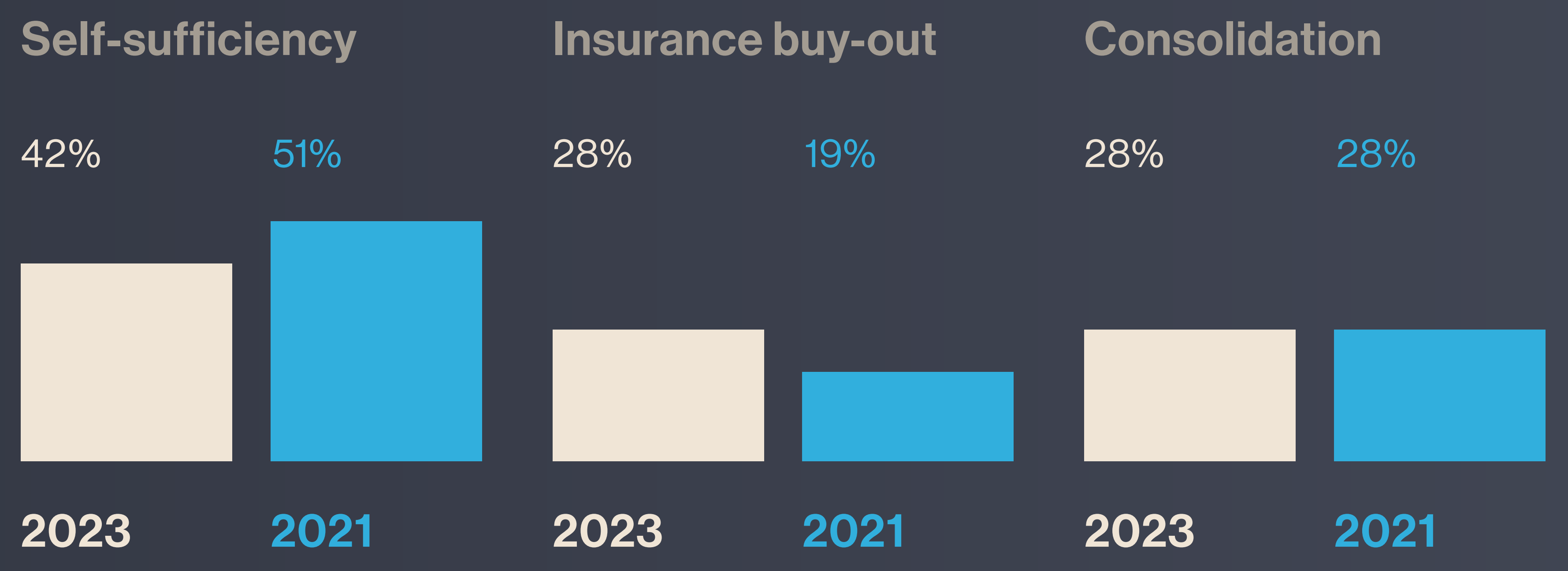
39% have set a LTFT

37% expect to set a LTFT in the next year

21% expect to set a LTFT in the next 12 to 24 months

3% don't expect to set a funding target

What are schemes' long-term goals and how have they changed?



How long will it take to achieve long-term funding objectives (all LTFTs)?

56% of schemes say that they have reassessed their long term funding target in the past 12 months.

72% say they are more likely to adopt fiduciary management in their scheme, as a result of the 2022 LDI crisis, whether or not they have set a LTFT.

Charles Stanley insight

Barnaby Low, FIA, Strategic Client Portfolio Manager, Charles Stanley Fiduciary Management

DB schemes' assets and liabilities changed at a pace that came as a surprise for many trustees towards the end of 2022.

That has driven many schemes to review long-term objectives and associated investment strategies that were set in an era of low interest rates. Our survey found a 140% increase in the number of schemes targeting buy-out between 2021 and 2023, and a 60% reduction in self-sufficiency as an end goal over the same period.

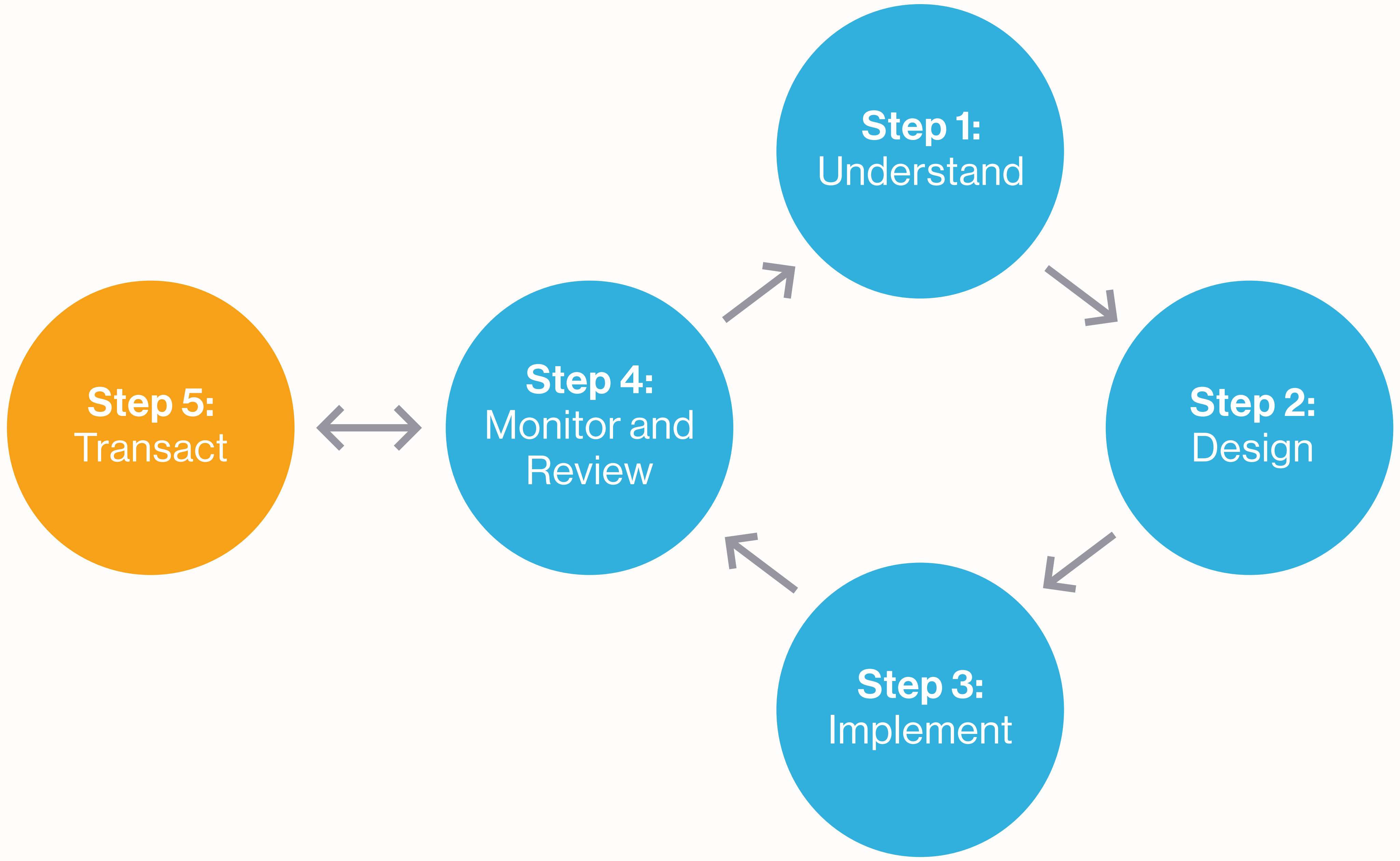
Working towards buy-out with a fiduciary manager enables schemes to monitor market conditions and react swiftly, even when activity is unusual or unexpected. They can then lock in improvements in funding position and stay on track to achieve their LTFT.

How to work with a fiduciary manager to reach buy-out

With the right plan in place, a fiduciary manager can become a central force in setting and reaching buy-out as a LTFT. Charles Stanley Fiduciary Management uses a five-step process to support trustees and schemes.

1. **Understand:** we make a detailed assessment of every scheme's needs and ambitions. That includes helping schemes set a LTFT such as buy-out.
2. **Design:** we work with trustees and sponsors to create a bespoke, achievable journey plan and investment strategy for buy-out tailored to the scheme's specific needs.
3. **Implement:** we build and execute the investment strategy aligned with the journey plan, monitoring risk and ensuring that the scheme's journey plan remains on track. That could include managing LDI strategies, or making portfolio changes based on changing risk tolerances.
4. **Monitor and review:** We work closely with both trustees and sponsors to monitor progress towards buy-out, including adjustments to the portfolio and investment strategy where needed. We also monitor external sources as well, such as live buy-out pricing data from a range of suppliers.
5. **Transact:** We help make sure schemes are as ready as possible to transact, by building relationships with insurers across the market. We liaise with advisers for both sponsors and trustees, making sure preparation paperwork is completed in advance, and track the status of the buy-out as it progresses.

Charles Stanley Fiduciary Management's tactical approach.



Three key questions to ask when choosing a fiduciary manager for buy-out:

1. What is the scope of the fiduciary manager's role in buy-out preparation?
2. Can the fiduciary manager build relationships with a wide range of insurers across the market? This offers wider opportunities to find the right deal and take advantage of openings to transact.
3. Is the approach genuinely tailored to each individual scheme and is there an appropriate team of experts in place to support us with the proposed investment strategy?

Case study: Fiduciary management and LTFT in action

What happened?

Charles Stanley started working with Scheme A in 2016. At the time, the scheme had around £80m assets under management and was 64% funded on a self-sufficiency basis.

Its investment strategy was focused on static asset allocation in passive funds, with a low level of liability hedging.

However, the trustees and their adviser wanted to set a LTFT and adopt a more sophisticated de-risking strategy.

We helped trustees appreciate the value of adopting progressively higher degrees of liability hedging as well as gradually de-risking their growth assets as part of a long-term funding plan.

The plan

The scheme set a target date for self-sufficiency of 2030, assuming no additional employer contributions other than those already agreed.

Scheme A's long-term de-risking flight plan increased diversification in its portfolio and gradually increased liability hedging over time. The plan immediately reduced expected funding volatility (tracking error vs liabilities) without sacrificing expected returns.

The results

By the end of 2021, the scheme had achieved its long-term funding objective and had completely de-risked to a buy-out-aware strategy, seven years ahead of target.

The scheme had completed all five stages of its flight plan and was 100% funded on a prudent long-term funding basis. Asset growth (+84%) had substantially outperformed liability growth (+18%), powered by a 43% net return (+7% p.a.) since inception to end Q3 2021.

The fiduciary team worked closely with the trustees and their advisers during Q4 2021 to lock-in the funding position and enable a smooth transition to a buy-out provider which was finalised before Christmas that year.

Charles Stanley insight

Rebekah Bennett, Director,
Consultant Relations,
Charles Stanley Fiduciary Management

Scheme A's trustees were conscious of the limitations of their decision-making process, as well as the delays involved in making even straightforward portfolio changes.

Fiduciary management enables schemes to adopt a more sophisticated investment approach that trustees might not be able to support on their own. The approach we took with Scheme A enabled us to take advantage of market conditions and optimise asset growth as well as making sure we were able to lock in those improvements and take action to transition to buy-out.

Case study: Securing a buy-out deal under time pressure

What happened?

Scheme B is a long-standing Charles Stanley client, with around £10m in assets under management. We have worked with the scheme as a full service fiduciary management client since 2018. At that time, the scheme adopted a 12-year flight plan targeting self-sufficiency by 2030.

The scheme had made good progress on its flight plan and was ahead of target when, in February 2021, its sponsor announced an imminent M&A transaction. The sponsor would immediately fund the deficit needed to carry out a buy-out, provided the trustees were able to secure a transaction before the M&A deal closed.

That gave Charles Stanley and the trustees just nine weeks to project manage a buy-out transaction, liaising with advisers both for the trustee board and the sponsor, to successfully finalise a buy-out deal before the deadline.

The plan

The announcement triggered a series of urgent meetings with the trustees, scheme sponsor and scheme advisers to establish next steps. Charles Stanley's actions included:

- Supporting the trustees to appoint a formal buy-out adviser
- Providing urgent strategic advice to reorganise the portfolio for buy-out awareness, with our investment teams executing the changes within four weeks of first notification
- Providing draft paperwork for signed instructions during the process to minimise legal fees and ensure quick progress.

The results

Throughout the process, we liaised with advisers, monitored the scheme's funding position and tracked the progress of the transaction. Once terms had been agreed with a buy-out provider, we worked with the trustee to liquidate the scheme and make the final settlement directly with the insurer.

The buy-out process was completed to the satisfaction of the sponsors and the trustees, and M&A activity could go ahead as planned.

Charles Stanley insight

Bob Campion, CFA,
Head of Fiduciary Management,
Charles Stanley Fiduciary Management

Scheme B's experience shows that pension schemes don't operate in isolation from a sponsor's perspective: they are part of a wider business infrastructure.

Its buy-out journey shows that with the right decision-making structures, plus alignment from trustees, sponsors and advisers, buy-out can be achieved very quickly.

Charles Stanley is able to work with the whole of the buy-out provider market to quickly identify opportunities, agree terms and prepare for transactions at short notice.

Conclusion

As the case studies in this guide show, no two schemes' circumstances are the same, even among those targeting buy-out. The business drivers and conditions surrounding transaction can be very different.

We see many reasons why the trend towards working with a fiduciary manager to prepare for buy-out is set to continue, including:

- The last 18 months have made buy-out a more affordable and achievable end goal for schemes of all sizes. Improvements in long-term gilt yields have increased funding levels and have even created surplus for some.
- We continue to see fast-moving investment markets affected by political, economic and regulatory change. In this ongoing uncertainty, keeping journey plans on track and being positioned to take advantage of opportunities in the buy-out market at short notice is vital.
- Last year (2023) was a record year for buy-out transactions, and analysts are expecting 2024 to follow suit. New entrants are increasing competition and that means more choice, better affordability and value for schemes.

Get in touch

Charles Stanley Fiduciary Management is focused on understanding and meeting the unique needs of every one of our clients, with a tailored approach to investment and journey plans.

Get in touch, using the contact details on the following pages, to discuss how we can help your scheme take control and meet your pension scheme's LTFT objectives.

Contact

For more information on our fiduciary management and buy-out services, and how we can help your pension scheme visit www.charles-stanley.co.uk/fiduciary-management or call 020 7149 6922

Bob Campion, CFA
Head of Fiduciary Management
T: 020 7340 9291
E: bob.campion@charles-stanley.co.uk

Rebekah Bennett
Director, Consultant Relations
T: 020 7149 6922
E: rebekah.bennett@charles-stanley.co.uk

Barnaby Low, FIA
Strategic Client Portfolio Manager
T: 020 7149 6187
E: barnaby.low@charles-stanley.co.uk

CHARLES STANLEY
Fiduciary Management