Bulk annuity briefing, Quarter 4 2020

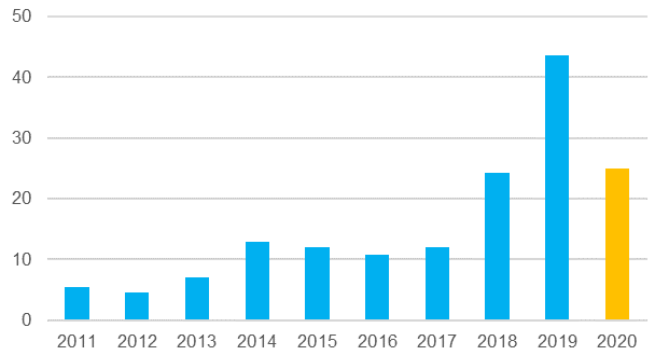
In this briefing, we review activity in the bulk annuity market during 2020 and discuss how the market might develop over the next 12 months.

We also take another look at the First Actuarial Bulk Annuity Index, which monitors general trends in the pricing of bulk annuity transactions relative to self-sufficiency liabilities.

Review of 2020

We are still waiting for the insurers to publish their final year-end results. However, we expect total buy-in and buy-out volumes to be around £25bn, making 2020 the second busiest year ever after 2019.

Total value of bulk annuity transactions (£bn)



Impact of Covid-19

Unlike many industries, activity in the bulk annuity market remained strong throughout the pandemic, with eight different insurers writing bulk annuity business during the year.

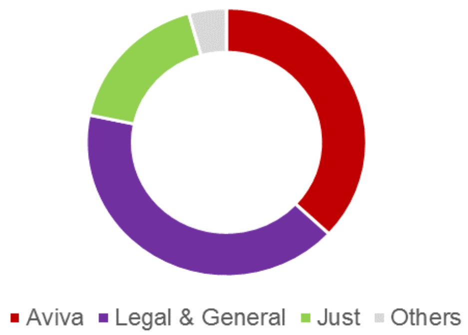
For some schemes, falls in the value of growth assets made the gap to buy-out more difficult to bridge.

However, schemes that had hedged their interest rate and inflation risk relative to gilts saw very attractive terms on offer during the spring, due to widening credit spreads on corporate bonds.

One key difference between 2020 and 2019 was that fewer £1bn plus transactions were completed. This created opportunities for smaller schemes, and in the first half of the year, there were 46 transactions under £100m.

At the smaller end of the market, three insurers – Legal & General, Aviva and Just wrote over 95% of these sub £100m deals.

Number of transactions under £100m, during the first half of 2020, split by insurer



Looking forward to 2021

Although the economic outlook remains uncertain, we predict that 2021 will be another strong year for bulk annuities, with total volumes likely to exceed £25bn.

Insurers are continuing to invest in technology and operational capacity at the smaller end of the market, and therefore we believe that competitive terms will continue to be available to well-prepared smaller schemes during 2021.

First Actuarial has helped several smaller schemes to transact over the last few years. We believe that we are particularly well placed to help smaller schemes navigate the bulk annuity market.

First Actuarial Bulk Annuity Index

The First Actuarial Bulk Annuity Index monitors general trends in the pricing of bulk annuity transactions relative to self-sufficiency liabilities.

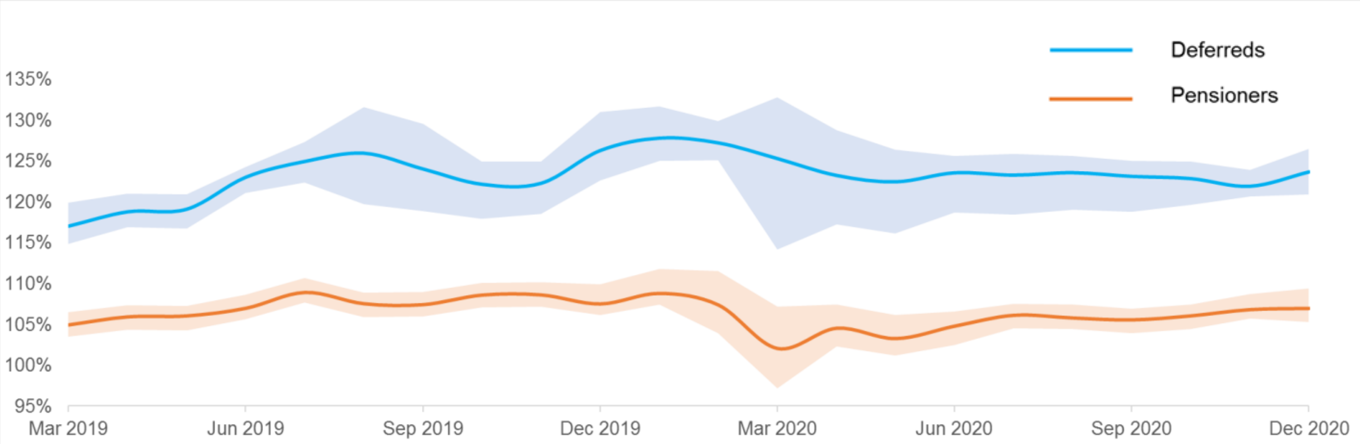
The chart below shows the average price of a £50 million bulk annuity transaction (with a mixture of fixed and inflation-linked liabilities) as a percentage of the liabilities measured on a self-sufficiency basis, using a discount rate of 0.5% pa above gilt yields.

The solid lines represent our estimate of the average price relative to self-sufficiency liabilities. The shaded area shows the range of sample pricing received, which illustrates that pricing between insurers can vary materially.

Insurers charge a higher premium for deferred members than for pensioners of the same age. This is because it is more difficult to predict the benefit outlay, as deferred members are entitled to exercise options around when to retire and whether to take part of their benefits as a tax-free cash lump sum.

For many schemes, the cost of a full buy-out can be prohibitive. But generally, as schemes mature and approach a self-sufficiency target, the extra funding required to reach buy-out reduces.

First Actuarial Bulk Annuity Index (£50 million transaction) – pricing relative to self-sufficiency liabilities



Pricing has generally been attractive throughout 2020, particularly for pensioners. Schemes that were ‘buy-out ready’ were able to obtain extremely attractive pricing from late March to early May, on the back of the market shock caused by Covid-19.

At 31 December 2020, we estimate that the average price of a bulk annuity covering pensioners would be 7% higher than the equivalent self-sufficiency liabilities. In other words, for a scheme that was 100% funded on a typical self-sufficiency basis, we estimate that for every £10 million of liabilities an additional £0.7m of funding would be required. However, for every £10 million of deferred liabilities, we estimate an additional £2.4m of funding would be required.

Further information

Find out more about our buy-in and buy-out services on our website.

To discuss bulk annuities with us, please contact your usual First Actuarial consultant or email enquire.buyout@firstactuarial.co.uk.