



DB Endgame update Q4 2024

This is our regular note discussing emerging issues and market activity in the DB Endgame space.

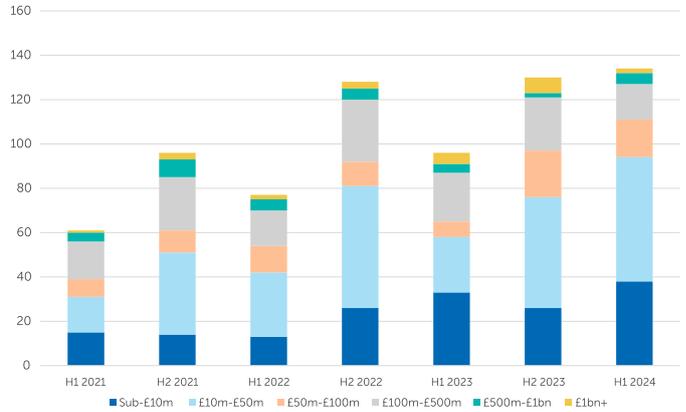
Bulk annuity market update

Number of transactions by half year

Insurers have released their results for the first half (H1) of 2024. Highlights include:

- The 134 transactions completed was a half year record. Historically the second half of the year (H2) has been busier than H1, and so we expect the record 226 transactions completed in 2023 will be broken by a significant margin in 2024.
- The increase in transactions has largely been driven by Just and Aviva, who completed 55 and 39 transactions respectively. Collectively they accounted for 89% of all transactions in the sub-£10m space.
- Despite this increase in transactions numbers, the total premiums written reduced from £21.2bn in H1 2023 to £15.1bn in H1 2024, reflecting a reduction in the average deal size from £220m to £113m.
- Over 80% of transactions related to schemes with assets of less than £100m. The PPF's latest Purple Book indicates that 75% of schemes have assets of less than £100m, and so transactions in the first half of the year have been slightly skewed to smaller schemes. This could reflect that larger schemes are considering whether to run-on for a period of time, or that they are taking time to work through data preparations and consider the implications of the Virgin Media judgment.
- Rothesay wrote the largest share of premiums in H1, with a market share of 27% (£4.2bn). This was driven by a £3.5bn deal completed with an unnamed scheme.
- Historically, Legal & General have shown impressive consistency to maintain a market share of c. 25% of premiums each year. Their CEO has publicly indicated that they are targeting £65bn of new business over the period to the end of 2028, and so we expect this to provide attractive pricing opportunities for large schemes.

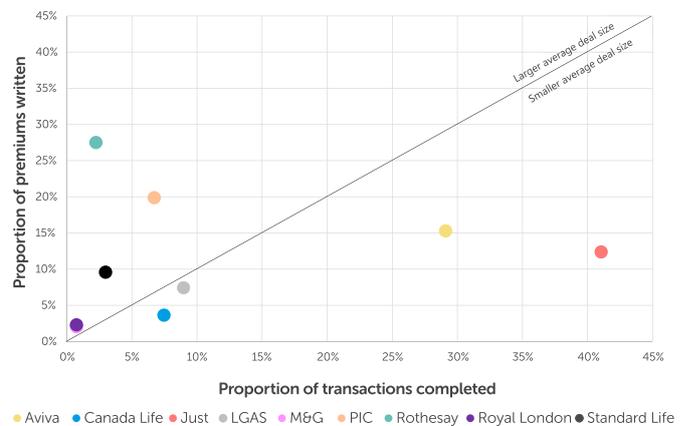
Number of transactions by half year



Distribution of transaction sizes by half year



Share of premiums and transactions by insurer in H1 2024





Market participants

Royal London formally entered the bulk annuity market on 30 September 2024, having completed two transactions with their own pension schemes in November 2023 and January 2024 and two transactions with external pension schemes in July and September 2024. Their entry provides a welcome additional option for schemes seeking to secure their benefits with an insurer.

As reported last quarter, Brookfield have filed paperwork with the Prudential Regulation Authority to set up a new insurer, and we understand a number of other parties are also actively considering whether to enter the UK's bulk annuity insurance market. The choice available to schemes therefore looks set to continue growing.

Small scheme capacity

A number of insurers are actively looking at their small-scheme offerings and considering either developing small-scheme streamlined solutions similar to those offered by Just, Aviva and Legal & General, or increasing their capacity/willingness to provide quotations at the smaller end of the market.

BW risk transfer activity

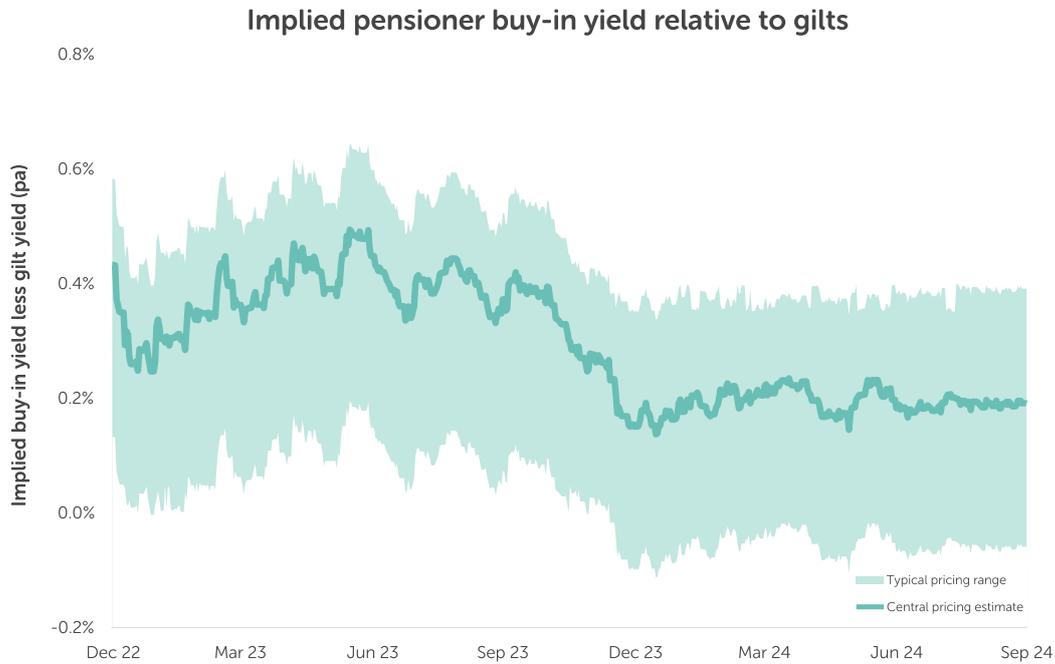
BW's risk transfer team have now acted as lead adviser on over 100 transactions, including over 30 since the start of 2023. Over that period every scheme we have taken to market has successfully transacted, with the premiums for these transactions ranging from less than £1m to in excess of £1bn.

Whilst the market remains incredibly busy, we have been able to complete a transaction for all of our clients wishing to do so, irrespective of size or benefit complexities. Some recent cases studies are available on our website, including:

- A [case](#) where the transaction was completed within 6 weeks of the initial quotation request. This was achieved by simplifying benefit complexities and partnering with an insurer to adapt their streamlined offering to the scheme's requirements.
- A £35m [case](#) where a competitive process was completed. The trustees and sponsor decided to go with the more expensive quote, as it reduced the period over which the scheme remained exposed to risks.

Pricing levels

The chart approximately tracks the implied margin above gilts that has typically been achievable when securing pensioner benefits with an insurer. The implied margin remained broadly similar across the quarter.

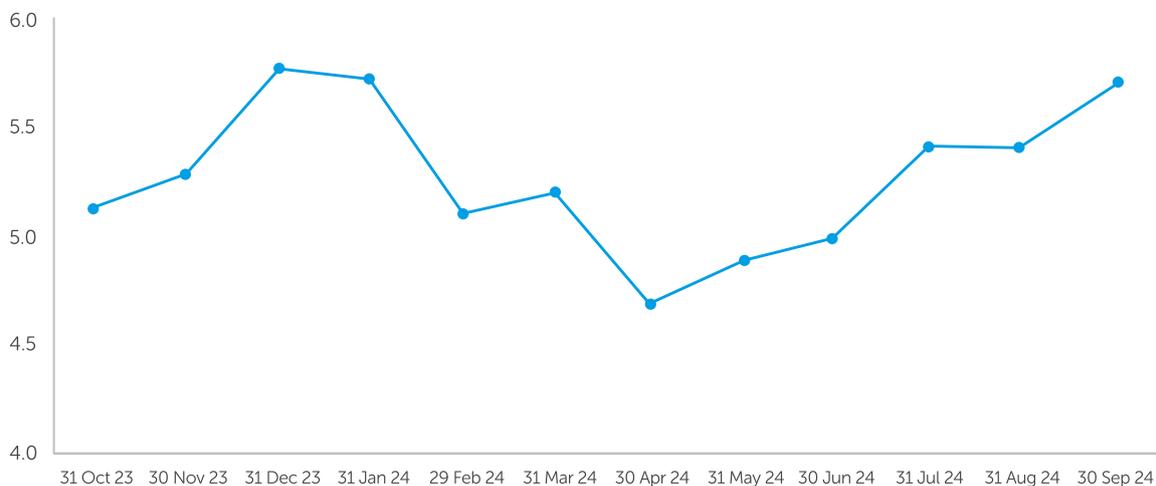


Source: Insurers and Barnett Waddingham research

Notes: This is for a typical transaction covering liabilities of £100m. It also assumes that the demographic assumptions used to project future benefit payments are consistent with our understanding of those an insurer might be expected to adopt. The pricing is based on both observed market pricing and indicative pricing information provided by bulk annuity insurers. The pricing actually achieved will depend on a particular scheme's circumstances and insurer appetite for a particular transaction.

DB End Gauge index

Our DB End Gauge index shows the average expected period over which full buy-out transactions are expected to be self-financing for FTSE 350 companies with DB pension schemes. The average period to full buy-out funding increased over the quarter due to a reduction in government bond and swap yields (with these schemes typically being underhedged relative to their buyout liabilities).



Further information on our end game-gauge can be found on our website:

www.barnett-waddingham.co.uk/db-end-gauge/#analysis

Alternative Risk Transfer – Superfund update

What is a Superfund?

Superfunds and other 'capital-backed funding solutions' provide a means for pension schemes to transfer or manage risks using third-party investors' capital, potentially for a lower premium than would apply in the bulk annuity insurance market. The vehicles sit outside the insurance regime and are subject to different capital requirements.

Transactions to date

So far, the only active superfund, Clara-Pensions, has completed two transactions, resulting in the transfer of around 20,000 members and over £1bn of assets. Two further deals are also set to be publicised during November 2024.

Regulatory update

In the absence of a formal legislative framework, superfunds are currently subject to an interim regulatory regime overseen by TPR.

TPR initially published guidance in 2020, both to set out the high standards of capital management and governance to which it expects superfunds to operate, and to explain the factors that should be taken into account by trustees and employers before undertaking a superfund transaction. They then released an updated version of the superfund guidance in July 2024 (following industry consultation), which acts as the interim regulatory regime for superfunds while we await formal legislation. The main updates regarding superfunds are as follows:

- Generally, TPR have clarified the **application of the guidance** and have been more specific about which types of capital-backed funding solutions will (and will not) need to comply with the guidance.
- Subject to certain controls/conditions being met, TPR have relaxed the rules regarding **capital release** to external investors. Previously, capital could only be extracted as profit after a successful buy-out of all member liabilities, however feedback from the industry suggested this was limiting the types of superfund models that could succeed in the market. TPR's updated position is consistent with the government policy of supporting a competitive superfund market.

- **"Standalone principle"** – TPR will consider future deals based on the overall capital held by the provider rather than requiring specific capital to be attached to each deal. As a result, a superfund may choose to use surplus capital either to provide a return to investors or to reduce the capital required to write new transactions.
- **"Lower capitalisation in insolvency cases"** – schemes in PPF assessment will now have the option of demonstrating to TPR that a "non-standard" superfund transaction (i.e. involving a lower level of capital) is in the interest of members. This may apply in cases where a PPF+ buy-out with an insurer would result in a material reduction in members' benefits, but a superfund transaction – if capitalised to a lower level than would apply under the standard TPR guidance – provides a viable means of delivering scheme benefits in full.



Bulk annuities: who steers the ship?

A well-run bulk annuity process can look like plain sailing, while a badly run one is very much battling choppy waters and storm force winds.

Below we consider some of the different advisory structures for leading a bulk annuity process, including the rise of co-led processes. There are definitely some icebergs in the water and the best outcome for any scheme is to avoid these, something best achieved by using an experienced team who know what to look out for.

It's important to remember that the "buyer" of a bulk annuity contact is the scheme's trustees, who are required to take formal advice as part of the process. However, sponsors have a key role to play, and we actively encourage them to be involved in the process from the outset, taking advice where relevant (e.g. in relation to any accounting implications and affordability). Ultimately, the views of the sponsor are important for any bulk annuity purchase, particularly if additional funds need to be paid into the scheme.

Traditional approach

In our experience the vast majority of bulk annuity transactions have been led by a risk transfer advisor selected by the Trustees – be that an existing advisor or an external firm brought in to support this project. One of two approaches is typically taken:

1. Establish a Joint Working Group

A Joint Working Group (JWG) would include representation from both the trustee board and sponsor. In some cases the trustees' risk transfer advisor will provide advice to the whole JWG, while in others the sponsor will appoint a separate advisor who might join meetings and feed into discussions. The decision on which of these approaches to adopt ultimately depends on the extent to which the trustee board and sponsor's objectives are aligned, and the advice the sponsor needs to manage internal stakeholders on the transaction process.

The JWG structure can be used for pension schemes of all sizes but typically are not used by the smallest schemes where processes are streamlined to help control costs.

This recent testimonial from a scheme sponsor using a Joint Working Group shows how things can work effectively: "We are grateful to Barnett Waddingham for successfully managing the recent bulk annuity purchase for our defined benefit scheme. They brought expert knowledge of the process to help all parties work together towards a common goal, and very much felt like 'one team' working with our own actuarial advisers. Their flexibility through the process and clear project updates helped us keep up to speed on matters right up to signing the contract. They kept us well informed of budgets and fees so there were no unexpected surprises."

Where the same party is advising both the trustees and sponsor, the specific nuances around this will depend on the level and nature of the work required and the conflict policy of the relevant advisory firm. Where this approach is being taken, it is important to have clearly drawn-out conflict lines to help should there be any ambiguity.

2. Working collaboratively in a light touch way

Many trustee boards – particularly those of small schemes or those associated with family run businesses – will share the advice they receive with the scheme sponsor (on a non-reliance basis) and allow them to join meetings/discussions and input their views. Essentially facilitating a light touch 'Joint Working Group'.

In our experience, this approach works well, enabling a proportionate advisory process to be followed with both parties receiving the advice/information they require without doubling up on advisory fees. Where there is a strong working relationship, it also facilitates a quick and efficient decision-making process.

The Corporate Captainty

A theme over recent years has been sponsors committing to support a transaction but requesting or requiring that their advisory team lead the insurer discussions and are appointed to provide the trustee advice process. From a sponsor perspective it's not an unreasonable ask where they are paying in a contribution and believe their advisory team will better represent their interests with insurers.

This can be an appropriate and necessary process in some situations. Particularly if there's a corporate governance route that needs to be followed, or more importantly if the trustee advisory team isn't sufficiently experienced or doesn't have the capacity to support.

This approach risks friction with trustees as they are the ones who need formal advice on the transaction and under this approach would require the trustees to appoint the sponsor's advisers. In some cases we've been involved with this hasn't been a problem, in others it has been a bigger issue and has caused push back from the trustees with a potential dent on the wider trustee / sponsor relationship.

Again, a robust conflict policy is needed. The trustees will need to consider the default appointment if there is a conflict that can't be managed, leaving them with the very possible risk that they could be left "high and dry" mid-way through a transaction.

A risk with this approach is the draw of the initial deal rather than the bigger picture objectives of the scheme. By that we mean the sponsor and their advisers focus on getting a transaction done quickly but don't consider the approach, scale and feasibility of the post transaction work required. In cases where the advisory appointment terminates on the completion of a transaction, the trustee can be left feeling somewhat at sea, having to work out how to deliver their requirements under the buy-in policy. Ensuring the trustee views and objectives are being represented at all stages is critical to ensure the initial deal doesn't cause any unexpected surprises post transaction. In reality, having a thorough process throughout to pension scheme wind-up is just as important for the sponsor to help guard against residual risks.

Co-led processes

Given some of the challenges around a single corporate driven appointment, it has become increasingly popular to use a "co-led" structure. Historically this was the domain of larger schemes, but more recently this has started moving across to the smaller end of the market.

Under this approach each party has their own adviser (which helps with conflicts and division of responsibilities), who both sit on a Joint Working Group, and are actively involved in the market approach and insurer negotiations. This approach can come about when the sponsors and trustees want to receive independent advice and have trusted advisory teams.

The key challenge of this approach is cost. With more hands-on deck there's a risk of duplication of work and scope for increased discussions and negotiations. Having said that, two brains can be better than one, and arguably there's increased pressure on the insurer to deliver when engaging with two experienced advisers. Insurers can also find this process frustrating if it is not clear who the lead negotiating adviser is or if mixed messages are provided on objectives. Agreeing a protocol for sharing information and negotiating positions with insurers is critical to making this process successful.

We have worked in this way on a number of transactions. When doing so it is critical to ensure that everyone is navigating to the same outcome - advisors trying to point score doesn't add anything to the process other than frustration, delays and a worse outcome.

As always there's a bit of detail to work through, such as data processing, ensuring the right processes are in place to share data and agreeing which advisor will be sharing the data with the insurers.

Role of the Independent Trustee

Many trustee boards now include an Independent Trustee, either as part of the trustee board or as sole trustee. These firms and individuals are critical to the overall advisory structure. They know the consultants and know what works well in terms of an advisory structure. Given their experience of completing transactions, their involvement can also help ensure a quick and efficient process is followed, and enhance the outcome achieved.

Independent Trustees will likely work with the sponsor closely to agree an approach that works for both parties.

"Independent Trustees are now effectively repeat buyers of bulk annuities and accumulate considerable practical experience of the process and the technical challenges. Given these transactions are significant, irreversible, complex and game-changing events, a scheme's trustees will be making some of the biggest decisions they will have faced. Having an experienced independent trustee on the board to augment the decision-making team can be enormously beneficial in the planning, key commercial negotiations and ultimate decision making and project execution. PAN Trustees have completed many transactions across the wide market of insurers, deploying different governance and advisory structures that are the best fit for the scheme's requirements. A critical part of the role is to know your scheme's stakeholders and identify efficient and collaborative ways of working with them. If allied with the right advisory inputs and project management, this should lead to the very best outcomes."

Steve Delo, Chairman of PAN Trustees

Summary

In summary there's no right answer to the question "what's the best advisory structure?". The answer depends on the specifics of the situation and parties involved. At the outset of a bulk annuity transaction project, we work with our clients identify what approach will work best for them, and to ensure that the other party involved is supportive of this to prevent the process from becoming derailed.

Our three top tips, regardless of the structure adopted, are:

- Use an experienced advisory team who know how to run a process and knows the market
- Ensure the different parties involved are working collaboratively to the same goal
- Remember the transaction journey extends beyond the day you sign the deal



"Collaboration between trustees and sponsors is critical to a successful buy-in project. When a scheme first approaches the market, transaction certainty is a key factor in an insurer's triage process. Evidence of all-party engagement and alignment, which most often is in the form of a well-considered, nimble governance structure, gives us confidence to commit resources to a transaction. We've seen many forms of adviser structures be successful, but from our perspective, the process is most efficient when there is a clear reporting and negotiating lead which can engage flexibly with us to navigate the broking and execution process."

Kieran Mistry, Director of Defined Benefit Solutions at Standard Life, part of Phoenix Group



Find out more

For more information on this topic or advice on how to navigate the shifting sands in the UK bulk annuity market, please get in touch with one of our experts. We help our clients tackle their DB risk transfers confidentially and successfully.



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