Getting to the front of the queue

Record bulk annuity volumes are expected this year – what can schemes do to stand out from the crowd in the eyes of insurers?

Summary
- Fears of an insurer 'capacity crunch' over the number of DB schemes attempting a buyout have increased.
- A lack of human resources, rather than financial matters, would more likely be the cause of any hold-ups.
- The insurer market is increasing manpower to meet the boom in demand.
- In this environment, scheme preparation before entering the buyout market is more important than ever.

Talk of a pension risk transfer capacity crunch is not new. Defined benefit schemes have been creeping towards better funding levels and end-game scenarios in recent years, fostering doubts about whether the UK's eight bulk annuity providers could absorb and manage great swathes of member benefits.

In the past year or so, however, with the macroeconomic environment catapulting many funds into surplus, fears of insurer volume overload has become all too real.

Analysis conducted by LCP in the summer found that at least £20.2 billion of buy-ins and buyouts were executed over the first half of this year. As transaction volumes in the second half of any given year are usually larger than those registered in the first six months, the consultancy has predicted that 2019's £43.8 billion record of risk transfer deals will be broken in 2023.

Proprietary research from K3 Advisory backs up this forecast. The firm estimates that over 1,000 DB sponsors are now in a position to offload their pension liabilities. K3 Advisory managing director, Adam Davis, says that there are also a substantial number of other schemes who are probably only an "employer cheque-writing distance away" from being fully funded. "That means there could easily be 2,000 to 3,000 schemes that want to access this market in the relatively short term," he says.

"And this is a market that typically trades with 200 to 300 schemes a year. So, something, at some point, will have to give. We've not worked with a scheme that couldn't access the market yet, but it feels like a matter of time before that might happen."

Turning away schemes will not come as a result of financial constraints, however, as Legal & General head of origination and execution, UK pension risk transfer, Dominic Moret, explains. "There is excellent capacity in the market and the industry has a long track record of meeting increasing demand," he says. "It was only a decade ago that we were writing volumes in the single-digit billions across the whole market. We are projecting volumes of between £45 billion and £50 billion for the full year. This would make 2023 the largest and busiest-ever year by a comfortable margin. This significant step up in volume suggests that insurers have plenty of asset, capital and reinsurance resources."

A people problem

Instead, the main problem lies in human resources.

All insurers have been recruiting rapidly to allow them to write more business, says Broadstone head of trustee services, Chris Rice. This has led to a doubling in size of the insurer pricing and transition teams within some providers.

"In addition, insurers have been developing innovative approaches to streamline the deal and transition process, particularly to help them complete smaller deals," says Rice. "There are also rumours of other insurers keen to enter the bulk annuity market, which would add further capacity and competition. This suggests that while insurers are incredibly busy at the moment, the market is moving to meet the increased demand."

But the problem of a lack of sufficient manpower extends beyond the insurance world, says Davis. "You need enough people on the consultancy side as well," he says. "Both sides of the equation need more people if you're going to process more schemes."

Despite recruitment ramping up – coupled with faster adoption of technology and the streamlining of internal processes – insurers are being forced to be more selective at present. LCP principal, Ruth Ward, says that many schemes are seeing fewer insurers participate in competitive broking processes. There is a silver lining, however. "Despite these pressures, we are seeing strong insurer engagement with no

evidence of price hardening for the deals that we're bringing to market," says Ward.

How to prepare

In this environment, trustees and employers need to work hard to avoid being placed at the back of the risk transfer queue.

"With evidence of insurers declining to quote for even large transactions over £1 billion, focused preparation is more important than ever," explains Ward.

"Quotation processes, even for small transactions, are resource intensive for insurers, so it's important that scheme data and benefits are clearly presented and that quotation requests are well thought through and focus on key requirements, with no unnecessary complexity. Demonstration of commitment to a transaction and having an investment portfolio that is suitably liquid to meet an insurance premium are also important."

"Flexibility to accelerate or extend the process, as needed, can increase insurer focus and participation," she adds.

In Davis' experience, for smaller sub-£100 million schemes, two main issues abound: A lack of data readiness and illiquid assets.

"We have an increasing number of clients who come to us who will have illiquid assets within their investment portfolio, which makes transacting not impossible, but more difficult," he reveals.

At the same time, many schemes have not carried out the preparatory steps that might have been expected in relation to scheme data and benefits, either due to complacency, or having not expected to reach a fully funded status so soon.

As Rice explains, this causes easily avoidable problems. Without clean data, the insurer transition will not be smooth. At the same time, considering minor benefit amendments to fit insurer standard approaches, including fixing discretions, can significantly aid the process. "This means schemes can gain an advantage by being flexible over their approach to insurers," says Rice, who believes that waiting for a window of opportunity, or working exclusively with a single insurer, can also be advantageous in terms of transaction times.

Early engagement

Whether choosing to negotiate with one insurer or not, collaborating with a provider from the onset of the risk transfer process can help considerably, says LGIM head of endgame solutions, Mathew Webb.

"Working with their advisers, we believe that schemes should set clear objectives and engage with insurers early," he says. "This holds true whether your preference is a traditional multi-insurer auction, or a newer approach, like a collaborative partnership.

> **"With evidence of insurers declining to quote for even large transactions over £1 billion, focused preparation is more important than ever"**

"Every pension scheme is unique, so early engagement and close collaboration allow us to offer a solutions-focussed approach across all elements of the transaction."

At the same time, trustees should be mindful of the risks involved in rushing to market, says Moret. He encourages all schemes to read *Preparing Pension Schemes for a Bulk Annuity Quotation,* the best practice guide compiled by DLA Piper with the help of all eight UK providers. By doing so, schemes can take onboard the necessity of scrutinising affordability, engagement and governance — as well as assets, benefits and data.

On the point of affordability, Moret says carrying out a feasibility study, with input from advisers, can potentially help a scheme to set a target premium and understand whether a buy-in or buyout is actually affordable. "Demonstrating this can give insurers confidence that a transaction will go ahead if the target is met," he says.

In terms of governance, establishing an efficient and flexible decision-making process can also be hugely beneficial to schemes ahead of a transaction process. "Opportunities can be short-lived, so it's helpful if schemes can make decisions quickly," warns Moret.

Precious resources

Adequate preparation is not just important at an individual scheme level, says Davis. It also aids the entire pension risk transfer industry.

"The days are gone where schemes can come ill-prepared to market, because insurers know how to sniff that out," says Davis. "And they're not going to waste their precious resources on quoting on schemes that aren't in well-prepared position."

Davis and his colleagues have to spend more time than ever trying to discourage clients from contacting insurers, as they are not ready to do so. "We have to say: 'You need to go collect this piece of data, or you need to figure this thing out on your benefits, or we need to work through that asset holding', before we let them approach the insurance market," he says.

"If we don't do that then fewer insurers are going to quote for them and in a worst-case scenario, no insurers will provide a quote. It's our role as consultants to be guardians of the insurance market and only let forward schemes that are ready.

"Otherwise you're wasting insurer resources, and given how many schemes want to use them, that's quite unforgivable."

Written by Marek Handzel, a freelance journalist

In association with