



Buy-in and Buy-outs: Considering the financial strength of your insurance counterparty

November 2023



Why assess insurer financial strength for buy-in and buy-out transactions?

There has been an improvement in funding levels for many DB schemes over recent periods. As such, more than ever before, trustees and sponsors are considering transactions with insurers to de-risk their schemes.

The process of selecting an insurer for such an important transaction can be complex with a range of potential counterparties to choose from, including new entrants.

Understanding the financial strength of shortlisted or selected counterparties is a key stage of the diligence process for many trustee boards, and it can be valuable to fully understand the regulatory framework and protections in place for annuity policyholders.

Although the UK's Solvency II regulatory regime for insurers is robust with close oversight from the Prudential Regulation Authority ("the PRA"), variations in strength and risk exposures across the market should be understood by trustees considering a transaction.

How can LCP help?

We have worked closely with our clients and LCP's de-risking experts to develop a cost-effective approach to insurer financial due diligence advice. This gives trustees confidence in a selected or shortlisted insurer's ability to meet obligations to members, and enables them to understand key aspects of post-transaction security.

Our full-scope approach to the analysis helps trustees and sponsors to:

- Understand the insurance regulatory regime, in particular the financial safeguards that insurers are required to maintain;
- Understand and assess the key financial strength indicators of their chosen insurer(s);
- Understand the risk profile and sensitivities of their chosen insurer(s); and
- Compare the insurers across the market based on key financial metrics.



Case study

Insurer financial diligence on a selected buy-in counterparty

Client Leads –
Fran Bailey and James Silber

We were appointed by the scheme's trustees in 2022 to support them with understanding the key financial strengths and risks of their insurer ahead of signing final contracts to complete a full buy-in transaction. The scheme's sponsor was a general insurer and there was a range of experience and understanding of insurance across the trustee board. Working to a compressed timeframe, we provided the trustees with a detailed report setting out the strengths and risks of their selected counterparty, subsequently presenting and discussing our advice at a trustee meeting. This work enabled the trustees to progress confidently with their transaction, understanding the security to member benefits that the policy from their insurer would provide. They are now working towards completing a full buy-out this year.

Find the perfect solution from our extensive offering



Market overview: KPIs across all insurers

Market review of providers in the bulk annuity market to help assess potential counterparties:

- Market position and strategy
- Headline solvency data, including insights into key solvency risk sensitivities
- Investment and reinsurance strategies
- High-level financial performance indicators



Risk review: Detailed desktop financial risk review

A deeper review into one (or more) insurers to support the trustee's decision to transact:

- Overview of the insurance regime, including insights into recent regulatory developments
- Review of the counterparty's corporate and ownership structure, access to capital and recent performance
- Solvency Financial Condition review, incorporating analysis of Solvency Capital Requirement and sensitivities
- Comprehensive risk profile review – investment portfolio, governance structure and approach to risks



Covenant comparison: Compare and contrast current covenant with the protection provided by a buy-in or buy-out policy

A compare-and-contrast review of the current sponsor covenant relative to the buy-in / buy-out protection:

- Comparing the regulatory frameworks and protections of DB Pensions vs Life Insurance policyholders
- Review of the current sponsor covenant support, following discussions with management
- Summarise relative strengths and weakness of the sponsor covenant vs an insurer (including KPI metrics)
- Comparing the exposure to downside risks for sponsor covenant vs a buy-in / buy-out



Bespoke offerings: Tailored to specific needs and concerns

Bespoke analysis can be offered acknowledging that there may be specific risks or concerns about an insurer that may require a detailed review.

Client testimonial

The LCP team prepared and presented a comprehensive but accessible report on our potential buy-in counterparty. They impressed a number of our highly experienced Trustee Directors, demonstrating their in-depth knowledge of the insurer counterparty and the subject matter.

Group Financial Controller, UK Motor Insurance Group and Chair of Trustees of the Insurer's DB Scheme

What our clients tell us sets us apart

Our approach

- Reports are clear, informative and aim to bring out the key considerations for trustees with clear conclusions drawn.
- Analysis looks beyond the numbers to help trustees understand the wider risks and the protections provided by the regulatory framework.
- Highly pragmatic approach, cost-effective & flexible to client needs.
- Analysis is tailored to specific needs and concerns.

Our experience

- Specialist team has considerable experience in conducting these reviews with over 15 clients advised in 2023 to date.
- Deep knowledge of the challenges impacting insurers and the regulatory framework in which they operate.
- Open dialogues with insurers through years of active engagement, with access to insurer management teams.
- Working closely with other market-leading LCP teams such as the de-risking, actuarial and insurance teams.
- Ability to add value in other areas, e.g. ESG reviews of insurers and reviews of administration services.

Our team

- Ability to deliver within quick timescales to fit into the wider project timeframe.
- Working collaboratively with clients and other advisors.
- Analysis and findings are delivered by experts in financial risks and pensions.
- Intuitive and jargon-free reporting style that is accessible by all knowledge levels.



Fran Bailey, ACA
Partner
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Fran leads the team at LCP advising on the financial risks (i.e. covenant) of insurers in the market. To date this year, she has supported six clients navigate full buy-in transactions with their sponsor, providing clear advice on the covenant implications of severing the sponsor link and risks and benefits of transferring to their chosen life insurer.



James Silber, ACA
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James has been involved in LCP's insurer due diligence work since inception. He has an extensive understanding of the evolving insurance regulatory framework and capital rules, including the expected changes from the upcoming Solvency II / UK reforms, and sits on the Bank of England's Subject Expert Group set up to consider stress-testing and disclosure across UK life insurers.

Awards

The strength of our people and quality of our service has resulted in a host of industry awards in recent years.



Judges' feedback

LCP was a clear winner, for "showcasing its impressive dedication to the covenant arena, and being in tune with the different ways a sponsor covenant provider can and should assist its clients, at whatever stage of the pensions journey they may be".



Pensions Age 2023 Awards Winner - Covenant advisor of the year