Summary

- The DB de-risking market has been thriving in recent years, as scheme sponsors sought to lock in recent funding improvements, with more money transitioning from the pension industry to the insurance sector.
- Some schemes are still adopting a 'wait and see' approach while awaiting further clarity on DB surplus sharing rules, although many have already set their endgame strategies.
- Industry experts have raised concerns that this lack of clarity could therefore limit the DB sector's ability to help meet the government's intent to increase UK investment.

Too little, too late?

The DB de-risking market has seen record-breaking volumes in recent years, but is the DB space being overlooked by broader government policy, and is time for change running out? Sophie Smith reports

The DB pension market has faced growing scrutiny in recent years, after being thrown into the spotlight amid the 2022 gilt crisis, as headlines claimed that the sector was "on the brink of collapse".

But it seems reports of the death of DB were greatly exaggerated, and the significant funding improvements seen in the wake of the 2022 mini-Budget opened the door for record-breaking volumes in the bulk purchase annuity (BPA) market, as DB schemes and their sponsoring employers took the opportunity to de-risk.

Indeed, Standard Life BPA transaction manager, Alex Oakley, says that the BPA market has continued to thrive this year, with volumes expected to top £40 billion yet again.

"In addition, the pipeline of 2025 transactions is very strong and we are continuing to see strong demand from pension schemes of all size for insurance de-risking solutions," he says, highlighting this as demonstration that trustees and sponsors continue to see BPA as a secure home for members' benefits.

But the government's focus on DB has been dwindling, as the limelight recently shifted towards DC and the LGPS, in line with the focus of the government's Pensions Review.

And whilst the BPA market has continued to thrive, updates on alternative endgame options and broader DB changes have been sparse, despite industry calls for greater clarity around DB surplus rules.

A forgotten market?

In particular, whilst industry experts urged Chancellor, Rachel Reeves, not to overlook the role of DB pension schemes, the sector was omitted from her inaugural Mansion House speech to the disappointment of many in the industry.

"It is a shame that the recent Mansion House speech had no mention of possible changes in this area, as clearly the window for schemes to consider changing their long-term targets (or objectives) has a finite period and the longer the government remains silent on this issue the harder it will be for schemes to justify not securing their benefits with an insurer," XPS Group partner and head of investment risk settlement, Sian Pringle, says.

However, M&G associate director, corporate risk solutions, Max Koe, says that the group has seen some evidence of trustees and sponsors adopting a 'wait-and-see' approach in order to better understand the implications of any regulatory changes.

Pringle agrees, revealing that discussions about what the outcome of some of the various government consultations around the DB surplus sharing rules might mean for them has "undoubtedly" piqued the interest of a few schemes who are now considering run-on in the short term to see where these rules might land.

But with the BPA market showing no signs of slowing down, and limited progress on the clarity needed to encourage greater run-on, there has been some suggestion that the UK government could be 'missing its window' to make the most of DB investment in its push to encourage greater investment in the UK.

"Without unlocking the potential for run-on soon, it is hard to see that DB schemes will be able to provide sufficient investment in long-term growth assets to have an adequate impact on growth in the UK economy which could also lead to better outcomes for members," Pringle warns.

And whilst the government has been focused on how DC and LGPS investment could help address the £22 billion blackhole left in public finances, industry estimates suggest that 2024 volumes to date are around c.£40 billion, thanks to a number of 'megadeals'.

However, Isio partner, Steve Robinson, points out that the assets involved in these transactions are consolidating within the insurance sector, where the government can play a role in creating opportunities for productive investment.

"There are already billions of pounds in the insurance sector that could be allocated to suitable UK investments, even before the forecasted record-breaking wave of new business," he says.

Indeed, Koe also points out that, when a scheme transacts a buy-in, the insurer will typically invest those gilts or other de-risked assets into corporate bonds and private 'productive assets' such as infrastructure, social housing and the green economy, much of it in the UK.

Allowing the market to thrive

Whilst discussion around the potential public sector consolidator (PSC) has slowed since the general election, it has not been ruled out, with the Pensions Minister recently suggesting that further updates on this idea could be seen "in the coming months" *[read more about the PPF's latest thoughts on a potential PSC on page 56].*

But recent record-breaking volumes in the BPA market have prompted industry experts to caution the government against these plans.

Indeed, M&G associate director, corporate risk solutions, Max Koe, says that the BPA market is a competitive and thriving market, with "significant innovations" over the past few years.

"Market consensus from advisers suggests that a vast majority of schemes that approach the BPA market are able to receive affordable buy-in quotes from a number of insurers, and competition at the smaller end of the market in particular has increased significantly, which can only benefit trustees," Koe continues.

"We would expect any public sector consolidator to be focused on schemes that are not well-served by the insurance market, i.e. they would not be looking to cover the same schemes that insurers already do."

Isio partner, Steve Robinson, echoes this, arguing that the BPA market is already responding to accommodate these needs, although new entrants face barriers to entry such as regulatory requirements.

"Capacity in the bulk annuity market is at an all-time high, and operational consolidators already serve small schemes," he states. "Furthermore, most new entrants to the BPA market have explicitly stated their focus on smaller schemes. The market is demonstrating its ability to provide solutions without the need for a public sector intervention."

XPS Group partner and head of investment risk settlement, Sian Pringle, also says that there has been little evidence of barriers to scheme's getting quotes, revealing that, every single scheme that XPS has taken to market over the past two years has managed to get competitive insurer pricing.

"However, if the PPF considers extending its role to provide stewardship and support to insolvent sponsors' schemes that are well-funded but cannot afford to transact with an insurer imminently. It could assist those schemes to buyout over the medium term providing better outcomes for members," Pringle acknowledges.

Shifting policy focus

But this could make policy changes in the insurance sector a more attractive option than DB policy changes, if the government is looking to encourage greater investment in the UK.

In particular, Robinson says that, given insurers must comply with PRA regulatory constraints, the government could help by enabling the development of appropriate investment opportunities, such as addressing the non-Matching Adjustment complaint equity component.

Creating more options

Industry innovation could also prompt a shift in strategy, as M&G recently agreed the market's first BPA deal to share value with a corporate sponsor with an unnamed UK pension scheme.

The deal was completed using M&G's newly launched Value Share BPA proposition, which was designed to allow trustees to insure the scheme in exactly the same way as a traditional buy-in transaction, whilst also allowing corporate sponsors to participate in the risk and reward generated from insuring their DB scheme.

Indeed, Koe says that the mindset of sponsors seems to be a shifting and many are considering how they could participate in the potential profit created by schemes approaching the insurance market.

And whilst larger schemes are thought to be the main target for run-on, Koe confirmed that group will also be targeting larger DB schemes for its Value Share BPA proposition, with future transactions expected to be at least £1 billion in size.

"We see our Value Share BPA proposition working within the definition of run-on, given the sponsor is retaining skin in the game over a long-time horizon but providing trustees and members with the ultimate security of a buy-in," he states.

Written by Sophie Smith