A surfeit of opportunity

Last year's chaotic mini-Budget may have pushed UK pension schemes into surplus, but will it prompt them to seek buyouts with insurers? And if they do, what should they be considering?

Summary

- DB schemes in the UK are running at a marked surplus for the first time in years.
- Evidence suggests that this is leading to increased buy-in and buyout activity with insurers.
- However, a buyer's market means schemes will have to be extra prepared in order to be attractive.

There have been few bigger and more immediate impacts on the UK pensions sector than in September last year when the mini-Budget of then-Prime Minister Liz Truss seemingly tanked the economy overnight.

The impacts from Truss's and then-Chancellor Kwasi Kwarteng's tinkering with the economy were felt immediately as the pound plummeted in value, while the Bank of England – at odds with the then-administration – had to step in in order to right the ship. Once again in recent years, the UK was placed into a great crisis. Ultimately, Truss and Kwarteng were hoisted out of office by their actions.

Long term, the impacts of that mini-Budget are yet to be ascribed, but one thing that has become noticeable in that time is the improved funding positions of many of the country's defined benefit (DB) schemes. According to data from XPS Pensions Group, UK DB schemes had been running deficits between £200 billion and £486 billion since at least the middle of June 2019. However, since March last year, funding levels improved overall to reach a surplus of £85 billion by mid-May. There seems little sign that these levels will fall away again.

This begs the question as to whether we will see more pension schemes, on running such surpluses, turn to insurers for partial buy-ins or even, potentially, full buyouts.

The prediction for some time has been that there will be a surge over the coming years. Back in October, LCP released a report, *Insurance enters a new phase: A skyrocketing market,* which said the surge in funding positions could

lead to "significantly larger volumes over the next three years" in comparison to previous predictions.

LCP wrote that its projections in 2021 hastened a surge in the latter part of this decade, but current market conditions may have brought that forwards to occur in the next few years.

The authors wrote: "The total projected volumes over the next decade are broadly similar to last year at a little over £600 billion. This should be seen in the context of a much smaller DB pensions universe of £1,400 billion in September 2022 compared to £2,300 billion a year ago, indicating a huge increase in the proportion of schemes using insurance over the next decade."

The surge towards buyouts

There is some anecdotal evidence to suggest that larger deals are coming down the road.

In mid-May, it was announced that Legal & General had agreed a fourth and final buy-in policy with the British Steel Pension Scheme worth £2.7 billion that meant the firm had insured the entire £7.5 billion of the scheme's liabilities covering 67,000 pension holders. Earlier in the month, the Thomas Cook Pension Plan completed a £900 million buy-in with Aviva in a deal that came three days after Repsol Sinopec arranged a £160 million buy-in with Rothesay. April, meanwhile, saw the Ibstock Pension Scheme fully insured after a £190 million buy-in with Just Group.

Hymans Robertson were kind enough to crunch some numbers for *Pensions Age*. It says it expects between £20 billion and £25 billion of transactions to complete in the first half of the year, depending on how many finish signing before the end of June.

It adds: "It will also be worth noting that over half of this volume is from around four large transactions (RSA £6.5 billion, British Steel £2.7 billion, Safeway £1.4 billion, Thomas Cook £900 million)."

All of these seem to represent an ongoing trend.

"That's what the pipeline suggests to us," says Legal & General new business origination lead for buy-in and buyout business, Aysha Patel. "We've definitely seen an increase in the number of quotations in the market for schemes of all sizes. It's certainly an acceleration towards the buy-in and buyout market."

Patel says that it is no surprise that the increase can be seen across schemes of all sizes. "The improvements in funding levels," she says, "are not specific to fund sizes. They're very much across the board, but dependent on what might be described as their previous hedging positions. But we are seeing funds of all sizes, and particularly at the larger end – the £1 billion-plus funds."

A push towards risk transfer sounds good, but it may lead to a buyer's market. As LCP wrote last October in its report: "Based on insurer business plans and other information, we estimate that there is capacity of up to £45 billion across the eight insurers. In contrast, we estimate that there could be up to £60 billion of transaction opportunities next year."

That may lead to a situation in which insurers are able to pick and choose which schemes they complete with due to a surfeit of opportunity.

"From the insurer's perspective," says Russell Investment head of EMEA strategy and advice, David Rae, "they can be a bit pickier than they might have been in terms of the schemes they want to transact with and the type of liabilities that they want to take on. They're more inclined to begin discussions and negotiations with schemes that are well positioned for a buy-in or buyout. It also means that schemes that have done the work to get prepared are better candidates. And the overarching dynamic within the transfer market persists where the insurers need to insure some of the longevity risk and source some of the attractive assets to invest the proceeds of the buy-in premium. That puts constraints on the capacity and the timing to do more of these transactions."

There are, says Legal & General head of insurance solutions and strategy, Mathew Webb, challenges for insurers around the types of assets, particularly illiquid ones, that a pension scheme may hold.

"Those assets," he says, "may not be suitable for an insurer. We've taken illiquid assets as part payment for transactions, but many of them will not be suitable for an insurance balance sheet and will have to be sold. But they're illiquid by definition! That's a pressing issue in the market."

Webb says there are three ways to tackle this. One, the insurer takes the asset. Two, the insurer loans money, essentially as a deferral of premium while the fund sells the asset. Three, the fund waits and sells the asset, then comes to the insurance market."

He adds: "There are three economic drivers in getting ready for a transaction: Can I transact today? How much risk do I have? Are my assets ready? You have these three things going on at the same time and they impact each other. That's why having a plan to execute, in thinking of all three at the same time, is so important. Because if any one of them goes wrong, the market is against you, and you lose the opportunity."

Other things to consider

There are other considerations a scheme must undertake when angling for risk transfer, says Secor Asset Management head of UK distributions, Jason Allan.

"It's essential to have the data in order," he says, "and that it is clean and looks good in terms of all the details. It sounds like minutiae but it's vital for individual members. And that takes time, at least 12 months, depending on the complexity of the scheme."

Rae makes a similar point. "Historically, it's been a combination of looking at the integrity of liability data and making sure that it's clean. That whole process makes it easier for the insurer to understand the liability, and then to accordingly price the transaction."

In terms of what schemes can do to make themselves more attractive for buyout, Rae returns to the idea of looking at what assets a scheme holds, pertinent if many are looking to transfer risk at an earlier point than previously expected.

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"The objective was, for many schemes, over a longer time horizon," he says. "With things like illiquid assets, even a 12-month period of trying to raise liquidity can present considerations for trustees."

Patel outlines the steps that Legal & General take when going through the process – affordability, benefits, data, governance, and engagement.

That last step – engagement – may be the most important.

Patel says: "It's the communication between all the stakeholders that are involved in the transaction. So that could be the insurance market, particularly if there are complexities around assets. But there also needs to be clear lines of communication between the various stakeholders on the client side, particularly between the sponsor and the trustees."