Expanding horizons in pension risk transfer

LCP pension risk transfer update

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Expanding horizons in pension risk transfer

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The pension risk transfer market is experiencing rapid change

Following significant improvements in many schemes' funding levels in the last two years (see our October 2023 buy-in/out market report) and the DWP's recently concluded consultation on DB options, the short- and longer-term objectives of sponsors and trustees of UK DB pension schemes are taking centre stage.

Nearly 25% of respondents to our LCP 2024 annual DB pension scheme survey told us their top priority in the next year was a de-risking transaction (the top-ranked response), with journey planning not far behind (20% of respondents).

Against this backdrop, in our latest pension risk transfer update we share our views and analysis on:

- **An expanding buy-in/out market** – with record transaction volumes, numbers and individual deal sizes in 2023;
- **Increasing market capacity** – through both existing insurers and new entrants;
- **Developing solutions to current challenges** – experienced by both smaller schemes and those with illiquid asset holdings;
- **Expanding alternatives to buy-in/out** – including superfunds and new DB options being consulted on; and
- **Outlook for 2024** – the year has got off to a less frenetic start than in 2023, but insurers are reporting record pipelines, with 20 or more £1bn+ transactions in the market or expected to be shortly. Total activity will depend on how many of these proceed this year – particularly the larger £5bn+ transactions – in the light of an expanding range of endgame options, run-on strategies and greater emphasis on preparation.

We hope you enjoy reading our market analysis and we would be delighted to discuss implications for your scheme.

LCP's record-breaking 2023

- We led **33 transactions** in 2023, including **three over £1bn**, totalling a record **c£14bn**
- This included **17 transactions** through our streamlined buy-in and buy-out service for smaller schemes
- Lead transaction adviser to the **British Steel Pension Scheme** to complete **£7.5bn of buy-ins** through an innovative strategic partnership with Legal & General, the largest ever UK scheme to insure in full
- Lead transaction adviser to RSA Group and its parent, Intact, on a **£6.5bn buy-in**, the largest ever buy-in transaction in the UK

Over the past 18 months, the pension risk transfer space has seen rapid change with volume records broken at both market and transaction levels, new insurer entrants, and the first superfund transfers.

At LCP we've expanded our core pension risk transfer team, as well as our post-transaction and data services teams, allowing us to continue to provide specialist end-to-end support across a large variety of risk transfer projects.

Charlie Finch
Partner

Expansion across the market in 2023

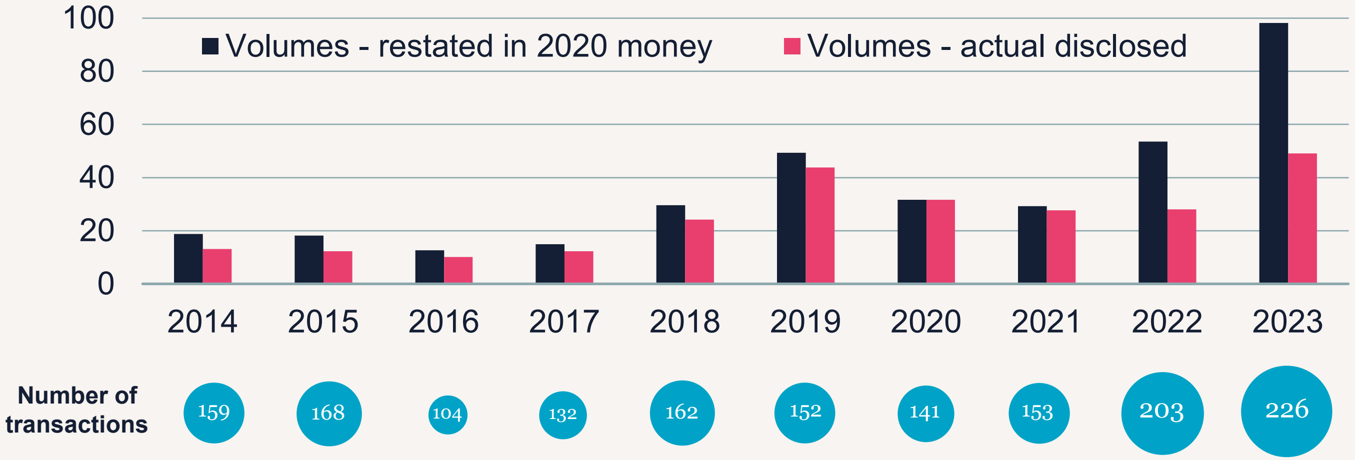
2023: A record-breaking year across all fronts

A number of pension risk transfer records were set in 2023:

- Record volumes of £49.1bn, exceeding the previous record of £43.8bn in 2019.
- Record 12 transactions over £1bn (surpassing 9 £1bn+ transactions in 2019).
- At £6.5bn RSA took the headlines for the largest single transaction to date; meanwhile at £7.5bn the British Steel Pension Scheme became the largest scheme to reach full insurance.
- The giant deals grabbed headlines but there was also unprecedented activity at the smaller end, with a record 226 transactions in total. This represented more than a 10% increase on 2022 and is roughly 50% higher than the average annual number completed prior to 2022 (c150 pa).

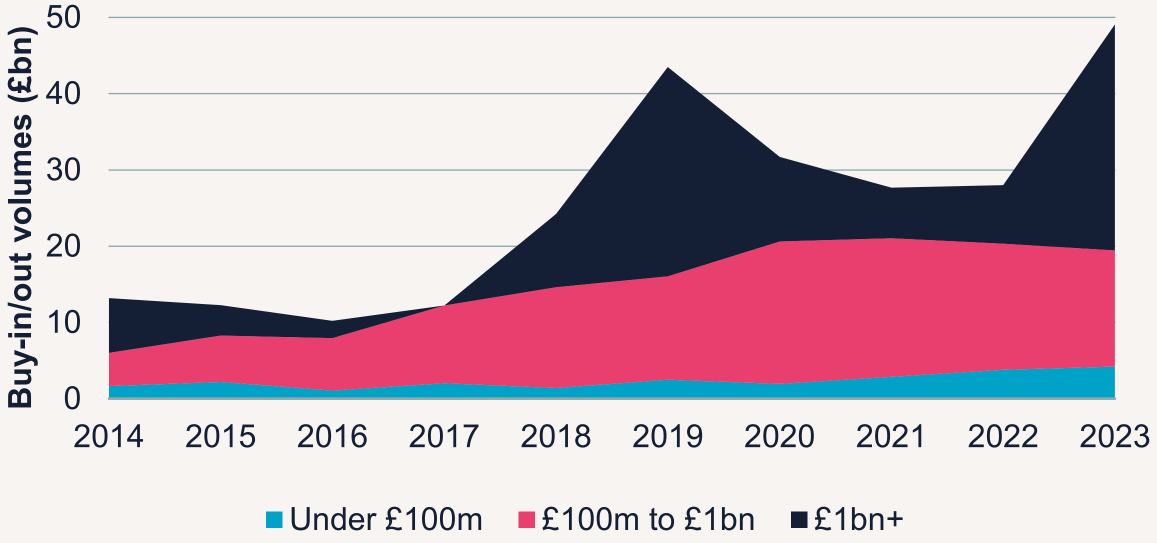
And yet, remarkably, these record statistics don't do full justice to 2023 activity. Higher gilt yields mean that 2023 volumes have been dampened relative to those in previous years (when average yields were higher). The chart below shows actual volumes (in **pink**) and restated volumes (in **navy**), putting them in '2020 money' (ie rebasing volumes to be calculated relative to yields in 2020). This shows that whilst actual volumes in 2023 were c10% higher than in 2019 (£49.1bn in 2023 vs £43.8bn in 2019) on rebased yields 2023 volumes were nearly £100bn - around double 2019 levels - pointing to the gear-shift we have seen in the market since the gilt crisis in 2022.

2023 saw record buy-in/out volumes, particularly when adjusted for changes in yields



Source: LCP analysis based on insurance company data to 31 December 2023

Total buy-in/out volumes have been driven by £1bn+ transactions



Source: LCP analysis based on insurance company data to 31 December 2023

As the chart above shows, much of the early growth in the market was fuelled by a steady expansion in mid-sized deals between £100m to £1bn, but volumes in this segment have plateaued since 2020. Instead, volume growth in recent years has been driven by £1bn+ deals, with the record 2023 volumes boosted by 12 transactions over £1bn, making up over 60% of total volumes in 2023.

For annual volumes of £50bn+ to become the new normal, the market will need a regular and steady stream of £1bn+ deals, as well as some larger £5bn+ deals. As 2019 and 2023 demonstrate, the market has the capacity to handle large numbers of giant deals and insurers have been growing their teams and expanding their implementation and administration capacity. Demand from large schemes also seems strong but inevitably £1bn+ transactions are lumpy and that is likely to mean continued volatility in volumes.

Expanding market capacity – from new entrants and existing insurers

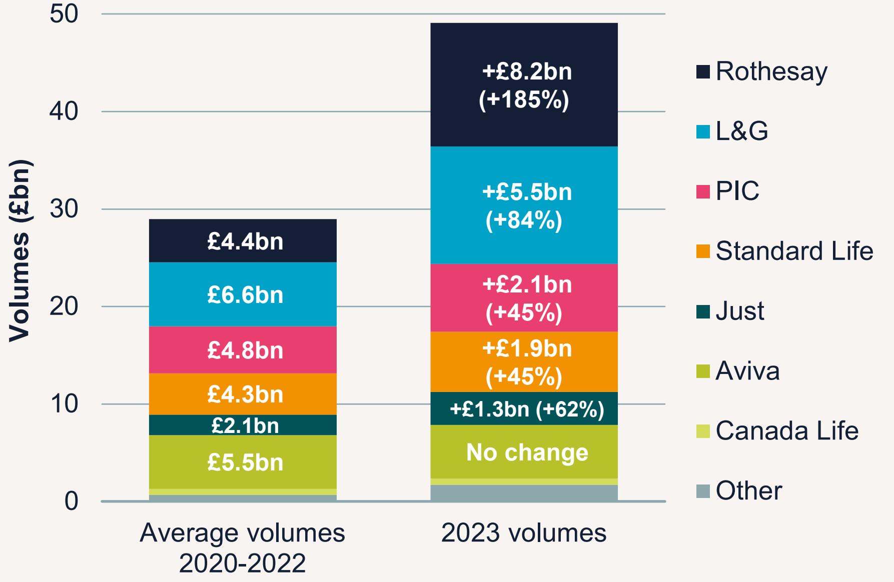
Capacity within the existing insurers

Much of the attention on market capacity has been focused around the new entrants to the market, but the vast majority of the increase in market volumes has in fact been catered for by the existing insurers scaling up their capacity.

The chart below shows the increase in volumes in 2023 for each insurer relative to their average over the prior three years.

Overall, the existing insurers scaled up to increase their volumes by over £19bn (67%) relative to the average over the preceding three years. Rothesay and Legal & General (L&G) were the two insurers topping the list, accounting for over half of the increase in volumes between them.

2023 insurer volumes vs previous 3-year average



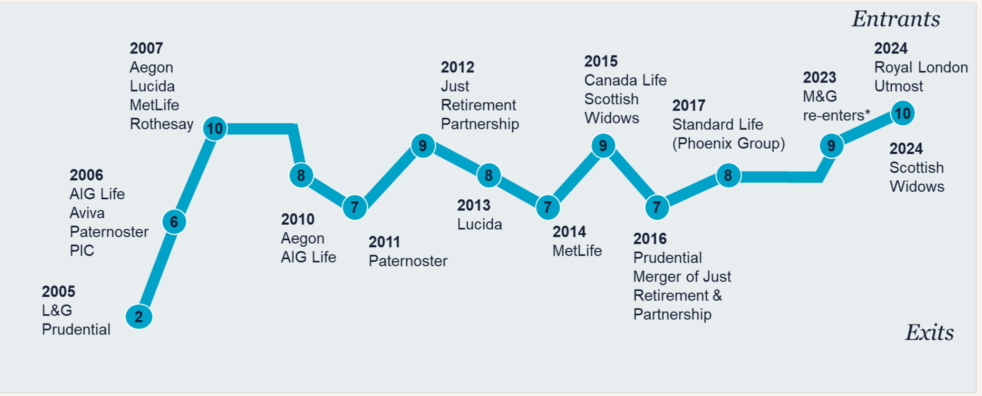
Source: LCP analysis based on insurance company data

New market participants

At the start of the year, we predicted two further new entrants to the market in 2024, following M&G's re-entry in the second half of 2023 (having previously been a part of Prudential plc who left in 2016). Already in 2024 this prediction has been met - Royal London formally entered the market in March (having already written two deals with their own schemes) and, in April, Utmost announced plans to formally enter the market later in 2024.

We are expecting one further new entrant to the market before the end of the year, leading to a record 11 active insurers in the market. This reflects regular conversations we have with a wide range of investors and institutions who are at varying stages of developing a proposition.

M&G and Royal London are both targeting mid-sized transactions which could help ease pressures on the so-called "squeezed middle". Meanwhile, Utmost are targeting smaller-sized schemes, which brings further competition to this end of the market.



Source: Insurer public announcements as at June 2024 *M&G was formed from the de-merger of Prudential plc in 2019 with the UK insurance business becoming part of M&G plc

Additional 2023 volumes

Existing insurers: £19.1bn

New entrants: £0.9bn

Looking forward: How much capacity will new insurers bring?

With the existing insurers having already scaled up significantly over 2023, the market may look to see how much capacity can be provided by the new entrants.

We expect this to be – at least initially – relatively modest as the new entrants will need time to scale up their operations. They are also subject to many of the same supply-side constraints the existing insurers have been navigating in recent years; all the insurers compete for the same pool of experienced personnel, reinsurance capacity and post-transaction resource plus there is considerable overlap with other insurers in the types of attractive assets they seek to back their pricing.

As demand continues to grow, market participants will need to continue to innovate to ensure capacity can be appropriately matched to demand.

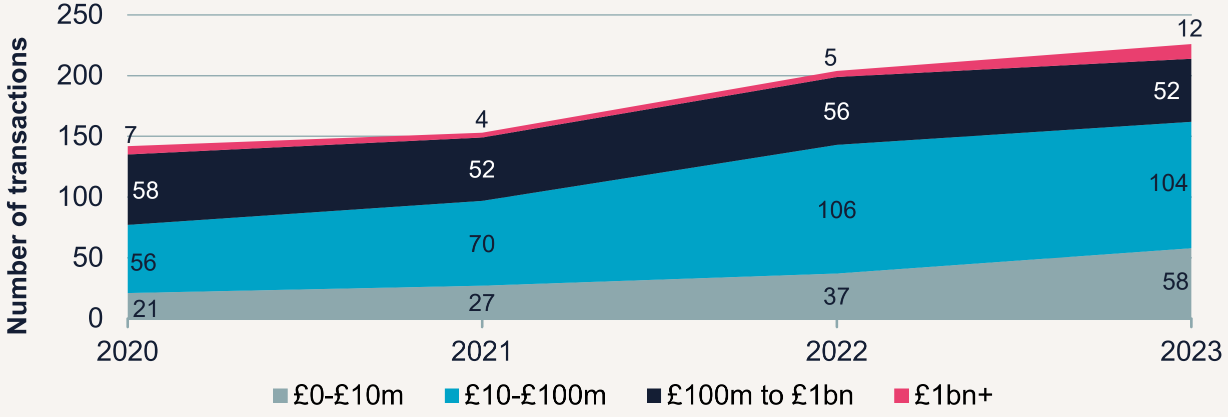
Expanding solutions to address current challenges – smaller transactions

Is the market competitive for smaller schemes under £100m?

The number of schemes under £100m seeking buy-in/out transactions doubled in 2023, and the top-end of the market has accelerated with insurers reporting 20 or more £1bn+ transactions currently in the market or expected to be shortly. So it's no surprise there has been intense focus on whether the smaller end of the market can keep pace.

The evidence to date is however reassuring. The record 2023 volumes were propelled by £1bn+ transactions (see page 3) but smaller schemes were the driving force behind the record number of transactions. The chart below shows the number of transactions under £100m more than doubled in the last three years, from 77 in 2020 to 162 in 2023. Most of this growth was driven by Just (making up c65% of the increase) and by Aviva (c20% of the increase). In contrast the number of mid-sized buy-ins between £100m-£1bn has remained static and the number over £1bn has grown but still makes up a small proportion of the overall number.

Growth in transaction numbers has been driven mainly by smaller schemes



Source: Insurance company data to 31 December 2023

What about micro transactions under £10m?

Counterintuitively it was transactions under £10m that drove most of the increase in activity seen in 2023. This surge in numbers of micro transactions was similarly driven by Just, who wrote 41 transactions under £10m in 2023; three times more than in 2022 (12) and six times more than in 2020 or 2021 (6). This was facilitated by a streamlined process they have been refining since 2018.

Smaller scheme market at a glance – 2023 saw:

162 transactions under £100m, of which **58** were under £10m

6 insurers wrote 5 or more deals under £100m

3 insurers wrote 5 or more deals under £10m

Double the number of schemes under £100m seeking pricing*

c25% sustained insurer participation rate* for transactions under £100m since 2021 (whilst insurer participation in medium and larger transactions has declined)

*For full analysis, see LCP's pension de-risking report – October 2023 (p10-11).

Which factors and solutions are needed for a continued buoyant smaller scheme market?

Insurer streamlined processes – four insurers (Aviva, Just, L&G and PIC) now have streamlined processes aimed at participating efficiently in smaller transactions. All have different transaction size preferences and criteria but all aim to support a healthy and competitive smaller scheme market.

Adviser streamlined processes – well established and clearly structured broking processes with pre-negotiated contracts (such as LCP's streamlined service which was first-to-market in 2011) give insurers confidence that transactions will go ahead efficiently and with minimal costs.

New entrants – two recent new entrants with core appetite for transactions under £100m, Utmost (under £100m) and Royal London (primarily above £50m), will add further capacity.

What challenges remain for smaller schemes seeking to buy-in/out?

Smaller schemes need to weigh up the costs and benefits of populating multiple streamlined formats for a multi-insurer broking process. The biggest challenge is for those with complex benefits that do not fit well in a streamlined format – these schemes may need to work exclusively with one insurer.

Insurers continue to have low tolerance for under-prepared schemes when triaging transaction opportunities – with a focus on avoiding post-transaction costs and log-jams. This is increasingly true for mid-sized and larger transactions too, with insurers often favouring well-prepared processes with specialist post-transaction support in place to ease the burden on implementation teams.

Expanding solutions to address current challenges – illiquid assets

The challenge

Funding levels have improved dramatically in recent years (see LCP estimates) so many schemes have reached full funding on a buy-in/out measure ahead of plan and whilst still holding illiquid assets. This has brought a need to accelerate exit strategies for illiquid assets in parallel with planning a buy-in transaction.

Expanding solutions

Insurers and the wider market have innovated to meet this challenge. LCP have been at the forefront of these innovations building bespoke solutions for our clients.

- **Deferred premiums** from the insurers are widespread with the offerings increasingly flexible, allowing illiquid assets to run off over time post-transaction. In the current high interest rate environment, the interest charged is typically 5-8% pa. These costs, and the risk the scheme maintains over this period, have generally increased the attractiveness of other solutions.
- Insurers are willing to accept certain **illiquid assets to pay part of the premium** (with a haircut), even for mid-sized schemes. Insurers are being flexible to help win such transactions but appetite and capacity is limited and the haircuts may not be better than a secondary market process.
- The **secondary market for illiquid assets** is also functioning well and almost all illiquid assets have a market through a broker-led process. The valuation haircuts that apply on such a sale can vary widely, and so the broker selection is key to finding the right buyers. The key advantage of a secondary market process is it gives certainty on cost which is valuable to many schemes.

Asset exit strategies

- Transfer to sponsor / sister scheme
- Secondary market sale
- Pass to insurer

Liquidity options

- Deferred premium
- Company liquidity / loan facility
- Third-party financing (eg bank loan)

Case study – Project Resolve

Background

£260m scheme looking to reach full insurance but with a £30m illiquid private credit holding due to run until 2028 and a £35m buy-in funding shortfall.

LCP helped the Trustee and Company consider their objectives, balancing overall costs and risks.

This brought clarity that the Company was unwilling to take the risk of running off the asset, also recognising a c25% deferred premium might be unattractive to some insurers.

Approach

We developed a strategy to approach the full buy-in market for proposals to defer some premium and to transfer the illiquid asset to insurers. Two insurers met this brief and indicated they were willing to take the illiquid asset (with a haircut) and could also accommodate a deferred premium structure for contributions.

In parallel, the Trustee appointed a broker, leveraging LCP's relationship to get attractive fee terms, and then sought bids for the asset from the secondary market, obtaining strong interest.

The Trustee and Company decided the secondary market sale was the optimal route for the illiquid asset, giving the best economic outcome.

Outcome

The illiquid asset was sold at the point the final insurer was selected, freeing up liquidity to enter into the insurer's price-lock, and at a value better than budgeted for and ahead of the insurer's offer. A modest deferred premium structure enabled Company contributions to be spread over three years.

Top tips

- **Careful strategic planning** – consider early the options for any illiquid assets and agree a strategy that dovetails with your wider market approach. Everyone knows you need good data and a clear benefit specification before approaching the market – a clear exit strategy for your illiquid assets is just as important!
- **Be clear on your key objectives** – this can help determine the right options to pursue. For instance, for schemes with a weak sponsor reaching insurance as soon as possible and ensuring illiquid assets are exited early may be preferable to the sponsor underwriting the illiquid asset run-off risks through a deferred premium. For some, pausing an approach to market to enable illiquid assets to run off to maximise value may be preferable, providing the risk of an opportunity being lost is understood.
- **Integrate illiquid asset solutions with the wider process –** an experienced adviser can design a strategy to dovetail timings so that the right illiquid asset information is obtained to both make robust decisions with full visibility of the impact, and to maximise engagement from insurers (see case study).

LCP's experience

- **c£2.5bn of illiquid assets transferred to insurers**
- **Over 12 transactions involving an illiquid asset transfer in the last two years**
- **Over £1bn of deferred premium agreed**

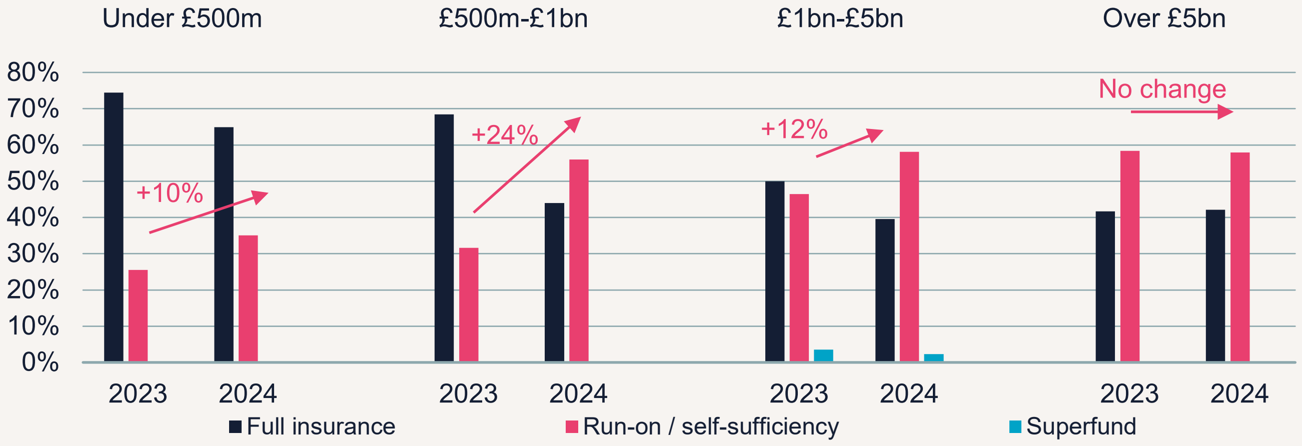
Expanding alternatives to buy-in/out

A changed landscape for DB schemes

In January 2024 LCP predicted a greater focus this year on run-on, superfunds and alternatives to buy-out on the back of regulatory, market and industry developments. There is evidence of this trend in LCP's 2024 annual DB pension scheme survey, which shows that close to 10% of respondents had revisited their journey plan in the last 1-2 years as a result of the Mansion House proposals and/or new solutions available in the market.

There's also emerging evidence that new options are changing schemes' longer-term intentions. Our survey revealed significant increases in the proportion of schemes targeting a run-on or self-sufficiency endgame (rather than full insurance at an earlier stage), with the biggest change of +24% for schemes of size £500m - £1bn. Very few schemes are actively targeting superfund transfers but that may change following early superfund activity (see box opposite).

Proportion of schemes of different sizes targeting alternative endgames



Source: LCP 2023 and 2024 annual DB pension scheme survey

Buy-ins as part of a run-on strategy

Run-on and buy-in strategies do not have to be mutually exclusive. There are large schemes that use buy-ins as part of a run-on strategy. We are working with schemes with DB surpluses who are seeking to buy-in their DB benefits in the short-term, with an intention to then run-on using the DB surplus to fund DC contributions and augment DB benefits. Others, typically those with stronger covenants, are adopting a run-on strategy over the short/medium-term to grow DB surplus ahead of future insurance.

The UK's first DB superfund transfers:

£590m Sears Retail Pension Scheme transferred to Clara-Pensions in November 2023

£600m Debenhams Retirement Scheme transferred to Clara-Pensions in March 2024

Both the above schemes had nil or limited employer covenant. The Debenhams scheme had been in PPF assessment following its sponsor's insolvency and the capital injection by Clara allowed members' benefits to be restored to full levels.

A superfund transfer can be suitable for schemes not in PPF assessment provided the transfer satisfies TPR's gateway principles - in particular there is "no realistic prospect of [full] buy-out in the foreseeable future". This could be the case, for example, where an overseas parent company is offering to facilitate the transfer through a cash injection to the scheme.

LCP act as investment consultant to Clara Pension Trust and helped to support with the investment aspects of the transactions including the transitions to Clara.

Government consultation on new options for DB schemes

As promised in the Chancellor's Autumn Statement, the DWP has recently conducted a consultation on "Options for DB schemes". The aims are:

- Firstly, as per **LCP's powering possibility in pensions** proposal, the Government plans to make it easier to invest for and release surpluses in DB schemes – to support investment in productive assets for the benefit of both members and sponsoring employers; and
- Secondly, the Government intends to establish a **public sector consolidator** administered by the PPF by 2026. This will be available to DB schemes who are unattractive to insurers or commercial superfunds.

The outcome of the consultation has been delayed by the general election but the proposals have wide cross-party support so we expect them to move forward in a similar form under any incoming new government.

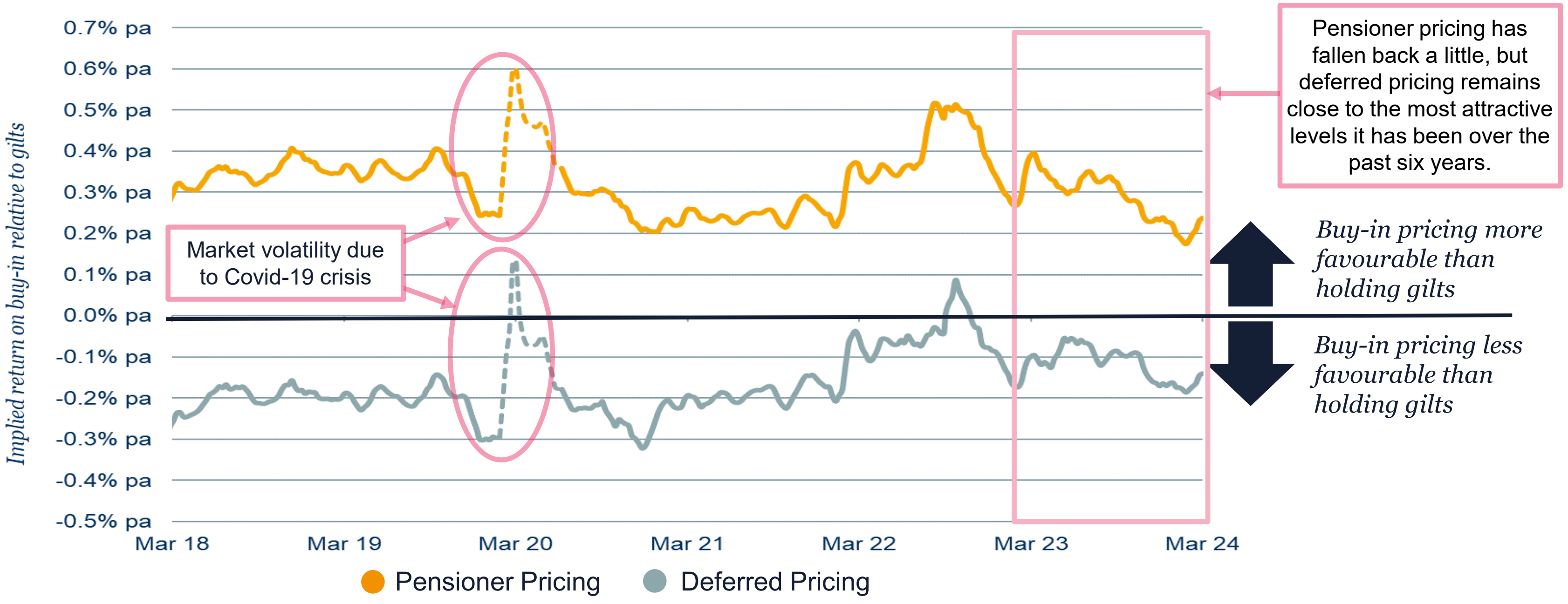
Outlook for 2024

Key drivers of insurer buy-in/out pricing

As the chart below shows, pensioner pricing has fallen back a little since the highs in late 2022, but deferred pricing remains close to the most attractive levels it has been over the past six years. The key factors driving pricing – relative to a gilts valuation – have been:

1. Upward pricing pressure due to a reduction in the risk-adjusted yields on the assets insurers can source, partially mitigated by greater use of 'funded reinsurance' as an asset class.
2. Improved pricing due to the introduction of Solvency UK and a reduction in 'risk margin' – see LCP's analysis on regulatory developments.
3. Improved pricing due to good longevity reinsurance pricing and mortality data continuing to indicate a slowdown in improvements in longevity.

Insurer pricing continues to be at attractive levels compared to holding gilts



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.

How will pricing pressures play out?

We currently do not see any strong reasons to expect pricing to improve or deteriorate over the medium term. New insurers are bringing welcome additional competition but there is likely to continue to be pressure on insurer asset pipelines.

Our advice to schemes is to consider their endgame options carefully, do detailed preparation and agree a clear strategy with key stakeholders that they can articulate effectively to insurers before approaching the market for pricing. An effective strategy to market is the best way of achieving favourable insurer pricing.

2024: will further records be broken? The jury remains out…

2023 finished with a flurry of risk transfer activity pushing it to record breaking levels. In contrast, it's been a less frenetic start to 2024. Insurers are, however, reporting record pipelines, with 20 or more £1bn+ transactions currently in the market or expected to be shortly – compared to the 12 such deals that completed last year.

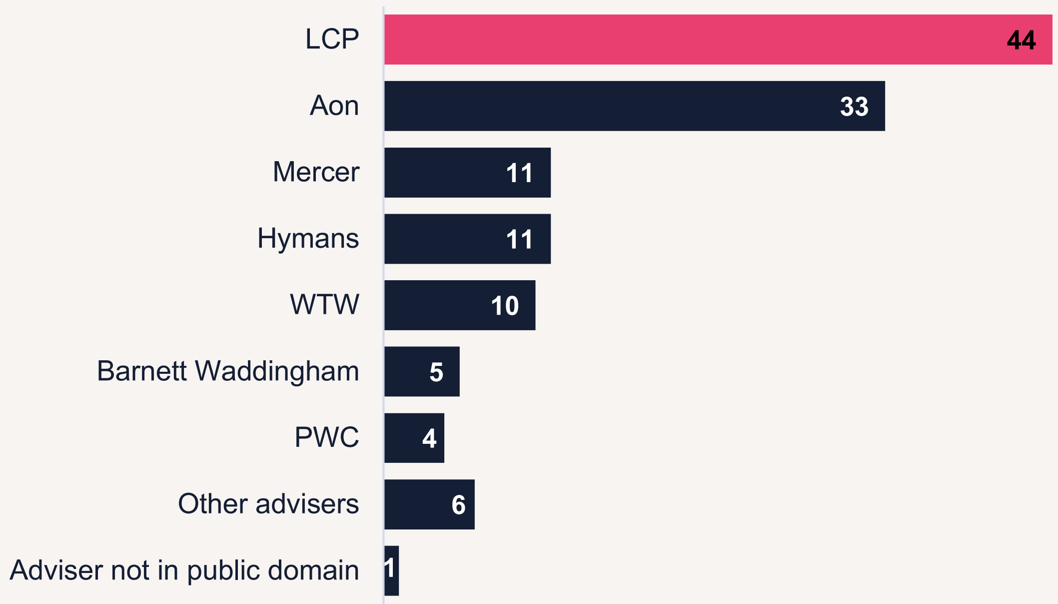
As the analysis on page 3 shows, whether 2024 sets new records for buy-in/out volumes will depend crucially on how many of the £1bn+ deals, and in particular the larger £5bn+ deals, do come successfully to market and whether they complete this year.

As the market has expanded, at LCP, we have also significantly expanded our core pension risk transfer team (now numbering over 60 experienced consultants plus wider supporting teams) which gives us capacity to resource a large variety of risk transfer projects – across all market sizes – without any drop in our high service standards.

The pension risk transfer market is expanding – the expertise and insurer perspective of an experienced adviser is more valuable than ever in weighing up your options and designing an effective approach to market.

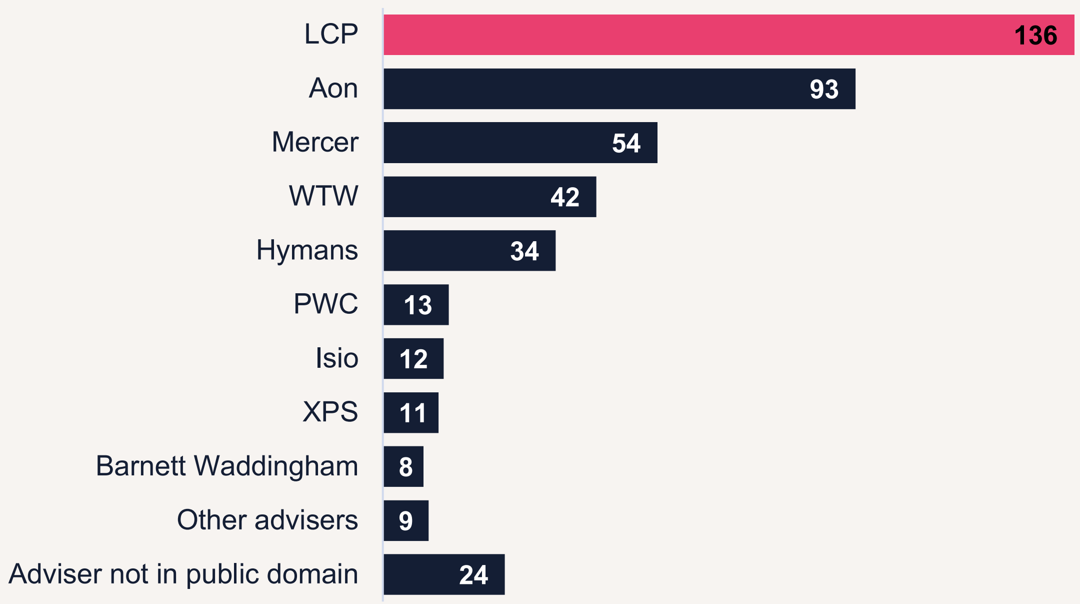
LCP is a market-leader in all segments of the buy-in and buy-out market

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



Source: Insurance company data up to 31 December 2023.

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



Source: Insurance company data up to 31 December 2023.

Under £100m: Lead adviser on over 120 buy-ins/outs under £100m since 2014

LCP has been the lead adviser on **over 120 buy-ins and buy-outs under £100m** since 2014. 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 **90 transactions** through our **streamlined buy-in and buy-out service** for smaller schemes, bringing the total liabilities insured through this service to **over £3.7bn.**

LCP has been the lead adviser on

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

Our latest pensions risk transfer thinking

Longevity report 2024: Unlocking mortality trends

We analyse recent trends in mortality and their impact on pension schemes. We delve into how a rigorous assessment of future mortality can help ensure better outcomes for members, trustees and sponsors of DB pension schemes.

+ Explore the report

2023 report: Future demand and supply in the buy-in and buy-out market

Our 2023 report analyses the seismic shift in the buy-in/out market and how the market has adapted to this. There has been a dramatic acceleration in demand for buy-ins and buy-outs. We address the questions schemes and sponsors should consider in a changing market.

+ Read the report

Accounting for Pensions 2024

LCP's latest annual Accounting for Pensions report analyses the 2023 disclosures of FTSE100 companies, highlighting how pension surpluses appear to be embedded, and discusses accounting for full scheme buy-ins.

+ Explore the report

Some recent case studies

+ ICI A £900m pensioner buy-in with Legal & General, securing the benefits for over 7,000 members.

+ St Paul's Cathedral An £18m full buy-in with Aviva, securing the benefits for all members of the scheme.

+ Hyde Housing A £60m full scheme buy-in with Just of all remaining uninsured members.

+ Deutsche Bank A £500m buy-in with Legal & General covering 2,000 retirees and deferred members.

+ Bayer A c£280m pensioner buy-in with Canada Life, insuring the benefits of 1,300 retirees.

+ Cable and Wireless A £340m full scheme buy-in with Legal & General, insuring the benefits of 1,800 members.

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 such schemes understand their options to plan ahead.

+ Watch our latest webinar

+ Read the guide to our streamlined buy-in/out service

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

Our investment thinking Vista Spring 2024

A World in Flux: Shaping a More Positive Future

We help investors set their strategy and assess opportunities in a new landscape. Discover how to shape the future and navigate market volatility, demographic shifts and environmental challenges and invest for a shared surplus.

+ Read Vista

Investment Uncut podcast

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

+ Washington update: Politics, policy & geopolitics with Andy Blocker – What are the key political and policy issues ahead of the US elections in November 2024?

+ Using ethnographic research to capture growth opportunities in emerging markets – What are the growth opportunities in emerging markets?

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

LCP Elevate

A flexible active run-on strategy for the endgame helping turn DB pension schemes into real assets. It challenges what is possible in the new world of better funded pension schemes and enables schemes to run on securely.

+ Find out more

Seize the moment: A pivotal opportunity for corporate sponsors

We explore the variety of options now open to mature DB schemes approaching the end of their journey and urge schemes to get their strategy right before making their plan of action.

+ Find out more

Shifting GEARS: Key stages to success

Our 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

Contact us

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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 shape a more positive future. We have market leading capabilities across pensions and financial services, insurance, energy, health and analytics.

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