Navigating a changed bulk annuity market

LCP pensions de-risking update
May 2023

Navigating a changed bulk annuity market

The bulk annuity market has fundamentally changed

There has been a step change in the de-risking market with buy-ins and buy-outs on track to hit **record volumes of £45bn-£60bn** this year and as many as **15 £1bn+ transactions** in 2023. We estimate that around 1,000 schemes (almost one in five) are already fully funded on buy-out and foresee no let-up in activity.

In this update, we analyse the market data and trends. We also consider the dynamics around insurer pricing and key structural features in the market such as residual risks cover.

Throughout the update are case studies of LCP projects over the past 12 months. We are proud that we have continued to be able to make a real difference to member outcomes including for some of the largest transactions ever concluded such as RSA's record £6.5bn full buy-in in February, British Steel Pension Scheme's £7.5bn full insurance programme through a strategic partnership which completed in May and British American Tobacco's £4.1bn full insurance programme which completed in October. We also executed nine smaller transactions during 2022 through our highly efficient streamlined buy-in service.

We are optimistic about the direction of the market. Despite the capacity crunch at insurers, we're continuing to see transaction opportunities be fiercely contested where we have helped schemes to present optimally to insurers. We're also finding that insurer capacity is still being made available for smaller (sub £100m) deals. Further, M&G has confirmed it plans to re-enter the market later this year. This will take the market to **nine insurers** with other potential entrants exploring their options.

In the current market landscape, the expertise and insurer perspective of an experienced de-risking adviser is more valuable than ever before in helping schemes navigate the market, alongside focused preparation, robust process design, and collaborative problem-solving.

LCP's record-breaking 2022

We led a record **24 transactions over £100m in 2022** – almost twice as many as our closest competitor

LCP transacted a unique umbrella structure for a longevity swap

£11.8bn LCP-led buy-in/out transactions

Over 40% LCP buy-in/out market share

The above statistics are based on insurer data and public announcements.

How is LCP responding to the much busier market dynamic?

In anticipation of higher market demand for de-risking services, we have expanded our core specialist de-risking team to **60 experienced consultants**. Alongside external recruitment, in 2022 we initiated an intensive training and transaction shadowing programme to enable the transfer of 10 experienced consultants from our broader actuarial practice to our de-risking team, enabling us to be well ahead of the curve in meeting the demand from pension schemes wishing to explore a buy-in transaction.

This initiative will help LCP continue to maintain a deeply resourced transaction team with significant capacity to support demand from both existing and new clients. A key differentiator of LCP is that we regularly act in a specialist de-risking adviser role working closely with incumbent advisers. It is this approach, as well as the depth and capacity within our team, that has helped LCP to deliver the transaction statistics above and be in a position to help so many schemes achieve their aims.

Charlie Finch
Partner

Ruth Ward
Principal

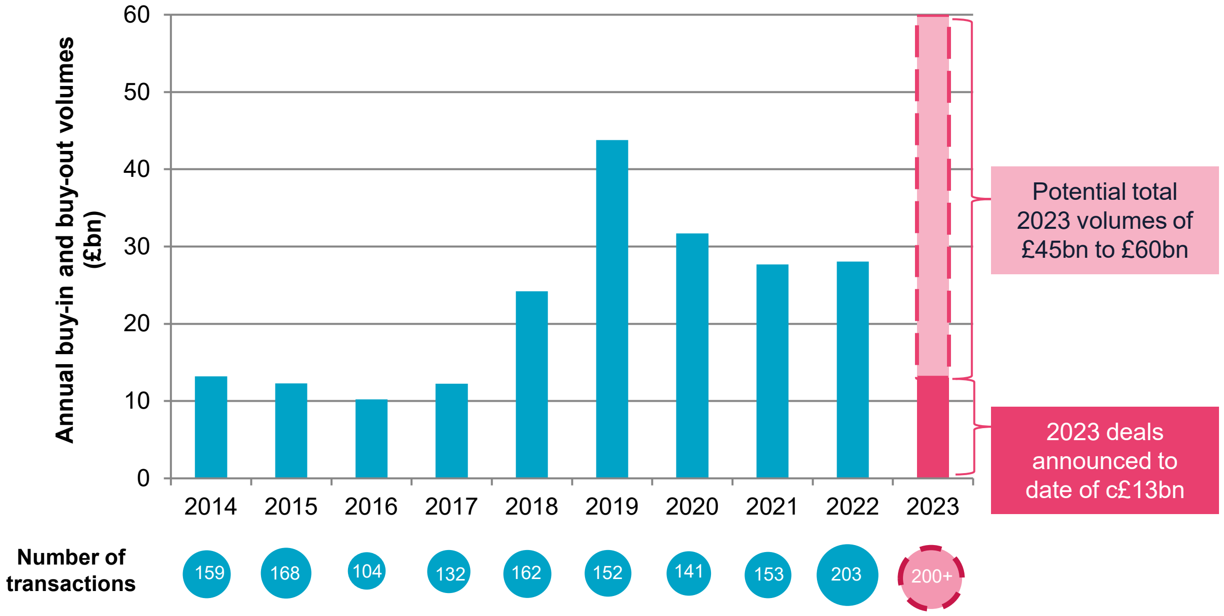
2023 is set to be a record-breaking year for de-risking

2022: similar volumes but record activity

There were a record number of transactions in 2022 at over 200 – a 30% jump compared to 2021 (see chart below). Much of this increase was driven by a c50% increase in smaller (sub £100m) deals. In contrast, transaction volumes were barely changed at £28.1bn (2021: £27.7bn), partly due to higher gilt yields reducing the size of pension liabilities.

It may come as a surprise that smaller schemes led the charge, being a segment of the market perceived as most at risk of being "crowded out". But smaller schemes benefited from being nimble and able to come to market more quickly than their larger counterparts when funding levels improved across the DB scheme universe. Several insurers also made improvements last year to automate and streamline their processes for smaller transactions, including extending their reinsurance flow treaties allowing them to write greater numbers of smaller transactions. As a result we found that our streamlined advisory process was more in demand than ever before.

We expect the market to continue to support higher numbers of smaller deals going forwards, particularly in a world where all schemes are now smaller. The view amongst several insurers is that a flow of well-run and efficiently-executed smaller deals gives an attractive steady flow alongside the less predictable deal flow from larger schemes.



Source: Insurance company data

2023: return of the giants

Insurers are reporting giant £1bn+ deals coming to market at unprecedented rates, with around 15 indicated to be lining up to transact this year. This would eclipse the previous record set in 2019, when 10 £1bn+ deals were transacted and is a big increase on the five £1bn+ deals written last year. Giant deal activity at this level is expected to drive record bulk annuity volumes of £45bn-£60bn for the year.

The year has already started strongly with the largest ever buy-in (c£6.5bn) for RSA, where LCP acted as lead transaction adviser to RSA and its parent Intact (see case study below), and the LCP-led £2.7bn British Steel Pension Scheme transaction (see case study overleaf) which completed the insurance of their £7.5bn scheme. A further c£4bn of deals have been announced, taking the total deals confirmed year-to-date to over £13bn.

CASE STUDY: RSA – largest ever bulk annuity transaction

c£6.5bn full buy-in with PIC

40,000 members

February 2023

- Improvement in funding levels in 2022 created a favourable opportunity for the sponsor to accelerate the schemes' de-risking, de-risk its own balance sheet, and for the trustees to enhance member security
- Pricing agreed amidst unprecedented market volatility during the LDI crisis
- Complex structuring considerations included accommodating the schemes' existing longevity and asset swaps.

LCP buy-in and endgame forum for larger schemes

Join us in-person on Monday 19 June to hear our experiences working on some of the largest transactions in the market such as RSA and British Steel Pension Scheme. Simon de Baat, Group Capital Director at Intact, RSA's parent company, will speak about his perspective.

Click here to register

2023 set to be a record-breaking year for de-risking (continued)

Funding levels of UK DB schemes

- LCP estimates that nearly one in five schemes are fully funded on buy-out – that is 1,000 schemes – with the average projected time to reach full buy-out reducing by over five years in 2022.
- The resultant acceleration in market activity has increased pressure on insurer triage processes, creating a crunch point around insurers' abilities to quote for all transaction opportunities coming to market. Schemes are having to be smarter to obtain insurer engagement and competitive pricing and terms (see our beat the triage report).

Navigating a changed bulk annuity market by scheme size

- Smaller schemes will continue to benefit from following certain de-risking advisers' well-established streamlined processes and transacting on pre-negotiated contracts (eg under LCP's streamlined service) – some insurers now insist on this before they will quote.
- We anticipate there will be ad-hoc pricing opportunities over 2023 for well-prepared and nimble smaller/mid-sized deals advised by specialist de-risking advisers with a "close ear to the market" – at the point a larger deal goes exclusive there will be one or more disappointed insurers looking to rapidly re-deploy higher-yielding assets to other deals waiting in the wings.
- Larger schemes should be clear on their "key asks" of insurers and the underlying rationale – this is certainly not the market for complex requests that are not well thought through. In addition, as insurers and reinsurers start to factor in post-pandemic longevity trends, there's an imperative to re-examine views on scheme-specific future life expectancies, with input from both actuaries and health professionals in order to negotiate optimised longevity pricing (read more in LCP's 2023 longevity report).

CASE STUDY: British Steel Pension Scheme – largest full insurance

c£7.5bn full insurance across four buy-ins with L&G

c67,000 members

May 2023

- Largest pension scheme in the UK to have fully insured all its members' benefits
- Entered into a strategic partnership with Legal & General as part of an initial £0.5bn buy-in in November 2021 and completed a final £2.7bn buy-in in May 2023 with £7.5bn buy-ins in total
- Completed the two largest deals of 2022 at £2.3bn and £2.0bn using an umbrella contract established to allow the trustee to complete each transaction quickly and easily on pre-agreed contractual terms
- Collaboration with selected insurance counterparty, Legal & General, and its in-house investment manager, Legal & General Investment Management (LGIM), to implement a strategy to improve the scheme's funding level by aligning investments with L&G's pricing and to solve illiquid asset issues.

Beat the triage: click here for practical hints and tips for getting your scheme prioritised in insurer triage processes

Key changes in market dynamics

An increasingly competitive landscape?

Competition in the market has steadily intensified in recent years. A record six insurers secured a 10% plus market share in 2022, a number that's increased year-on-year from three in 2019 (as shown in the chart below).

This trend was driven by a competitive market that delivered outstanding pricing to clients. Most 2022 LCP-advised deals were fiercely contested by two or three insurers at final selection stage, from a long list of four to seven insurers at initial quotations.

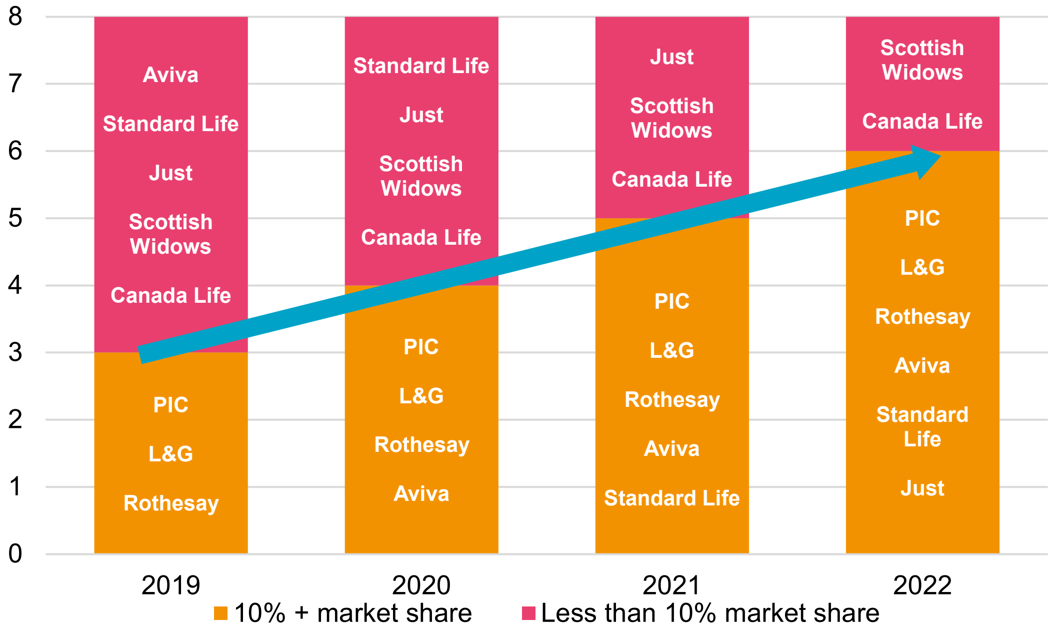
Although competition for market share remains fierce, we are starting to see a shift in market dynamics. The recent surge in demand for bulk annuity insurance means the market will be running at near full capacity in the short term. As a result, resource-constrained insurers are likely to be more selective about which schemes they choose to quote on. Schemes must therefore be able to demonstrate a high degree of transaction preparedness and a well-planned, well-advised process to secure competitive quotations from a range of insurers.

M&G enters the bulk annuity market

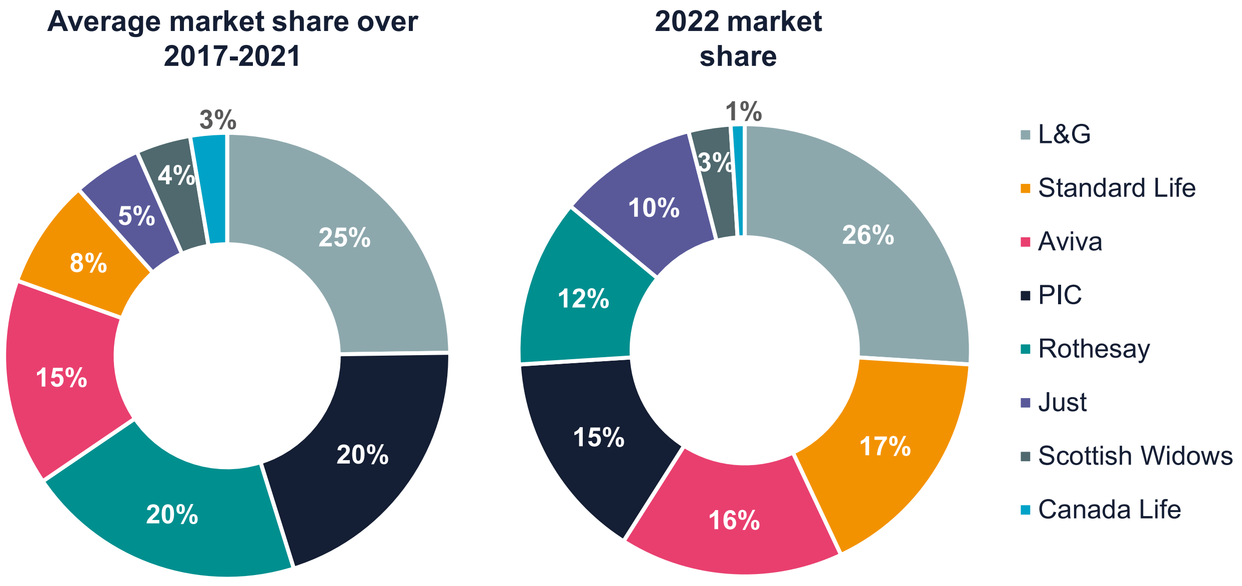
We predicted in January that 2023 could see the first new entrant in six years. M&G has now confirmed plans to enter the market later this year, which will increase the number of insurers in the market to nine, with other potential new entrants also exploring options.

M&G was formed by the demerger of Prudential PLC in 2019. It includes the Prudential insurance business that was active in the bulk market from 1997 to 2016. In the past 12 months M&G has recruited an experienced team. As well as bulk annuities, they are offering a wider suite of alternative endgame solutions.

Number of insurers with a 10%+ market share



Source: Insurance company data



Source: Insurance company data

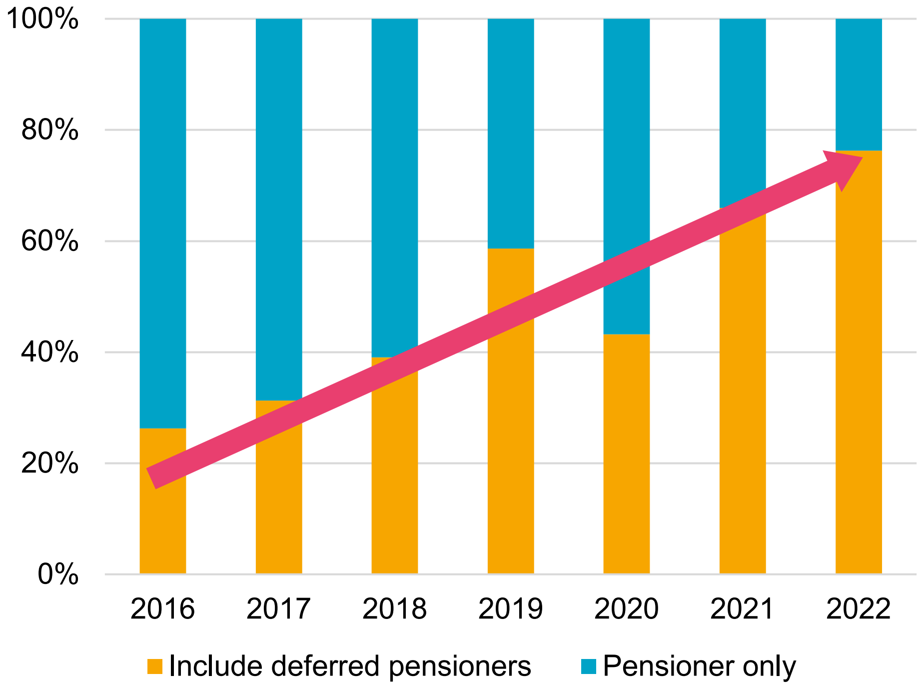
Key changes in market dynamics (continued)

Accelerated shift to full scheme transactions

There has been a further shift towards full-scheme transactions in 2022 as non-pensioner longevity pricing and scheme funding levels have improved. As shown in the chart below, over three quarters of buy-in and buy-out volumes in 2022 included deferred pensioners, up from around a quarter in 2016.

The market for insuring deferred members has never been better, with all eight insurers in the market now able to transact on full scheme deals and continued improvements in pricing of non-pensioners. With improved funding levels, we're seeing quotation pipelines being dominated by full scheme deals, particularly as revised collateral limits following the LDI crisis have made partial buy-ins less easy to accommodate.

Pensioner-only transactions as a proportion of total volumes

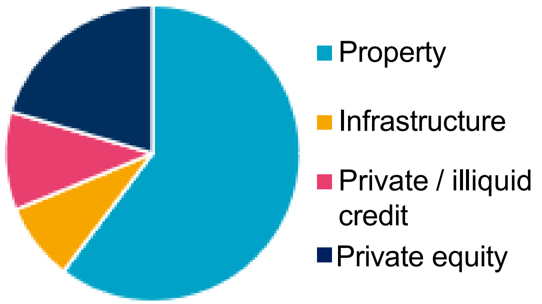


Source: Insurance company data

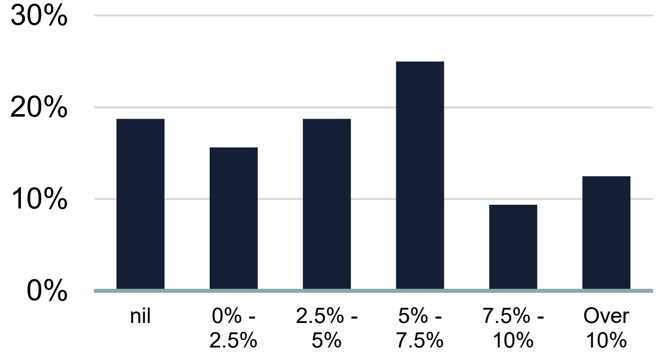
Solving illiquid asset challenges

The acceleration in end-game plans has brought challenges in the form of illiquid asset holdings, which cannot easily be transferred to insurers. Such assets have formed valuable components of schemes' medium-to-long-term investment strategies but careful planning is required if they are needed to fund a short-term buy-in transaction. LCP has recently established an Illiquid Asset Solutions Group to consolidate extensive experience of implementing solutions to release value from illiquid assets in the context of buy-in/out transactions.

Distribution of illiquid asset classes (FTSE 100 universe)



Distribution of allocation to illiquid assets (FTSE 100, £3bn+ schemes)



Source: LCP analysis based on information available within 2021 year-end company accounts

Our analysis indicates that 80% of larger (£3bn+) schemes have illiquid holdings, with nearly 50% having an allocation over 5%

CASE STUDY: British American Tobacco – phased buy-ins

£4.1bn full insurance across three buy-ins with PIC

10,000 members

October 2022

- Initial £3.4bn transaction (2019) scaled up to secure remaining benefits on pre-agreed contractual terms
- Attractive pricing secured on two additional tranches (2021, 2022) of long-dated liabilities to reach full insurance, making it the second largest scheme to date to do so across multiple buy-ins
- Required bespoke solution for illiquid asset holdings.

Insurer pricing improved markedly over 2022 and remains attractive

Key drivers of favourable insurer pricing over 2022, relative to a gilts holding, include:

1. Improved yield on insurers' asset portfolios, particularly around the LDI crisis, with a tightening at year end
2. Improved longevity pricing, particularly for non-pensioners, driven by better reinsurer pricing and appetite
3. Strong competition for transactions from insurers and reinsurers.

Increasingly, schemes had to come to market well-prepared to obtain pricing at the levels shown below.

How will pricing pressures play out over 2023?

Over 2023 to date, whilst pricing has fallen back a little from the near-record levels in late 2022, it has continued to be very competitive, with no indication of any price hardening for LCP clients from the surge in activity. Well-prepared deals continue to be fiercely contested, even if there are a smaller number of participating insurers, and fully funded schemes are being clear on their pricing metrics (or even actively exploring alternatives to full insurance) – ie they are not forced buyers.

The planned entry of M&G will introduce further competition. There continues to be interest in the UK bulk annuity market from other potential entrants and global providers of capital.

Source: LCP insurer pricing model. The model is calibrated against live quotation and final transaction pricing. Buy-in pricing depends on a wide range of factors such as transaction size, benefit structure, membership profile and insurer appetite and can differ materially from that shown above.

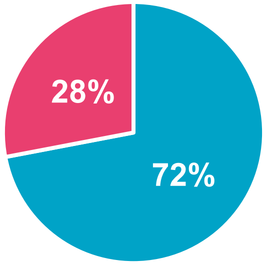
Residual risks cover – is it worth the cost?

What is residual risks cover?

Residual risks (RR) cover has become a big focus with so many schemes reaching full funding and finalising their end-game strategies. For many schemes RR cover can be attractive as it provides additional contractual protections against risks not covered by a standard buy-in or buy-out (such as data risk, benefit risk, missing beneficiary risk, GMP equalisation risk and legislative risk) but it comes at an additional cost.

RR cover is generally available from at least some insurers for transactions over c£250m with costs typically in the range 0.5-1.5%. Not all schemes choose to seek or ultimately take up RR cover but, in our experience, larger schemes choose to take it up more often than not (see chart below).

Uptake of residual risks cover for full buy-ins over £250m since 2015



- Proportion that took RR cover
- Proportion that did not take RR cover

Source: LCP full buy-in transactions over £250m

Common reasons for taking up RR cover

- Sponsor desire for clean break
- Surplus assets on buy-out, which can be used to meet the additional premium
- No long-term sponsor to stand behind risks
- Improved member protection and experience.

Common reasons for not taking up RR cover

- Comfortable with the risks given the due diligence undertaken and other available protections
- Strong sponsor to stand behind risks post wind-up
- Not deemed good value-for-money.

What do schemes need to think about?

Implementing RR cover is a substantial project, potentially doubling the amount of work required to complete a transaction. In the current crowded market, schemes should take time to assess whether RR cover is important to them, weighing it up against other available protections (with specialist de-risking and legal input) and then putting a clear, focussed request to insurers if they decide to pursue it.

Schemes wishing to seek RR cover need to engage on their residual risks strategy ideally 12+ months ahead of going to market. Key areas to consider include:

- Review of known benefit issues – typically by the scheme's incumbent lawyers as part of benefit specification preparation
- Scope of the cover – eg historic bulk transfers, execution of deeds, missing documents etc
- Whether to commission a due diligence report – and if so, is it produced by lawyers appointed to the trustees (vendor report) or external lawyers for the insurers (buyer's report)?
- Deciding on the preferred structure (see table below).

This is an area where careful preparation will pay dividends in the price and terms obtained from insurers.

CASE STUDY: WH Smith – full buy-in completed amidst market volatility

c£1bn full buy-in with Standard Life

c13,000 members

August 2022

- Transaction included price lock protecting deal metrics over volatile market conditions in mid-late 2022
- Collaborative approach allowed timescales to be accelerated, locking in improved funding position
- Comprehensive residual risks cover was negotiated to protect sponsor, trustees and members.

The table below sets out three common approaches to structuring residual risks cover and the corresponding trade-off between the upfront work involved and the upfront certainty on price and terms.

Residual risks structure	Timing of due diligence	Project complexity / up-front costs	Cost certainty	Scope of cover certainty	Risks covered during buy-in period	Insurer appetite
Commitment to provide a residual risks quotation at buy-out	Later, ahead of buy-out	Minimal work upfront so simpler initial transaction and lower costs	×	×	×	✔✔
Agree RR terms and price at buy-in as an option to take up at buy-out	Ahead of completing buy-in (top-up due diligence at buy-out?)	Significant upfront work	✔ Subject to any top-up due diligence	✔ Subject to any top-up due diligence	×	✔ Depends on process run
Implement from point of buy-in	Ahead of completing buy-in	Significant upfront work	✔✔	✔✔	✔	**Varies**

The bulk annuity market has changed – the expertise and insurer perspective of an experienced de-risking adviser is more valuable than ever in designing an effective approach to market.

LCP's core and wider de-risking teams and our capabilities

Investment strategy
We advise on asset strategy at all stages ahead of a transaction through to effective transition.

Transaction broking
We advise on buy-ins, buy-outs, captive structures, residual risks cover, collateral structures and longevity swaps.

Illiquid assets
Our Illiquid Asset Solutions Group finds solutions to release value from illiquid assets required to fund buy-in/out transactions.

PPF+ advisory panel
In 2022, we were appointed to the newly formed PPF+ advisory panel, advising on buy-outs for schemes exiting PPF assessment.

Longevity analysis
We support schemes' longevity assessment working with LCP Health Analytics to provide bespoke, tailored advice on expected future improvements with insights from actuaries and health professionals. This helps negotiate optimised longevity pricing.

Alternative risk transfer
We advise on the full-range of alternative end-game solutions including capital-backed journey plans, superfunds and alternative use of surplus.

Insurer due diligence
We provide insurer due diligence in all areas: financial covenant, administration and ESG and climate risk.

Strategic journey planning
We help schemes design, implement and evolve their strategic journey plans using our GEARS framework and our LCP Assure service allows a streamlined approach, with fixed fees for smaller schemes.

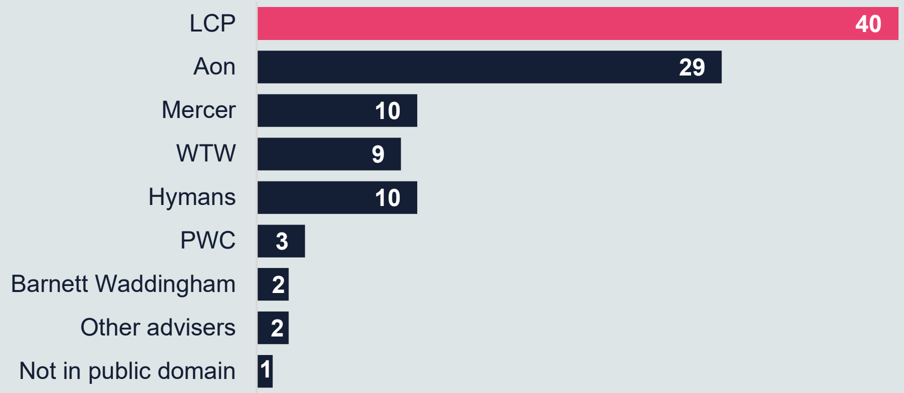
Data preparation strategy
We have a dedicated team to help schemes prepare their data well for market to maximise insurer engagement and optimise pricing.

Wind-up
We have a specialist post-transaction team, skilled at guiding trustees through the wind-up process.

Supplemented by experts across our wider de-risking team

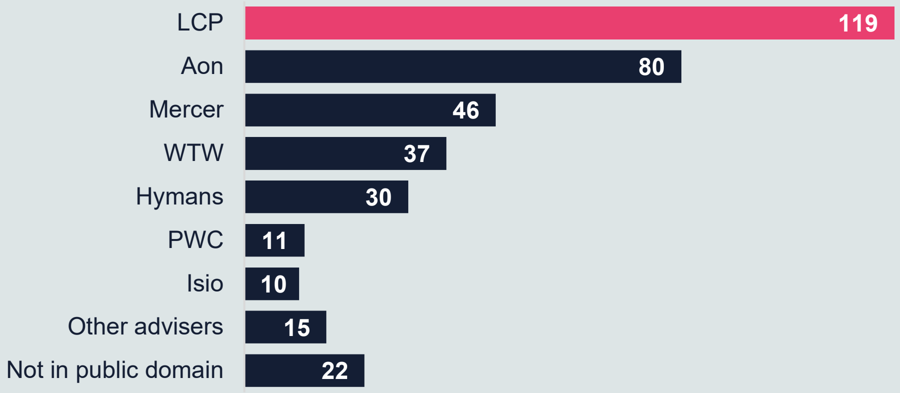
LCP is a market-leader in all segments of the buy-in and buy-out market

Over £500m: **Lead adviser on buy-ins/outs over £500m since 2014**



Source: Insurance company data to 31 December 2022.

Over £100m: **Lead adviser on buy-ins/outs over £100m since 2014**



Source: Insurance company data to 31 December 2022.

Under £100m: **Lead adviser on over 100 buy-ins/outs under £100m since 2014**

LCP has been the lead adviser on **over 100 buy-ins and buy-outs under £100m** between 2014 and 2022. It's not possible to produce adviser comparisons like the above for smaller transactions as insurers do not publish granular data on lead adviser for transactions under £100m.

LCP has now completed **69 transactions** through our **streamlined buy-in and buy-out service** for smaller schemes, bringing the total liabilities insured through this service to **over £2.9bn**.

LCP has been the lead adviser on

100+ **buy-ins and buy-outs under £100m since 2014**

Our latest de-risking thinking

Longevity report 2023: A new era for longevity

We analyse recent trends in mortality and their impact on pension schemes. We delve into the challenges and opportunities faced by trustees and sponsors, covering topics such as future drivers, insurer pricing and climate change.

+ Explore the report

Pensions de-risking report: Insurance enters a new phase – a skyrocketing market

For many schemes, the sheer rate of improvement to their buy-out funding level will be as unexpected as it is welcome. There are a range of new considerations to work through in this new phase for the buy-in and buy-out market.

+ Read the report

+ Overview of the insurers – 2022

+ Analysis of transaction data - 2022

Shifting GEARS: Key stages to success

Our new hub for strategic journey planning gathers all the resources you need to design, implement and evolve your plan using our GEARS framework.

+ Find out more

Some recent case studies

+ RSA – A record-breaking £6.5bn full buy-in with PIC, covering c40,000 members

+ British Steel Pension Scheme – A record-breaking £7.5bn full insurance as part of a strategic partnership with L&G

+ WH Smith – A £1bn buy-in with Standard Life covering c13,000 members

+ House of Fraser – A PPF+ buy-out insuring c£600m of liabilities with PIC, covering c9,000 members

+ Deutsche Bank – A £400m bulk annuity deal with Aviva

+ Yell – A full scheme buy-in of £370m, the second between PIC and the trustee, securing benefits for all plan members

+ British American Tobacco – A phased £4.1bn full scheme buy-in with PIC covering 10,000 members over three transactions

Resources for smaller schemes

With the surge in demand for bulk annuity insurance, some insurers are becoming more selective at the smaller end of the market. These resources will help those schemes understand their options to plan ahead.

+ Watch our latest webinar for smaller schemes

+ Read the guide to our streamlined buy-in service

+ LCP Assure – A streamlined and joined-up strategic journey all the way to wind-up, with fee certainty

Our investment thinking Vista Spring 2023

A new landscape
We help investors set their strategy and assess opportunities in a new landscape – we still expect a bumpy road ahead!

+ Read Vista

Investment Uncut podcast

Our weekly investment podcast goes beyond the jargon to try and bring sense to the world of investing and bring clarity to your investment decisions.

+ The DB pensions buy-out boom – Will 2023 see record volumes in the bulk annuity market?

+ Human rights and your portfolio – Are your investments exposed to modern slavery?

+ Re-imagining a fairer financial system – Can we change the inbuilt incentives in the financial system to work toward a more equitable society?

Getting buy-in ready: How to get your scheme prioritised in insurer triage processes

Find out what really matters to the insurers, the issues they are facing, and the key preparation steps to take when approaching the market.

+ Beat the triage report

+ Practical hints and tips

Contact us

If you would like more information please contact your usual LCP adviser or one of our specialists below.

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At LCP, our experts help to power possibility by navigating you through complexity to make decisions that matter to your business and to our wider society. We are powered by our desire to solve important problems to create a brighter future. We have market leading capabilities across pensions and financial services, energy, health and analytics.

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