BPAs: Attention turns to small DB schemes

Summary
• Although small schemes already take up the majority of the market, experts agree that buyout activity in this segment will increase in 2025.
• Despite both large and small schemes' needs being largely the same, insurers and advisers are continuing to create new solutions that cater to the latter's nuances.
• The government's heightened interest in DB schemes' use of surplus funding isn't expected to disrupt smaller scheme de-risking activity, but this is an area many experts watch with interest.

With insurers increasingly taking a shine to smaller schemes, what does this mean for the bulk purchase annuity (BPA) market?

The bulk purchase annuity (BPA) market continues to grow in volume, with LCP reporting that a "cruising altitude" has now been reached in the space. This is set to average around £40-£60 billion a year, with the firm specifically forecasting up to £50 billion activity alone in 2025. LCP risk transfer principal, Ruth Ward, sees smaller DB schemes driving this trend, in large part due to the number of such schemes coming to market.

"Transaction numbers increased on average by circa 17 per cent per year in the three years 2020-2023. We expect this increasing trend to continue, with H1 2024 the busiest half-year on record and the market on course to reach close to 300 transactions for the full-year of 2024 – a 30 per cent growth rate year-on-year," says Ward, who sees particular activity in the sub-£100 million space.

"These smaller transactions had a two-fold increase over 2020-2023 and made up over 80 per cent of all transactions completed in the first half of 2024. Growth has been led to date by two insurers, Just Group and Aviva, which have the most established streamlined propositions for smaller schemes," she adds.

Innovating for smaller firms

This is opening up new opportunities for insurers, helping create competitive edges in an increasingly crowded space. Earlier this year, Utmost Life and Pensions entered the BPA market with what the firm's head of BPA business development, Gary Needham, describes as a "strategic focus" on small schemes.

"Our view has always been that small schemes should be able to shine and deserve the attention just as much as larger schemes," explains Needham. "We know that for members, trustees and employers being labelled a small scheme doesn't start the journey to buyout in the best way, given the importance of their scheme and pensions to them personally."

Others have already been able to carve out a niche in this area. Just Group participates across the market but has been particularly active with small to medium transaction sizes, completing 129 alone in 2024 (up from 80 the year before). Just Group managing director of DB solutions, Pretty Sagoo, says she sees a "buoyant" supply of small schemes, identifying this as a growth area.

"Over the past few years, insurers have expanded their capacity and scaled their businesses – which has enabled them to successfully complete deals with more small schemes," says Sagoo. "Of the 55 deals Just Group completed in the first half of 2024, 50 were for transaction values of under £100 million."

Specific offerings have also been launched with smaller schemes in mind. Recent years have seen the launch of Broadstone's SM&RT Insure (Set up, Monitor and Risk Transfer) – to guide schemes through the buyout process – and PIC's Mosaic, a streamlined solution specifically designed for smaller schemes, alongside many more similar solutions.

"The smaller end of the market is certainly increasingly attractive for insurers, with funding improvements meaning many hundreds of schemes are suddenly in a position where they may be able to transact," says Broadstone head of trustee services, Chris Rice. "Insurers have ramped up capacity and innovated rapidly to meet this demand as they look to capitalise on the market opportunity. Innovations such as SM&RT Insure, and automated pricing tools developed by many insurers, help smaller schemes monitor in real-time when a transaction may be achievable to drive efficiencies and lower cost."

Smaller scheme nuances

Despite these new solutions being launched, small schemes coming to market have similar requirements to their larger counterparts. They likewise want to find a secure home for members' benefits, gravitating towards insurers with proven quality administration services.

There are some differences however, and Aon associate partner, Joe Hathaway, points out that buyout costs will largely be reflective of the work required with smaller schemes seeking services appropriately costed for them.

"Getting to buyout requires schemes to have completed any remaining data and benefit work, and for smaller schemes completing large data projects, such as GMP equalisation, can often appear both expensive and resource intensive relative to the size of the scheme," says Hathaway. "For these reasons, smaller schemes can see various benefits from operating a more streamlined process when transacting a bulk annuity, and this is something we have operated for many years."

Needham says that, despite the fundamental similarities with larger counterparts, 'nuances' must be considered. These, he explains, can include requirements with regards to the price lock given the type of assets they invest in, such as pooled funds.

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"This may require a different, more tailored approach to interacting with the sponsoring employer around areas like the data cleanse and move to buyout," says Needham. "Given current supply and demand dynamics in the market, we are aware that smaller schemes have had to restrict their approach to market in order to attract and engage insurers."

The outlook for 2025

Given the composition of the UK DB market – with smaller schemes making up the majority of the landscape – many expect smaller scheme deals to continue taking up the majority of buyout activity. Although the government has been looking at how DB schemes running a surplus could more easily 'run-on', proposing rules that make it easier to unlock surpluses for the benefit of the UK economy, Ward insists that buyout remains the "ultimate endgame" for many.

"Overall, we'd expect small schemes to continue to represent a high proportion of overall transaction numbers, but for scheme funding levels and transaction readiness, coupled with insurer capacity, to be bigger drivers for small scheme transaction numbers than larger scheme run-on decisions," she explains.

The government's interest in DB schemes running-on could continue to attract attention, but many expect smaller scheme trustees to look past this and keep their endgame goals in sight. Hathaway argues it is still too early to accurately predict how government proposals could influence such decisions but sees logic in schemes staying the course.

"We expect the recent government announcement will be a topical discussion point for many pension schemes, and, no doubt, attitudes to refunds before wind-up will depend very much on the criteria that are imposed, such as funding level and covenant strength," he says. "Whilst schemes may have a wider range of endgame options going forward, we expect that for the majority risk settlement will remain their goal, particularly at the smaller end where the rationale for running a scheme on will likely be less clear."

Regardless of how the government's plans impact smaller schemes' buyout intentions, Sagoo warns of the delicacy of such policies. She points out that the DB de-risking market is "the envy of the global insurance world" and trustees should not forget their members' goals.

"The government will need to think very carefully before drafting guidance or legislation that could disrupt the de-risking market," she adds. "The idea that shareholders would prefer companies to operate their DB schemes as independent profit centres is debatable. Managing the core business effectively poses significant challenges."

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