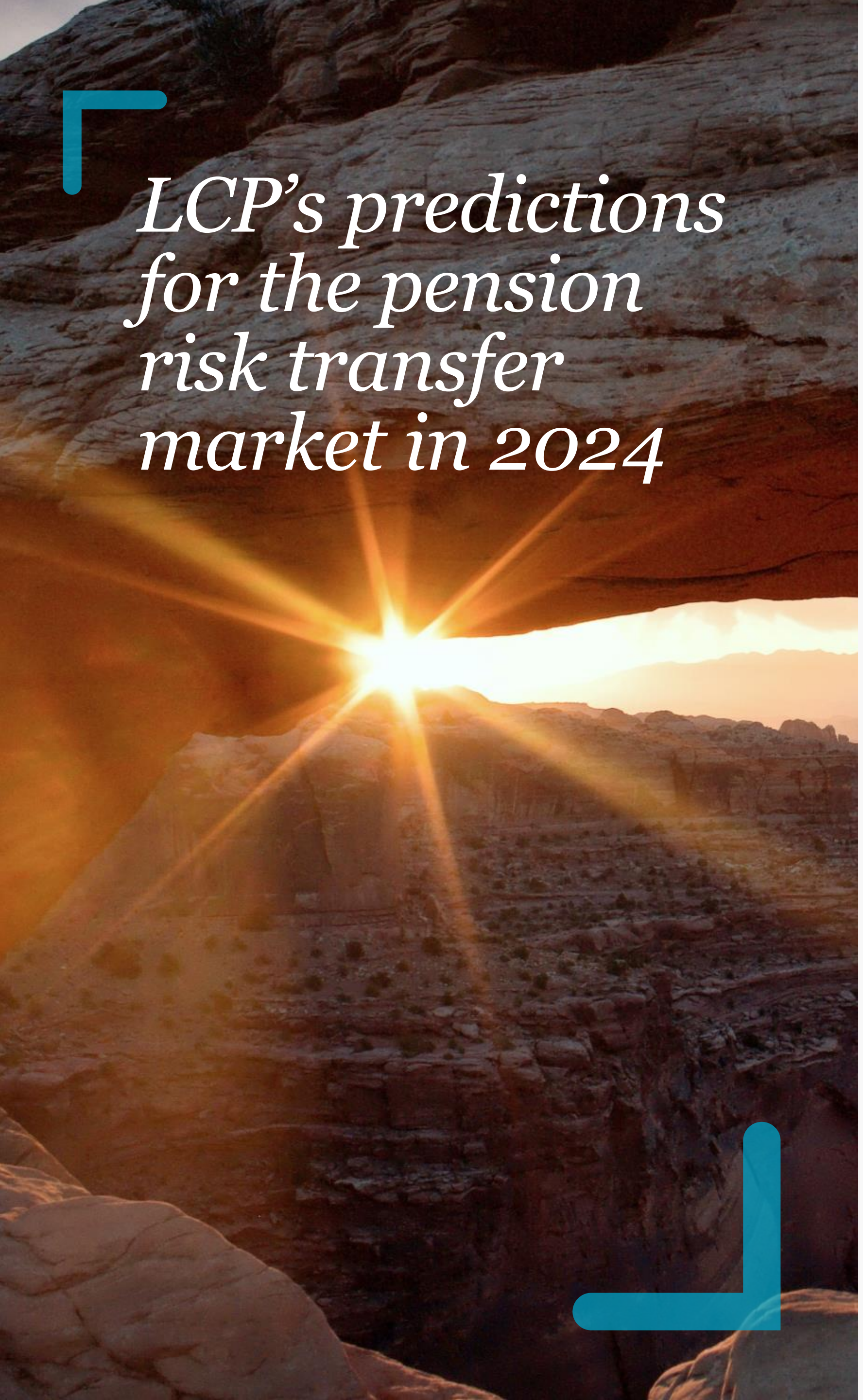


LCP's predictions for the pension risk transfer market in 2024

Charlie, Imogen and Ruth, supported by LCP's pension risk transfer team, have considered what might lie ahead for the UK pension risk transfer market in 2024. Here, they share their key predictions for 2024 and discuss how these might impact schemes that are considering insurance through a buy-in, buy-out or longevity swap, or a wider risk transfer option such as a superfund transfer.

This time last year, we were the first consultancy to bring out the crystal ball and make five predictions for 2023. These included that we would see buy-ins and buy-outs exceed the record £43.8bn of volumes in 2019 and that we could see a new entrant insurer. It is pleasing to see all five of those predictions came to pass – so no pressure for our predictions for 2024!

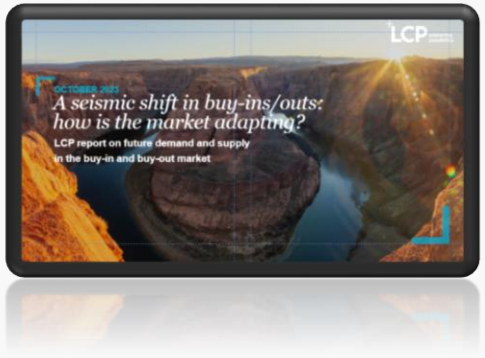
Our five predictions for 2024

Our five top predictions for the buy-in, buy-out and longevity swap market in 2024 are:

1. Volumes of buy-ins/outs will set (yet another) record of £50bn+, driven by higher numbers of £1bn+ deals
2. Pricing may harden, but attractive opportunities will still be available
3. Significant investment in the UK buy-in/out market with two new entrants
4. Greater focus on run-on, superfunds and alternatives to buy-out
5. More exclusive sole insurer processes

Our annual report on the buy-in and buy-out market issued in October 2023 analysed the seismic shift in the buy-in/out market. Improvements in funding levels have led to a dramatic acceleration in demand for buy-ins/outs, with a jump of over 50% in the number of schemes seeking quotations in H1 2023 compared to a year earlier.

Our latest pension risk transfer report:



Charlie Finch
Partner

Imogen Cothay
Partner

Ruth Ward
Principal

Buy-in and buy-out volumes set to increase to record levels

1. Volumes of buy-ins/outs will set (yet another) record at £50bn+, driven by higher numbers of £1bn+ deals

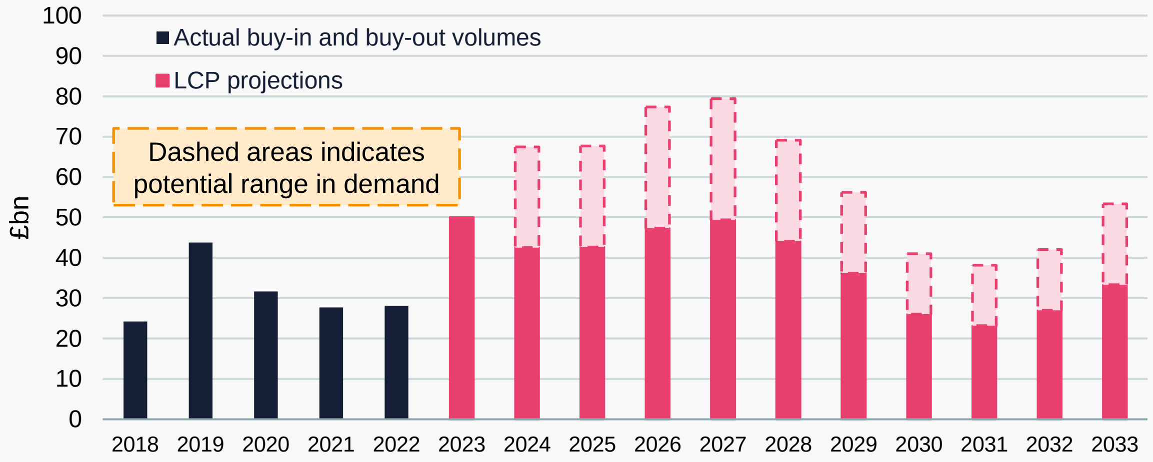
Final 2023 buy-in/out UK market volumes won't be available until March, but we expect 2023 to land at around £50bn of buy-ins/outs – so around £80bn in "2019 money". Several insurers have already declared total volumes, with Rothesay set to have written the most on £12.7bn, closely followed by Legal & General on £12.1bn – a record year for them.

In our October 2023 report, we projected 2024 volumes of c£45bn to c£65bn. Based on our current pipeline of transactions and the pipelines reported to us by insurers, we'd go further and predict that 2024 volumes will reach over £50bn, making it yet another record year.

The growing volumes will be driven by a greater number of £1bn+ transactions. There have been at least 10 £1bn+ transactions in 2023, exceeding the previous record of 9 in 2019 and double the number in 2022. This trend of more large deals looks set to continue into 2024, with insurers reporting record numbers of large schemes in their pipelines.

Where final volumes for 2024 ultimately land will hinge on whether some of the largest schemes contemplating transactions proceed this year.

Chart 1: Projected buy-in and buy-out volumes over the next decade



2. Pricing may harden, but attractive opportunities will still be available

Despite the surge in the number of schemes seeking insurer quotations, pricing has remained highly attractive over 2023 across the board, with the pricing for smaller schemes being just as attractive as for larger schemes.

This has largely been driven by competitive pressures, but there have also been a couple of other helpful factors.

Firstly, reinsurance has helped support pricing – longevity reinsurance has priced in further reductions in life expectancies, and there has been an expansion in the use of funded reinsurance over 2023. For example, Legal & General reported that around 25% of its record 2023 volumes were passed to funded reinsurers. The PRA has been tightening the rules on these arrangements, but we expect funded reinsurance to continue to be an important asset class supporting pricing over 2024.

Secondly, reforms to Solvency II capital requirements have helped pricing over 2023, albeit much of the benefit has been diluted due to the extensive use of longevity reinsurance and higher interest rates. Further reforms come into effect in 2024, but we are not expecting any material impact on pricing this year.

Looking ahead, some insurers are reporting greater challenges in asset sourcing, which could lead to upward pricing pressure meeting accelerating pension scheme demand. In a higher interest rate environment, fewer corporate lenders are issuing debt, particularly over the longer durations that insurers like to hold in their bulk annuity portfolios. That said, for schemes whose advisers run an effective insurer process attracting a good level of competition, we expect there will continue to be attractive pricing opportunities.

Chart 2: Buy-in pricing remains attractive over 2023

Source: LCP insurer pricing model. The model is calibrated against live quotation and final transaction pricing. Buy-in pricing depends on a wide range of factors such as transaction size, benefit structure, membership profile and insurer appetite and can differ materially from that shown.

UK market will attract significant investment

3. Significant investment in the UK buy-in/out market with two new entrants

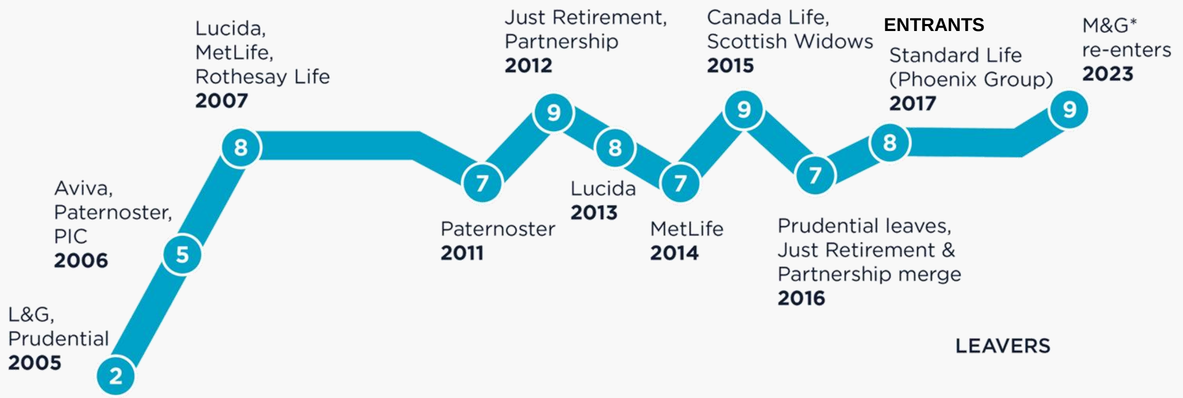
2023 has seen a surge in new capital providers exploring ways of participating in the UK buy-in/out market, which is no surprise given the predicted volumes of assets expected to transfer to insurers. We have had discussions with six potential entrants that are weighing up their options for gaining a presence in the UK buy-in/out market, including current UK insurers, overseas insurers and a range of investors.

We think we could potentially see two entrants this year, adding to M&G, who joined in September 2023. This could be through acquiring one of the nine existing bulk annuity providers (where there has been plenty of speculation in recent weeks) or as a new provider (noting the US bulk annuity market has 20+ providers).

That said, the hurdles to entry are high. The regulatory requirements under Solvency II are onerous – particularly for a provider who does not already have scale in annuities – and recruiting the necessary teams in a market that is already very tight on resources is a daunting prospect.

Many potential investors are, therefore, choosing the more straightforward route of providing capital in the secondary market – through funded reinsurance and other innovative co-investing structures – rather than setting up as a direct primary insurer.

Chart 3: Pension buy-in / out market participants



*Source: LCP analysis *M&G was formed from the de-merger of Prudential plc in 2019 with the UK insurance business becoming part of M&G plc.*

4. Greater focus on run-on, superfunds and alternatives to buy-out

Against the background of so many schemes close to or at full buy-out funding, the Government plans to consult on changes to encourage schemes to consider longer-term run-on and other alternatives – the so-called "Mansion House" reforms. LCP has been one of the leading voices calling for a shake-up of the rules, and it is pleasing to see LCP's idea as part of the planned consultation.

This is already encouraging much positive debate about "run-on" and other endgame innovations. The Mansion House reforms will play out over coming years and their significance will depend on the outcome of the consultation and, in particular, the appetite of any new Government to drive them forward.

The long-awaited first superfund transaction by Clara in November 2023 was a key landmark. The Government is planning to introduce regulations to provide a firm footing for superfunds and also to introduce a public consolidator run by the PPF by 2026 to help sub-scale pension schemes. However, the policy objective for these routes is focussed on schemes with "no realistic prospect of buy-out in the foreseeable future" so they may only have limited impact on the buy-in and buy-out market.

5. More exclusive sole insurer processes

A key debate in recent months has been the merits of exclusive sole insurer processes, with some advisers promoting them as a way for smaller schemes to get access to pricing. However, an audience poll in our November 2023 webinar showed there remains strong appetite for multi-insurer processes, and LCP's streamlined buy-in service continues to be an effective way of accessing this. In our experience, all schemes – even down to £10m – can run multi-insurer processes if they wish and should not feel forced to go down a sole insurer route to access pricing.

That said, sole insurer processes can be effective in the right circumstances. For example, many of our clients that have an existing buy-in in place choose to run a sole insurer process with the incumbent insurer when entering into further buy-ins. Provided the insurer can meet the desired pricing metrics, this approach has the benefit that all members are placed with the same insurer.

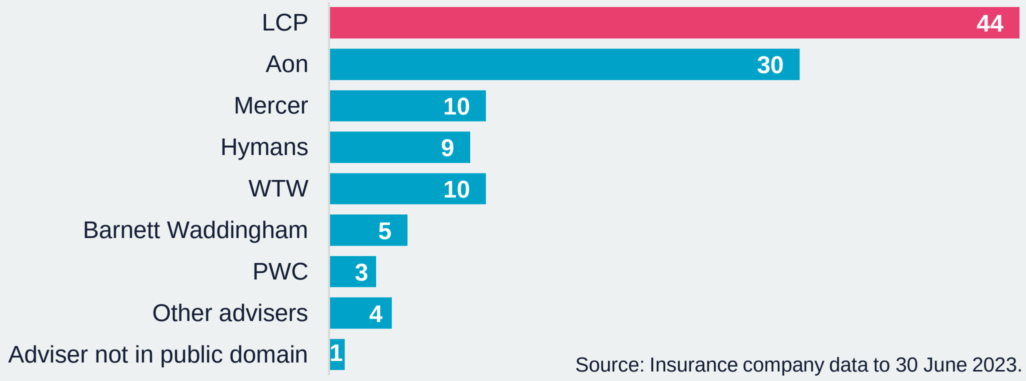
With many schemes having complex and specific requirements, we expect to see further sole insurer processes over 2024. The most high-profile example to date being the British Steel Pension Scheme, where LCP designed and led their strategic partnership with Legal & General that allowed them to reach £7.5bn of full insurance in May 2023 across four transactions in 18 months, including the transfer of a c£1bn property portfolio.

2024 will test insurers' resilience as a growing wave of schemes seek buy-ins/outs, including many more very large schemes. We remain positive about the market's ability to rise to this challenge, but schemes need to recognise that the market dynamics are now fundamentally different.

Charlie Finch, Partner

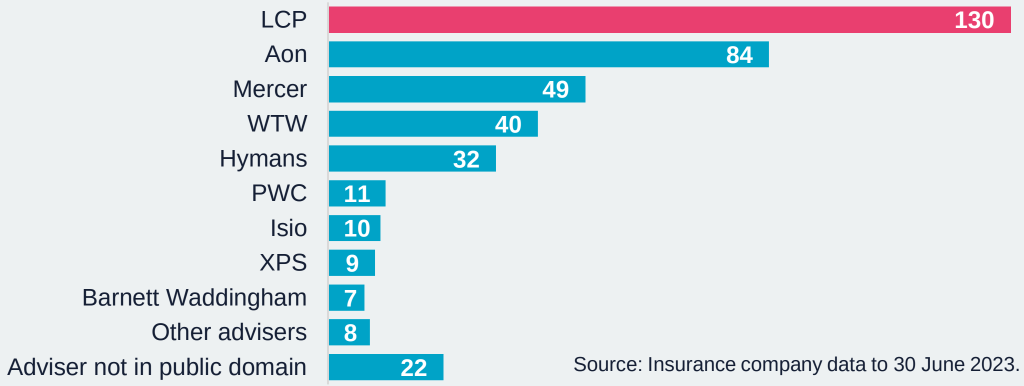
LCP is a market-leader in all segments of the buy-in and buy-out market

Over £500m: Lead adviser on buy-ins/outs over £500m since 2014



Source: Insurance company data to 30 June 2023.

Over £100m: Lead adviser on buy-ins/outs over £100m since 2014



Source: Insurance company data to 30 June 2023.

Under £100m: Lead adviser on over 100 buy-ins/outs under £100m since 2014

LCP has been the lead adviser on **over 100 buy-ins and buy-outs under £100m** between 2014 and 30 June 2023. It's not possible to produce adviser comparisons like the above for smaller transactions as insurers do not publish granular data on lead adviser for transactions under £100m.

LCP has now completed over 80 transactions through our streamlined buy-in and buy-out service for smaller schemes, bringing the total liabilities insured through this service to c£3.5bn.

LCP has been the lead adviser on

100+

buy-ins and buy-outs under £100m since 2014

LCP highlights from 2023

We're proud of the work we do for our clients in the pension risk transfer market. Some of our achievements over 2023 include:

- Acting as lead adviser to RSA Group and its parent, Intact, on the largest ever single buy-in transaction at £6.5bn, covering two schemes sponsored by RSA Group.
- Acting as lead adviser to the British Steel Pension Scheme to complete the largest ever full scheme insurance at £7.5bn through an innovative strategic partnership with Legal & General.
- Completing 17 transactions totalling £0.95bn through our streamlined buy-in and buy-out service for smaller schemes (typically under £100m).

Contact us

If you would like more information, please contact your usual LCP adviser or one of our specialists below.

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At LCP, our experts provide clear, concise advice focused on your needs. We use innovative technology to give you real time insight & control. Our experts work in pensions, investment, insurance, energy, financial wellbeing and business analytics.

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