Is the bulk annuity pricing boon here to stay?

Buy-in and buyout pricing was widely reported to have improved significantly over 2017 with the most attractive pricing seen in the market for a number of years. In this article Gavin Smith from Legal & General provides an insurer's insight as he considers if these pricing levels can be maintained in 2018

2017 proved to be a good year to purchase a bulk annuity for many schemes. A number of factors came together that led to outstanding pricing in the market despite a backdrop of continued historically low yields across the gilt and bond markets that, all else being equal, one would expect to lead to more expensive pricing.

One of the factors widely cited for the attractive pricing seen in 2017 was the level of competition, with as many as eight insurers actively quoting on transactions.

How much can competition drive down pricing?

To answer that question we need to understand the factors that drive insurer pricing.

Pricing a buy-in or buyout is a complicated affair. Each time we provide a scheme with a quote we are making assumptions about cashflows and investment returns long into the future, in some cases potentially for the next 60 years and beyond. Relatively small changes in those assumptions can have a material impact on the price we are able to offer. As markets become increasingly competitive, insurers need to remain on their toes to ensure that their pricing assumptions remain up to date and that any opportunities to improve pricing are taken into account where appropriate. Examples of this might be changes in mortality trends or investment opportunities.

Insurers investing directly in the UK economy

One of the biggest factors affecting pricing in recent years has been insurers' willingness and ability to invest in new ways. At Legal & General we are particularly passionate about investing in UK infrastructure and urban regeneration projects. These investments not only benefit our wider society by creating jobs and supporting the UK's economic growth, but they are also an excellent match to pension liabilities in that they generate long-term, stable and often inflation-linked cashflows. It is these kinds of investments that have played a key role in allowing us to offer pension schemes the attractive pricing seen over 2017.

However these direct investments are not a free lunch. Insurers must ensure that their investments continue to offer the security that is required. The Solvency II framework and PRA oversight help to ensure that insurers hold enough capital to maintain security over the investments that we make and the risks that we take on in buy-ins and buyouts.

So whilst competition will continue to play a part, it is the availability of suitable investments and how insurers decide to allocate them to transactions that will be the biggest factor driving pricing over 2018.

What does this mean for pension schemes looking to de-risk in 2018?

It is still relatively early in 2018 but initial signs suggest that pricing remains attractive. Those schemes that have approached the market early would seem well placed to benefit from pricing levels comparable to those seen in 2017 as insurers look to secure early transactions.

Insurers will want to ensure that they have a sufficient pipeline of investments to support the volume of bulk annuity business that they wish to target this year. These early signs would seem to suggest insurers are happy that they can continue to do that at 2017 pricing levels but only time will tell what size of market can be supported at those levels.

Buy-ins and buyouts are ultimately about certainty. For trustees, the prize is certainty over your liabilities and the security of your members' benefits. This means not only ensuring that your long-term objectives are aligned with your sponsoring company but having a clear idea about what you are looking for in an insurance partner.

Insurers also value certainty. If insurers have a degree of certainty that a transaction will take place, there are often levers we can pull, such as the allocation of resources, assets and capital that can help to make it a reality. In a year where demand in the market is high, engaging us early and showing commitment to your objectives will go a long way to helping you deliver the outcome you want for your scheme and members.

Written by Gavin Smith, director, core transactions, Legal & General

In association with Legal & General