



DB Endgame update Q3 2024

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



Narrowing credit spreads

Over the first 6 months of the year the additional yield provided by corporate bonds relative to government bonds (the credit spread) continued to fall, reaching levels very close to the lowest levels seen since before the global financial crisis (in 2007).

Insurers have historically allocated a significant proportion of their investment portfolios to corporate bonds, meaning the yields on these assets are a key driver of insurer pricing. In the past, wider credit spreads have generally resulted in more favourable pricing relative to gilt-based liability valuations and narrower credit spreads have generally resulted in less favourable pricing relative to gilt-based liability valuations.

However, this has not been the case over 2024 (albeit we have seen variation across insurers), with pricing not deteriorating to the extent seen historically (this can be seen on the chart on page 5). This has been the case for deferred liabilities in particular, which have remained at attractive levels relative to historic norms. This appears to be partly driven by insurers seeking to invest a smaller proportion of their portfolios in corporate bonds (i.e. using other asset classes to maintain pricing levels). This may have implications for the design of asset portfolios by schemes seeking to hedge insurer pricing, and we recommend that you speak to your investment advisers about this where relevant.

Historic investment grade corporate bond spreads





Run on

We are increasingly seeing larger schemes (those with assets of £100m or more) consider running on their scheme for a period of time to access the economic surplus within their scheme rather than passing this onto the insurance market.

If this is of interest to you, our webinar titled 'Improving pensions and returning surplus: the best of both worlds' will cover the actuarial, administration, investment and legal considerations of run-on.

You can watch the webinar on demand [here](#).



2024 market activity

Appetite to transfer liabilities to insurers and consolidators remains very strong, with a number of larger (£1bn+) schemes entering the market over recent months. Further details of expected market activity over 2024 are included in the article at the end of this document.

BW risk transfer activity

Since the start of 2023 BW have acted as lead adviser on c.30 transactions, with 100% of the schemes we have taken to the insurance market in the last 3 years transacting. The premiums on these cases have ranged from less than £1m to in excess of £1bn.

Brookfield announce intention to enter market

Brookfield have recently announced that they have filed paperwork with the Prudential Regulation Authority to set up a new insurer. If approved, this will take the number of insurers participating in the UK bulk annuity market to 11, following the previous entry announcements from Royal London and Utmost.

We understand that a number of other parties are also actively looking at whether to join the UK's burgeoning bulk annuity insurance market.

Small scheme / streamlined insurer solutions

The insurance market continues to innovate in the small scheme space, with 4 streamlined or small scheme solutions now available:

- Aviva formally launched 'Clarity' in April, following a detailed testing process across c.20 transactions. Clarity is aimed at schemes of all sizes and provides a guaranteed quotation following completion of a detailed spreadsheet setting out data and benefit information.

In Q2 we completed two of the first transactions using the full Clarity process since it was formally launched, having previously completed cases using Aviva's test proposition.

- PIC also formally launched 'Mosaic' in April. Mosaic is currently in the early stages of roll out, and PIC expect several schemes to transact using Mosaic each month. PIC are yet to complete their first transaction using Mosaic.
- Just have updated their 'Beacon' platform. This is available to schemes of all sizes and, following completion of a data and benefits template, provides monthly indicative quotations to help schemes track affordability over time. If an indicative quotation is deemed affordable then it can be converted into a guaranteed transactable quotation.

As standard Beacon does not provide an investible 'price lock mechanism'. We are particularly pleased that over Q2 we were able to obtain investible price locks for our clients using Beacon to transact. We have completed 5 transactions in 2024 using Beacon.

- LGAS 'Flow' continues to be available to schemes of all sizes. It requires a detailed data and benefits template to be completed and then provides a guaranteed quotation. LGAS are able to provide price locks which are linked directly to any appropriate (hedging) assets held with Legal & General Investment Management (LGIM).

We have completed 5 transactions using Flow, including a recent case with no post-transaction data cleanse period.

We understand that other insurers are also looking at how they can better support smaller schemes, with Utmost likely to enter the market later this year with a strategy of targeting this segment of the market. The innovation being seen in the small scheme market is likely to result in a record number of transactions in 2024 - see our latest quarterly article at the end of this document for further details.

Insurer due diligence

We are increasingly seeing trustee boards and sponsors undertake insurer due diligence as part of transaction processes, e.g. to consider the administration offerings, financial strength and ESG credentials of insurers. These factors are increasingly seen as critical given the material cost of transactions and their irrevocable nature.

This due diligence was utilised by the trustees of the Ricoh UK Products Pension Plan – further details of this case are available on our [website](#). Get in touch if you would like details of our due diligence offerings.

FTSE 350 survey

Our annual analysis of the FTSE 350 DB pension schemes was recently published. This shows that 35% of FTSE 350 schemes were fully funded on a buyout basis as at 31 May 2024 and so may look to access the bulk annuity insurance market over the coming years.

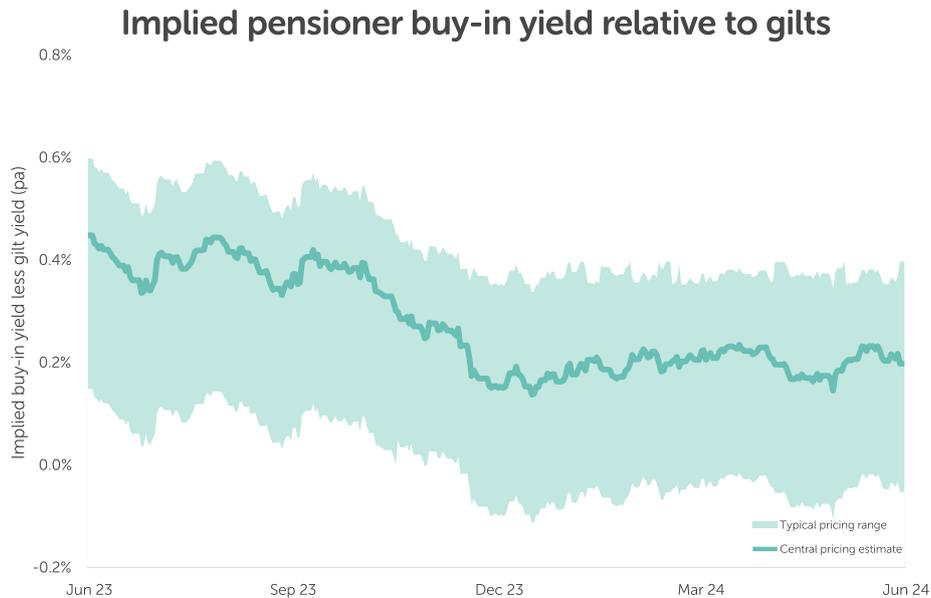
The FTSE 350 schemes are estimated to have a combined economic surplus of c.£125bn (being the difference between the best estimate cost of providing the benefits and the estimate cost of securing their benefits in the insurance market). It remains to be seen whether these schemes will complete insurance transactions or use this economic surplus to improve member outcomes and return funds to sponsors/shareholders.

The full report is available on our website:

<https://view.barnett-waddingham.co.uk/ftse350-research-2024-part-one/p/1>

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 unchanged over the quarter, albeit with a degree of variation within the quarter.

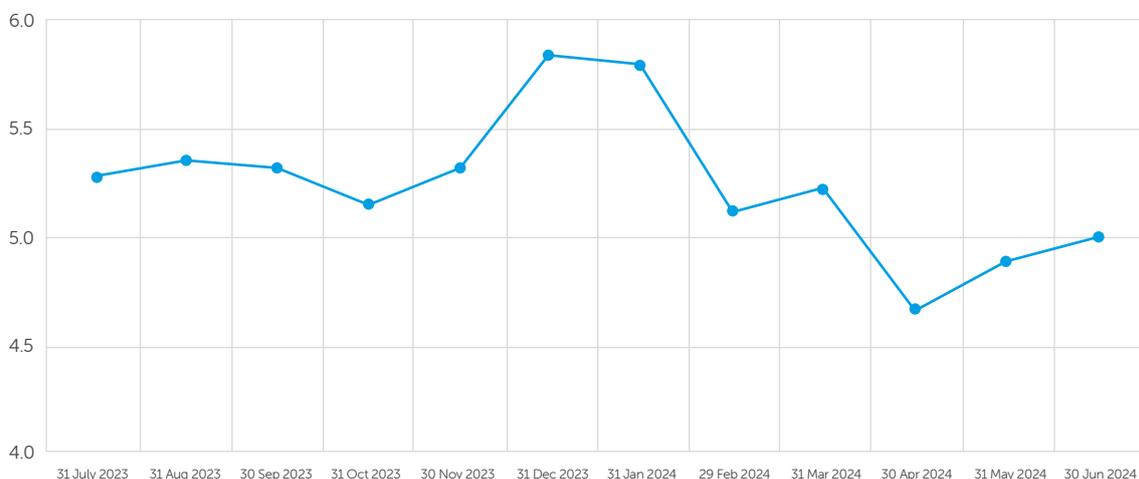


Source: Insurers and Barnett Waddingham research

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 reduced over the quarter, as average swap and bond yields increased (serving to reduce liability valuations, and improve the positions of underhedged schemes).



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

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

Quarterly article: Bulk annuity volumes – “the stage is set” to reach 2023 records

At the start of the year we predicted that the bulk annuity business written in 2024 would threaten last year’s record of £49.1bn.

As we enter the second half of 2024, and in advance of insurers publishing their half year data, we consider whether the market is on course to achieve this volume and outline how the “stage is set for volumes to get close to the record £49.1bn seen in 2023”.

Premiums

Outside of Rothesay’s £6bn purchase of Scottish Widows’ back book (subject to regulatory approval), it has been a slow start to the year for large transactions.

As we moved into 2024 pipelines were very strong, with a significant number of large (£1bn+) transactions expected to approach the market in 2024. A number of these deals have been delayed in their market approach as the advisory market has grappled with benefit complexities and issues identified when preparing benefit specifications, a growing administration logjam, and an increasing focus on run-on as a viable option. However, a number of these large deals entered the market in May/June with £15bn-£20bn of deals being actively priced, ready to provide a healthy boost to second half volumes.

Including the £6bn Scottish Widows back book deal, we understand that total volumes of business written to date (including those schemes that are in exclusivity and so may ultimately transact in H2) are of the order of £22bn.

Volumes in the second half of the year have traditionally exceeded first half volumes, with just 38% of total market volumes falling in the first half of the year over the last five years. As a number of the deals in exclusivity are likely to transact in H2, volumes at the half year stage could fall short of the levels that would have been required historically to achieve a full year record.

When this is combined with those being actively priced and further schemes that are expected to enter the market over the coming months, total volumes for the year should comfortably exceed £40bn, with the exact timing and structure of some large and mega transactions being the key driver of full year volumes.

“We anticipate some of the jumbo schemes seeking to transact in multiple tranches (e.g. by splitting into £5bn buckets) to increase insurer participation and allow price targets to be met. This could take up significant resource at multiple insurers, impacting transaction numbers / volumes and potentially pricing levels, particularly if these schemes have strict pricing targets and are willing to wait for these to be met.”

Rosie Fantom, Head of Bulk Annuities

Number of transactions

The number of transactions completed will be driven by activity amongst the 3,800 schemes with assets of less than £100m (including 1,600 with assets of less than £10m).

There has been no shortage of deals in this small scheme space over 2024, with Just continuing to churn out transactions at unprecedented speed. In May the firm completed its 400th transaction since its formation in 2012 and they expect to write more than 100 transactions in 2024 alone – those sorts of numbers would have been unthinkable before the 2022 gilts crisis and represent truly impressive growth of c. 250% in 3 years.

Just have also recently enhanced their streamlined proposition (Beacon) with a view to further efficiencies and increasing transaction numbers.

Other insurers are also increasingly looking to service the small scheme market, with Aviva and Pension Insurance Corporation launching streamlined propositions this year (Clarity and Mosaic respectively), Legal & General continuing to transact through Flow, a number of other insurers looking to ramp up their existing ability to service small schemes at scale, and others planning to enter the market with a particular focus on smaller schemes. The challenges many feared small schemes would face to transact do not appear to be coming to pass, with insurers innovating and growing rapidly to meet their demand.

Given this continued growth and support, we expect 2024 to be a record-breaking year in terms of the number of transactions completed, with activity continuing to accelerate into 2025 and beyond as further capacity comes on board from additional insurers and the proposed public consolidator.

Over the first half of 2024 we have also seen an increase in the number of insurers willing to participate in a typical process, showcasing how insurers have ramped up their pricing capacity. Moving forward this additional capacity should provide greater flexibility for the market to be able to service particular peaks in demand. As new insurers start to quote and look to land their first transactions, there is also potential for increased competition.

Market conditions

These activity levels have come against a backdrop of narrowing corporate bond spreads, with the spread on an all-stocks corporate bond index reducing from 1.75% pa in March 2023 to around 1% pa.

Historically this would have resulted in less favourable pricing and a decrease in the number of transactions completed. Whilst there has been some impact – most significantly for those insurers who allocate a significant proportion of assets to corporate bonds – this has not been the experience across the market with many insurers able to maintain pricing relative to gilts at the levels seen in late 2023.

2024 has also seen a c.0.5% pa increase in nominal gilt yields - this will have acted to reduce liability valuations (and hence the insurance premiums payable) by up to c. 10%. Given the direct relationship between yield levels and insurer premiums, any material movements in yields will have a direct impact on premium amounts, all else being equal. As such, gilt yields will influence whether the total business written will reach the £50bn mark. The path of central banks decisions on whether to reduce, maintain or increase interest rates could therefore prove pivotal.

Conclusions

Whilst first half volumes are likely to be slightly lower than predictions at the start of the year due to some delayed large transaction market approaches, the market is now hotting up for the year end, with an influx of larger cases hitting the market. The stage is set for volumes to get close to the record £49.1bn seen in 2023.

The key drivers of where the volumes land will be the exact timing of some large transactions (i.e. whether they complete in 2024 or early 2025) and the manner in which markets move over the remainder of 2024.

Given the increased activity in the second half of the year schemes may find it more challenging to get insurer engagement. This could result in some deals that might otherwise have transacted in 2024 doing so in early 2025. Schemes approaching the market should place paramount importance on being well prepared in order to maximise insurer engagement. This is particularly the case in the mid-market where the number of transactions completed over the last 18 months has been muted relative to the small and large scheme market segments.

What is clear is that we will continue to see records broken in the small scheme space, with a new record for the total number of calendar year transactions completed in 2024. A key driver of this will be the number of deals insurers pass through their streamlined processes. It remains to be seen whether the large deals within the market push premiums towards the levels seen in 2023.



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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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