The bulk annuity market changes up a gear

Guy Freeman looks at another record-breaking year for bulk annuities and what this means for schemes yet to turn to insurance

Every year it seems records are being broken in the bulk annuity market and 2019 has seen a string of very large deals. What could this mean for schemes that have not insured yet and how can they best prepare to approach the market when insuring becomes desirable?

2019 market update

Predictions for transaction volumes in 2019 are now at £40 billion, compared to the £24 billion completed last year and less than £14 billion in all previous years before that. This recognises increased demand from pension schemes and provides unambiguous proof that the appetite exists to transact at these volumes and sizes. So far, 2019 has seen:

- The largest buyout ever from Telent's £4.7 billion fund
- The largest buy-in with Rolls Royce's £4.6 billion
- The largest buy-in to include deferred members with Allied Domecq's £3.8 billion
- The largest-ever deficit contribution of £800 million from Walmart/Asda to complete their £3.8 billion buyout transaction.

Perhaps of greater significance for the future market are the large schemes transacting for the first time, for example the largest fund (National Grid at £20 billion of assets) and the largest UK company (BAT with a market capitalisation of over £60 billion) to have transacted to date. Why is this happening now?

Efficient risk management – There is a growing demand for outsourcing the sophisticated asset and risk management that is needed to pay pensions safely over decades. This is not only because of an emerging acceptance that insurers are simply more efficient and cost-effective than corporates at managing complex and long-dated asset-liability risks, but also the attraction of being able to communicate the simple message that the scheme has been being fully secured and transferred.

Solvency levels are higher – Whilst deficit contributions have helped, many funds have also seen asset-liability outperformance. When combined with a few years of falling costs for future longevity improvements and improved CPI hedging markets, solvency levels have reached their highest-ever levels for a sustained period. For overseas sponsors, the fall in sterling has also reduced the cost of a sterling deficit.

Regulatory pressure is increasing – With its 'clearer, quicker, tougher' mantra, its focus on contributions versus dividends and on investment risks for weak sponsors, The Pensions Regulator is applying more pressure on sponsors. Being forced to declare long-term funding aims might well trigger more companies to start to plan for a buyout, when combined with this increasing regulatory pressure.

What could this mean for the future?

All else being equal, schemes tend to see good pricing when insurers have an increased appetite and ability to transact. Appetite is driven by the availability of capital, which is currently good. Ability to transact is driven by availability of assets and human resources to price and process transactions. On the people side, insurers have been growing their teams but limited human resources mean they will continue to be selective about quoting. On the availability of assets for future deals, the recent announcements are stimulating an increased volume of enquiries about possible asset opportunities for Rothesay Life. This is an encouraging sign for 2020 pricing levels and bulk annuity volumes.

So, what should schemes be thinking about?

After a busy summer closing four large deals worth a total of £15 billion over two months, we can take stock and think about what made these schemes stand out. Apart from good preparation and planning, the key aspects from our perspective have been that:

- The company, trustees and their respective advisers work together effectively
- The advisers are experienced and regularly see transactions through to completion
- Early consideration is given to issues that might stall execution such as illiquid assets or complex benefits
- There is a price lock that matches assets held by the trustees with minimal caveats
- Contract negotiations recognise the needs and constraints of both parties

Good access to capital has helped us write multiple larger and longer duration transactions at competitive prices. Raising £1.1 billion in September means that Rothesay Life is well-primed for 2020 and has the appetite, resources and track record that trustees can rely on.

Written by Guy Freeman, business development, Rothesay Life