Bulk annuity briefing, Quarter 3 2022

In this briefing, we discuss how schemes can make themselves more attractive to insurers in a crowded market.

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

The last few weeks have been turbulent for Defined Benefit (DB) schemes. However, many schemes will have experienced improvements in their funding positions during 2022 as a result of increases in long-term gilt yields.

Schemes with lower levels of liability hedging will have seen particularly significant improvements in their funding levels. They may now be able to afford to buy out their liabilities with an insurer sooner than previously expected. This means that many more schemes are likely to be looking to secure a bulk annuity during 2023.

Smaller schemes

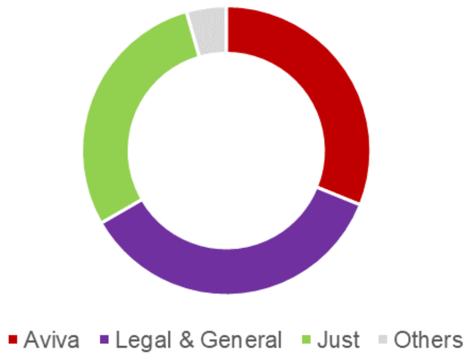
Smaller schemes will need to stand out in a crowded market. They will need to be well prepared and should approach insurers with a clear decision-making process involving both the trustees and sponsoring employer.

Insurers go through a triaging process when deciding whether to participate in any quotation process. It's essential that smaller schemes carry out all the preparatory work upfront – such as correcting any known data issues, collecting marital information, and calculating contingent spouses' pensions. And the benefit specification should already be signed off by the trustees' legal adviser.

Smaller schemes should also be willing to be flexible around transaction timing. Giving insurers a longer window to produce a quotation will allow them to resource the quotation around other clients.

Although there are currently eight insurers operating in the bulk annuity market, three insurers – Aviva, Legal & General and Just – wrote around 95% of sub £100m deals over the first half of 2022.

Number of transactions under £100m, during the first half of 2022, split by insurer



Looking forward to 2023

Insurers' profits are linked to the size of transactions. This means they are likely to have to write more transactions to meet their budgets in a higher-yield environment.

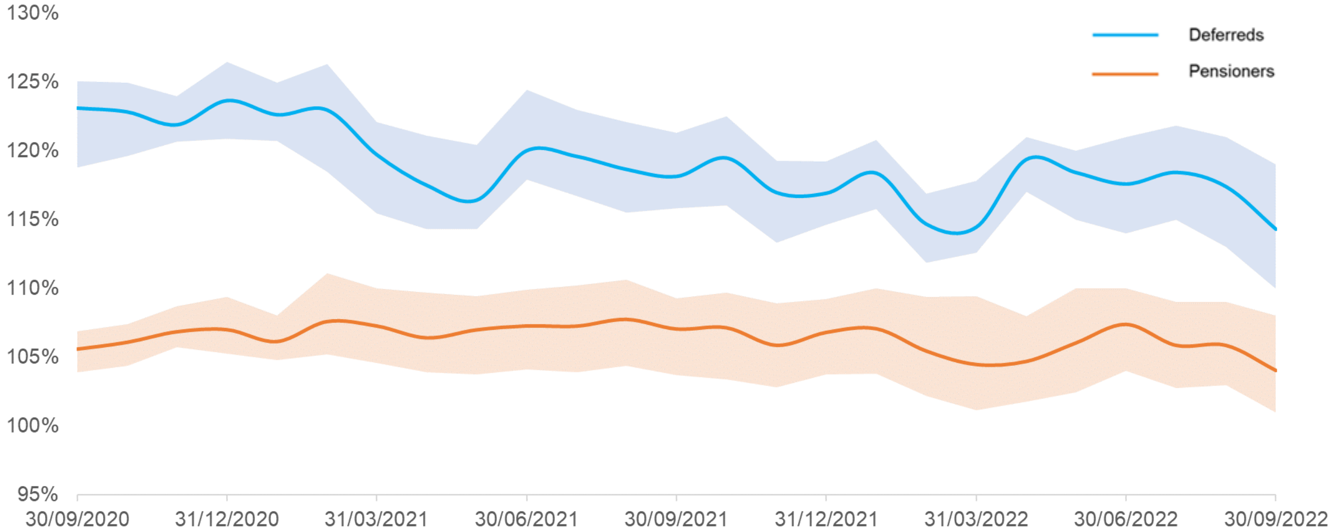
However, despite schemes of all sizes competing for attention, we are not expecting insurers operating at the smaller end of the market to shift their focus entirely to larger schemes. Insurers generally like a steady flow of business, and they're more likely to achieve this by competing in processes across a range of scheme sizes.

First Actuarial Bulk Annuity Index

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 from different insurers.

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



Insurers charge a higher premium for deferred members than for pensioners of the same age. This is because it is harder to predict the benefit outlay. 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 decreases.

Over the past three months, pricing has become more attractive, reflecting widening credit spreads above gilt yields.

As at 30 September 2022, we estimate that the average price of a bulk annuity covering pensioners will be only 4% higher than the equivalent self-sufficiency liabilities. In other words, for a scheme that is 100% funded on a typical self-sufficiency basis, we estimate that for every £10 million of pensioner liabilities, an additional £0.4m of funding will be required. However, for every £10 million of deferred liabilities, we estimate an additional £1.4m of funding will be required.

Further information

Over the last 12 months, First Actuarial has helped schemes secure bulk annuities with each of the three main insurers operating at the smaller end of the market. We believe that we are ideally placed to help smaller schemes under £100m navigate the bulk annuity market.

Find out more about **First Actuarial's buy-in and buy-out services**.

To discuss how we can help your scheme with a potential bulk annuity, please contact your usual consultant or **email our buy-out team**