Summary
- The UK PRT market for DB schemes is currently febrile.
- There is little-to-no constraint in capacity.
- Governance and data remain at the forefront for schemes looking to make a transfer.

The buyout game

As DB pension scheme funding levels have generally improved over the past year or two, many of those seeking buyout have seen their journeys to wind-up accelerated. But how is the sector reacting to this increased demand and how can trustees best prepare their schemes for a smoother journey?

There have been tumultuous shifts in British life in recent years, usually predicated on the shifting of one administration to the other: Boris Johnson's turn in No. 10 gave way to the truncated stay of Liz Truss, who was followed just over 40 days later by Rishi Sunak. Sunak's stay in power came to its endgame in July when Keir Starmer took the keys to Downing Street.

Behind the scenes, while all this political jockeying has been going on, there have been massive shifts in the country's pension transfer market as an accelerating number of funds have moved towards obtaining buyouts through insurers.

LCP, writing in its *A Seismic Shift in Buy-Ins/Outs: How is the Market Adapting?* report last October, said: "[*Our*] analysis shows a sustained period of high demand over the next five years to 2028 as many schemes reach full funding on buyout and choose to insure. Estimates of transaction volumes over the next five years of up to £360 billion represent a substantial uptick from historic levels."

In a later paper, *LCP's Predictions for the Pension Risk Transfer Market in 2024*, the same company went further, predicting that volumes in 2024 would reach over £50 billion, which it said would make it 'another record year'.

It added: "The growing volumes will be driven by a greater number of £1 billion+ transactions. There have been at least 10 £1 billion+ transactions in 2023, exceeding the previous record of nine 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."

It is not only the number of transactions that has shifted, says WTW managing director of transactions, Shelly Beard, but also the individual size of those transfers. "Five or six years ago," she says, "the transactions were mostly pensions buy-ins. You might have gotten £300 million, which would have covered about 60 per cent of a scheme. And volumes were somewhere between £25 billion and £30 billion a year."

The environment has been febrile and is aptly summed up by Just director of commercial, Rob Mechem.

He says: "What we've seen over the past two to three years is that as interest rates have risen, funding has improved to a point where many schemes no longer need contributions and are now in a fully funded position, meaning that they can transact quite quickly. And from the perspective of the insurers, there's more appetite and ability to source assets on their side. So we have a situation where supply and demand are working well together, and circumstances in which one is not outstripping the other."

The Truss budget

Many of those spoken to by *Pensions Age* put much of the onus for the improved funding position and the resulting acceleration in buyouts on the Budget put forward by then-Prime Minister, Liz Truss, in September 2022.

"The rise in yields throughout 2022 and beyond," says XPS head of risk settlement, Stephen Purves, "really helped the majority of funds move closer to their eventual target. That really focused the minds of trustees and sponsors, and it means that the endgame for a scheme went from being 10 years into the future to now just being a couple of years away."

Many UK schemes are now carrying heavy surpluses. In May, the Pension Protection Fund said that this had increased between March and April from £455.5 billion to £458.3 billion. At the same time, UK DB schemes were holding assets of £1.398 trillion against liabilities of £939.7 billion. Meanwhile, the funding ratio for the 5,050 DB schemes in the index increased from 146.5 per cent at the end of March 2024 to 148.8 per cent in April. It was also reported that 4,545 schemes were in surplus, compared to 505 in deficit – an overwhelming ratio.

There is also little risk of deceleration, says Purves, citing the fall in the cost of annuities from the rise in interest rates. Those schemes that have not yet gone for buyout, he says, will still be looking to de-risk their assets so they can be positioned for a future transaction.

"Lots of them," he adds, "will have come out of equities and gone into something like corporate bonds and gilts, which will lock them into that position. If the scheme has been sensible, it will have locked into the upside and de-risked, putting them in place for a buyout."

There seems also to be little constraint in capacity. Pricing has reportedly been good and while there have been fewer insurers placing bids, those bids have remained strong. Against that backdrop, two – and, possibly, three – insurers are also set to enter the market this year.

"The insurers have been seeing it come for a long time," says Legal & General Retirement institutional head of execution and origination of UK PRT, Dominic Moret, "and they've been scaling up their teams in preparation. So that, along with the new entrants, means that we don't see any capital constraints in the market – any scheme that is looking to transact will be able to transact."

There are challenges, however, on the administrative side. This is the view of Mechem, who says that while there is no issue with the insurers coming to market, the work involved in a transfer means there is often a deficit of skills and knowledge to make this occur at the same pace as before.

Mechem adds: "Having the capacity to get to that place with the data and the administration is where we are seeing some challenges. It used to take 12 months to complete some transactions, but they are now at 18 months. And the stuff that used to take 18 months has now stretched out into two years."

"We have a situation where supply and demand are working well together, and circumstances in which one is not outstripping the other"

It may also be that some smaller schemes may find themselves squeezed amongst the larger players, says Beard. She says that the beginning of the year saw no constraints and heavy engagement, but she has since observed greater selection in the past two months from insurers.

"That," she says, "has affected the smaller end of the market because the amount of work being done is not that dissimilar between smaller and larger schemes. It just happens that the prize and profits are bigger with the larger schemes, so the smaller ones get a little crowded out."

Preparing for buyout

There is a mnemonic, says LGIM head of endgame solutions, Mat Webb, for schemes looking to prepare themselves for buyout: ABADGE. It stands for, he says, Affordability, Benefits, Assets, Data, Governance, and Engagement.

"That," he says, "is what we tell schemes."

Perhaps the three most-important aspects amongst them are data, governance, and assets.

Webb says: "When it comes to data, we work with administrators to provide clear, checked, and verified data that we know is reliable without any unnecessary risks. For governance, we look for schemes that have clear processes in place that the trustees have discussed with the sponsors, along with a clear process for making decisions. And we, when it comes to assets, ask schemes to work with investment managers to understand what might be attractive to insurers, and we can then help design portfolios that are more efficient for the transfer process."

PIC co-head of origination, Tom Seecharan, adds one more thing to the mix.

"You also need to think about what you want from the process," he says. "Price is important, but there are different commercial points that are important to schemes. So it's worth talking to stakeholders and making sure that they're all on the same page. If they're not, you don't want to find this out at the last minute."

While the market is a heightened, heated state, it might be easy to assume that executive a pension transfer is easy. But the important thing to remember, says Purves, is that it is a process that is not completed in a week.

"It can take months," he says, "and it's similar to buying a house when it comes to effort and negotiation. There are lots of things that can prevent the transaction from going ahead. You need to keep continually monitoring and keep the champagne on ice until everything is signed and sealed."

Written by Pete Carvill, a freelance journalist