Bulk annuity briefing, Quarter 1 2023

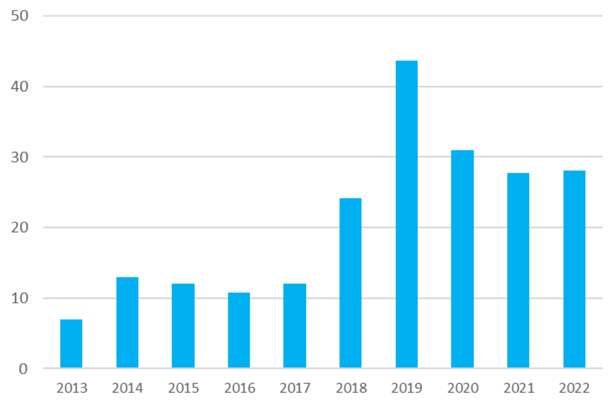
In this briefing, we review activity in the bulk annuity market during 2022 and discuss how the market may develop over the coming years.

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.

Review of 2022

Despite the turbulence that many schemes faced last year, the bulk annuity market remained resilient, with similar transaction volumes to the previous two years.

Total value of bulk annuity transactions (£bn)

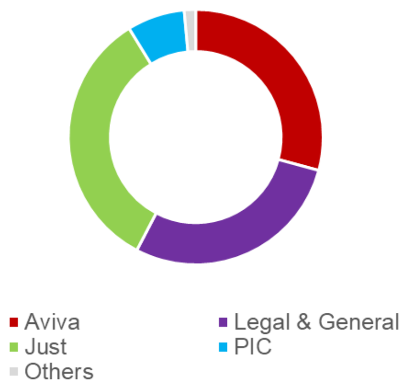


Smaller schemes

Based on our analysis of published deals and conversations with the insurers, we estimate that there were around 140 deals under £100m during 2022 (representing 70% of the total number of deals).

Although there are currently eight insurers operating in the bulk annuity market, four insurers – Aviva, Legal & General, Just and Pension Insurance Corporation – wrote over 95% of these sub £100m deals.

Number of transactions under £100m, split by insurer



Looking forward

Many schemes will have experienced improvements in their funding positions during 2022 as a result of increases in long-term gilt yields.

In particular, schemes with lower levels of liability hedging are likely to have seen significant improvements in their funding levels, and many schemes will be able to afford to buy out their liabilities with an insurer sooner than previously expected.

We are therefore expecting to see market volumes top £40bn in 2023 and over the coming years.

However, following the fall in liability (and therefore premium) values, insurers will now need to write even more business to reach their volume targets. Given this market outlook, insurers have been developing streamlined processes for smaller schemes and we expect this to continue throughout 2023.

Smaller schemes will need to continue to stand out in a crowded marketplace and to show that they are in a position to complete the transaction when they approach insurers.

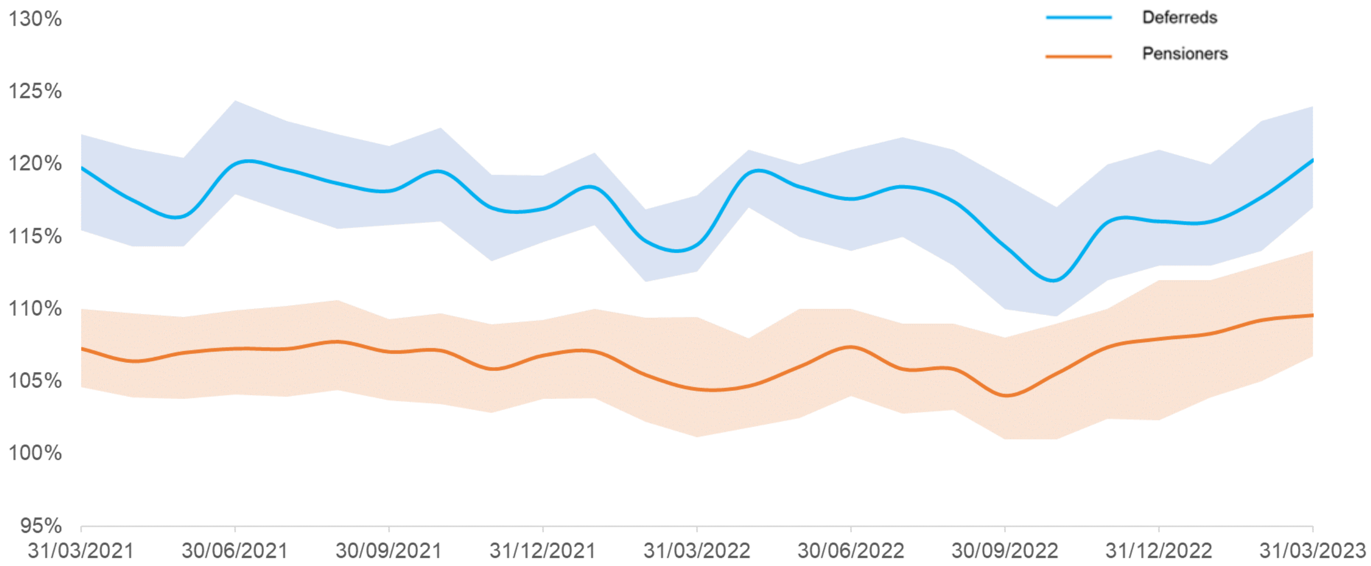
Smaller schemes will also need to be flexible around transaction timing, and may need to agree exclusivity with a single insurer before receiving any quotations.

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.

The increase in gilt yields has materially reduced the cost of buy-out and increased demand. However, buy-out pricing is also affected by other variables such as credit spreads, competition, insurer capacity and reinsurance pricing. The net effect of changes in these other variables has been to increase the cost of buy-out relative to gilts-based liabilities over the last two quarters.

As at 31 March 2023, we estimate that the average price of a bulk annuity covering pensioners will be 9% 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 £0.9m of funding will be required. However, for every £10 million of deferred liabilities, we estimate an additional £2.0m of funding will be required.

Further information

Over the last 12 months, First Actuarial has helped schemes secure bulk annuities with each of the four 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**.