Risk settlement – operating in a busy bulk annuity market

With 2018 predicted to break records for buy-ins and buyouts, Aon's **Mike Edwards** advises schemes to focus on their 'go to market' strategy

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Across pension scheme buy-ins, buyouts and annuity back-book transfers, the last three years have seen an average of around £15bn of transactions in the bulk annuity market. This is predicted to be a record-breaking year, with at least £30bn of transactions. More than £15bn of business has been completed already, including the recent announcements of £12bn of annuities to transfer from Prudential to Rothesay Life and £3bn from Standard Life to Phoenix. While these transactions have utilised some insurer capacity, these announcements are good news for pension schemes as there is now more clarity for insurers regarding potential sources of business for the rest of the year. The result being fully engaged pricing for scheme buy-ins and buyouts.

The twofold increase in demand has a number of implications for schemes considering buy-ins and buyouts. Those that follow the market and consider current market dynamics in their 'go to market' strategy will achieve the best outcomes.

Why has demand for buy-ins and buyouts increased?

Pension schemes are looking to de-risk through insurance for a number of reasons. Strong asset returns and improved funding levels have accelerated many schemes towards a long-term objective of buyout or self-sufficiency. In addition, insurer pricing improved to unprecedented levels during 2017 due to increased competition, growing use of illiquid assets and recognition of recent mortality experience among insurers and

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reinsurers. Combined, these mean that many schemes can now de-risk through pensioner buy-ins at no cash cost or that a full scheme buyout is now within 'cheque-writing distance' for some employers. The recent DWP whitepaper noted that most schemes closed to accrual have a long-term target or journey plan in place (where the destination might be buyout or a version of self-sufficiency), so we may see increased focus on risk settlement.

What does this mean for schemes considering buy-ins and buyouts in 2018?

Insurers need to manage their available resources – manpower, assets and capital – carefully. Current levels of demand mean we expect to see capacity crunches for insurers at certain points of the year. Another thing we expect to see in 2018 is fewer insurers bidding on certain cases. While the natural conclusion here may be that less competition results in worse pricing outcomes, in practice it can actually lead to more focused pricing (as insurers have an increased chance of success) and more efficient processes. We therefore expect there to be sufficient appetite for all but the smallest transactions to generate suitable levels of competition.

Evidence from processes we have advised on in the early part of 2018 support this view; we have seen pricing levels consistent with those in the second half of last year. However, it is more important than ever that trustees and employers carefully consider their strategy for approaching the market to maximise insurer engagement and achieve the best outcome.

What can schemes do to maximise insurer engagement?

On a personal note, having worked on the insurer side of the bulk annuity market for the last six years, I believe there is clearly a wide range of approaches used by advisers.

Thorough preparation sits at the heart of the best approaches. This covers a range of topics including:

- demonstrating that robust conclusions have been formed on whether a proposed transaction is right for the scheme and is affordable;
- ensuring that information provided to insurers for pricing is complete and accurate; and
- ensuring that a clear route through to successful completion has been planned

While this may appear straightforward, critical items can often be overlooked.

Determining the right size and shape of the buy-in can also be key in maximising insurer engagement. A de-risking approach that has become prevalent sees schemes insuring their liabilities over time through a series of buy-ins of liability subsets. This has obvious benefits in terms of increasing the scope and accuracy of any existing hedging on the subsets, while enabling market pricing opportunities to be captured. However, it raises the obvious question of which members to include or exclude from a buy-in.

Clearly, the priority consideration here for trustees and employer should be levels of risk reduction achieved versus cost. However, shaping subsets to maximise insurer engagement also needs to be considered. This may involve simple actions like excluding smaller sections of membership with different benefit structures.

Ultimately, from an insurer perspective, there is no substitute for trustees and employers working with an experienced adviser in developing their 'go to market' strategy. This means firstly, an adviser who is actively advising a range of schemes and seeing regular quotations and so can set expectations around levels of achievable pricing; and secondly, one with a robust, tried-and-tested framework for navigating the end-to-end settlement transaction process from initial engagement with insurers through to successful completion.

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