

Buyout with Illiquid Assets

case study

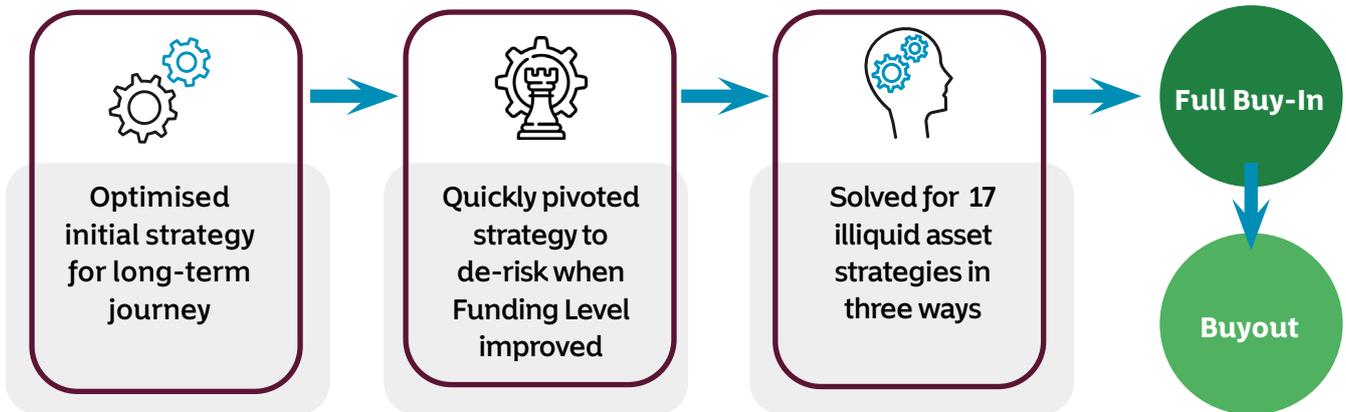
Many Trustees of DB schemes have overseen improved funding levels, especially in light of the rapid rise in interest rates witnessed during 2022. This has had implications for funding timelines and strategy.

Appetites for holding high return or illiquid assets have changed, buy-in is nearer and more affordable.

Here we outline how we worked to resolve some complex challenges faced by a DB pension scheme that held material illiquid assets and yet wanted to move quickly to secure buy-in and ultimately buyout.

The concepts work for a range of scheme sizes. The conclusion, illiquid assets needn't always hold up buyout.

What did Momentum do

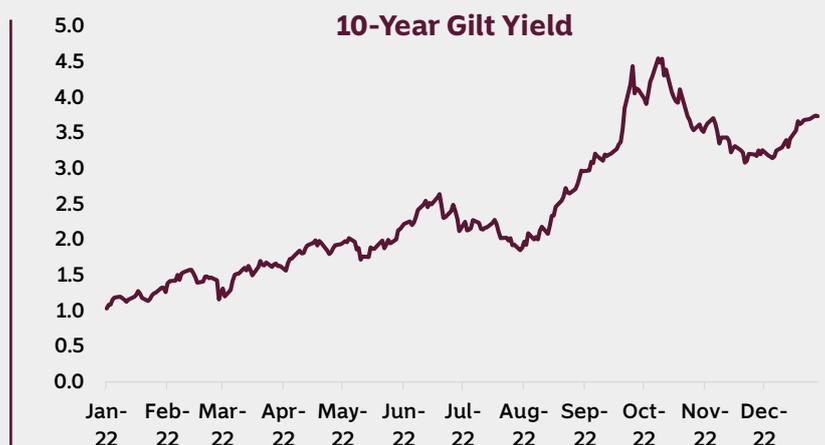


At the outset of our appointment in 2017, there was a long-term journey to full funding (>10 years), and we advised on several strategy changes including:



2022 was a year of significant change:

- » Ukraine was invaded by Russia
- » Truss / Kwarteng budget
- » Rising gilt yields: BoE intervention
- » The Sponsor enjoyed a windfall
- » Buy-in became more affordable



The Sponsor was suddenly keen to pursue a pensioner buy-in. We quickly concluded that with material illiquid assets, pursuing this approach would leave a poor residual strategy, and that full buy-in pricing changes meant it was now more achievable, if only we could resolve the illiquid asset challenge.

Over ~9 months, considerable work was undertaken through innovative solutions:

- » Liability hedging was increased to 100% on a buyout basis in favour of LDI while lowering LDI leverage overall (achieved quickly)
- » A phased disposal of liquid and semi-liquid assets e.g. multi-asset credit and property (c25% assets)
- » Illiquid assets (c30%) across 17 strategies were addressed in 3 ways:

Insurer accepted

6 strategies:
Infrastructure
Distressed Debt
Private Debt

Deferred premium

5 Strategies:
Backed by semi-liquid assets incl. Property, Credit, Insurance-Linked Securities (ILS)

Sponsor purchase

6 strategies:
Infrastructure
Private Debt

The insurer was encouraged to take c50% of illiquid AUM, a deferred premium element was backed by c20% semi-liquid assets and the Sponsor purchased c30% of assets.

Overall, there were 17 distinct illiquid strategies from Ground Leases to Care Homes, Renewable Infrastructure to Farmland, Private Debt to ILS.

A full buy-in was achieved. *Nearly there...*

Final stages...

More than half of the deferred premium was paid down in one quarter. 100% has since been paid. The Scheme has now moved to full buyout. Momentum are monitoring brokers for small collection of residual assets with the Sponsor.

Conclusions

Although the illiquid assets had represented a potential obstacle, we were able to work with the client stakeholders and our industry partners (insurer, brokers, alternative asset buyers) to overcome these challenges quickly and creatively. Key to this was:



Overall, the team have experience of taking >£10bn to buyout in the past 5 years. Momentum work with both small and large schemes (<£10m through to >£10bn) also advising clients who seek to run-on. We focus on Bespoke Strategy, Quality Service, and Independence.

Q What size of scheme was this?

A c£2bn AUM before the Sponsor contribution.

Q Can this work for smaller schemes?

A Yes. A prompt transition to hedge 100% of buyout liability risk and a reduction of liquid growth assets can typically be achieved for schemes of any size. With regards to illiquid assets:

- » Insurers will often take some illiquid asset types
- » Deferred premium is an increasingly common feature
- » Your Sponsor taking on assets is case specific

Q What about insurance capacity issues, and should I just wait?

A The market is busy: c£40bn+ DB AUM is being insured annually (c250+ deals p.a.). However, with the right advisors, you can make progress.

Q Should I buyout or run-on?

A A lot has been said on this topic. Overall, you pay a premium for buyout. However, we advise schemes pursuing both. There are a few simple calculations and a finite number of questions to answer to take an informed view, and ensure all paths are duly appraised for your members. We can walk you through this.



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