Summary
- It has been predicted that 2022 will be a record-breaking year for pension risk settlement deals.
- Improved funding levels and competitive insurer pricing are potential catalysts for increased activity.
- Deals of all shapes and sizes are expected as schemes increasingly target full buyout.
- Insurers appear to be confident in meeting demand, although some deals may be prioritised over others.

Record breakers

This year is predicted to be the biggest ever for the pension risk settlement market. Jack Gray investigates the factors that could drive the forecast increased activity and whether insurers have the capacity to meet scheme demand

Following the sharp downturn in funding levels at the outset of the Covid-19 pandemic in March 2020, defined benefit (DB) pension scheme funding levels have been steadily improving. The Pension Protection Fund (PPF) 7800 Index shows that the aggregate DB pension surplus stood at £146.4 billion at the end of January 2022, while the funding ratio was 109.1 per cent.

These conditions have led to companies predicting that 2022 will be a record year for pension de-risking activity. Mercer has forecast the year to have £60 billion worth of deals, beating the previous record of around £54 billion seen in 2020, while WTW estimates transactions to total £65 billion. Meanwhile, LCP predicts the market to see volumes of between £30 billion and £50 billion for each of the next five years.

Catalysts

As funding levels have improved more than expected, many pension schemes find themselves in the position of being further along in their journey plan than anticipated. This has led to an increased demand for pension de-risking deals, especially buyouts. According to LCP partner, Imogen Cothay, the improving funding levels relative to the cost of buyout is being driven by several factors: Higher interest rates, competitive insurer pricing, and longevity and Covid-19.

"Many schemes are now looking at seizing the opportunities this presents," Cothay continues. "This includes increasing hedging levels to bank gains and de-risking asset portfolios. Many schemes are also looking at buy-ins and buyouts. The buy-in/out transactions are likely to come through primarily in H2 2022 as it takes time to progress such transactions. We also seeing a change in mindset as even the sponsors of very large schemes are considering activity in this space."

Standard Life business development manager, Kieran Mistry, concurs, stating: "The market expectation for 2022 is based on the continuation of what we've experienced over the past few years; schemes with ever-improving funding levels looking to remove risk. Bulk annuities are now the widely accepted gold standard for removing risk and increasing member certainty."

Aon senior partner and head of risk settlement, Martin Bird, notes that while

schemes may have been hesitant during the pandemic, as we emerge from it many are seeking to progress projects at pace as they move towards endgame.

"This is also evident from the results of Aon's latest *Global Pension Risk Survey*, which suggested that buyout has for the first time overtaken self-sufficiency as the most common long-term objective, with 65 per cent of respondents expecting to reach their long-term target within 10 years," Bird adds. "We are most definitely experiencing this in practice and are readying ourselves for a very busy year."

WTW senior director, Shelly Beard, notes that schemes are "perhaps three to five years ahead of where they planned".

"This is amazing for those trustees and for the members who can get the additional security earlier than expected," she says. "It does bring some practical challenges; schemes might not be investing in particularly liquid assets, for example, if they thought that they had another five years."

All shapes and sizes

Although the number of buyouts in particular are anticipated to rise, some industry experts predict that 2022 will see a mix of buy-ins, buyouts and longevity swaps. "On the bulk annuity front, we are seeing an increasing trend towards schemes targeting full-scheme buyout as opposed to a phased buy-in approach, particularly at the smaller end of the market," explains Bird.

"Schemes with liabilities below £100 million are able to achieve settlement more efficiently than ever before through streamlined processes. With more insurers entering the deferred market, we also expect to see more attractive and competitive pricing for full scheme transactions. For larger schemes, full scheme buyout transactions are also increasingly common, particularly reflecting improved funding positions and as schemes accelerate towards their endgame."

This is corroborated by Cothay, who states that LCP's current pipeline of bulk annuity deals consists of around 75 per cent full scheme transactions, with the rest being partial buy-ins. "Our pipeline includes the full range of sizes from multi-billion transactions down to plenty of sub-£100 million transactions," she says.

Beard expects that the longevity swap market is going to be busier this year and will make up around £25 billion of WTW's predicted £65 billion of de-risking deals. She continues: "I think we will see all types of deals. On buy-ins and buyouts, I think it is going to be pretty equal. Five years ago, pretty much all the activity was dominated by pensioner buy-ins, but because of those funding level improvements we are seeing more and more buyouts.

"As I speak to insurers at the moment, they and the reinsurers are pretty hungry for vanilla pensioner buy-ins because they see so many buyouts coming down the track and they always like to get a nice balance of business between buy-ins and buyouts."

Meanwhile, Mistry expects that the mixture of deals in 2022 will depend on a small number of "very large" transactions. "If we were to make an educated guess, by value we'd expect bulk annuities to outpace longevity swaps, and for buyouts (or full buy-ins) to outpace partial pensioner buy-ins," he adds.

"In the wake of the pandemic, we're seeing more schemes with insolvent employers looking to secure their members' benefits above PPF levels through bulk annuities, an unfortunate trend we expect to continue for some time."

Meeting demand

The increased demand for de-risking deals will not translate to a record-breaking year if insurers do not have the capacity to meet it. However, industry experts appear to agree that insurers' capacity for de-risking will likely be sufficient, with Beard stating: "There certainly seems to be enough capacity in the market at the moment. As well as the increase in systems, a lot of the insurers have built up their teams over the past 12 months."

"We believe there is capacity within the insurers for the volumes we are projecting until around 2025," comments Cothay. "This reflects the increased appetite and competition within the insurers. The insurers have raised significant capital over the 12 months and are targeting increasingly larger transactions."

However, Cothay warns that it is less clear whether the capacity will continue to be there for the volumes it is projecting beyond around 2025.

"There is the possibility that medium-sized transactions get squeezed and that the higher volumes put upward pressure on pricing," she continues. "We do, however, take some comfort from the planned Solvency II reforms."

Mistry notes that there are a few areas that "could pinch" as volumes increase, including availability of suitably high-yielding long-dated assets, longevity reinsurance capacity, capital availability and people resource to get deals done.

"Aside from resourcing, some insurers indicated that asset sourcing may impact their ability to deliver over the coming years," explains Bird.

"With an increased focus on ESG across the pensions sector, insurer asset holdings are coming under more scrutiny with schemes now asking ESG-related questions as part of their request for quotations.

"While some insurers are further along the track than others towards a goal of investing in environmentally friendly assets, there is no doubt this will continue to be a growing area of consideration for schemes and, in turn, increased insurer demand for these asset classes."