Pension De-risking

Part 1 of 3
October 2022

Can the market insure £1 trillion of DB liability over the next decade?

pwc

Evolution of the pensions de-risking market

If you are a Trustee or a Sponsor considering the end-game of your defined benefit pension scheme, you're likely to secure better outcomes for your members by understanding the full range of options available.

Today, there are eight active insurers in the bulk annuity market, over ten providers offering reinsurance or longevity solutions, and several alternative capital providers, all with varying appetite and preferred deal size.

PwC's 3-part pension de-risking series covers:

Part 1: Evolution of the pensions de-risking market and what that means for end-game planning

Part 2: A closer look at the ever-expanding range of options available

Part 3: How to select and implement the right option for your situation

PwC's Funding Index showed that overall funding surpluses in summer 2022 were at the highest ever levels, leaving pension schemes better equipped than ever to target their de-risking objectives and exploit opportunities.

2005 – 2008: The start of de-risking and increased regulation

In 2005, the pensions industry saw the formation of The Pensions Regulator (**'**TPR**'**, replacing the Occupational Pensions Regulatory Authority), the Pension Protection Fund (**'**PPF**'**) and the introduction of reporting requirements on the accounting treatment of retirement benefits (FRS17).

The de-risking market was relatively small and undeveloped, mainly arising through M&A deals or insolvent sponsors through the PPF (and its predecessor the Financial Assistance Scheme). Improving longevity, falling bond yields and regulatory pressures were increasing defined benefit challenges and therefore the rising need for de-risking options.

Annual volume
up to £8bn

Number of insurers:
around 6

Other providers:
around 5 (mainly investment banks)

2008 – 2015: Financial crisis and increased demand

Despite the market volatility and uncertainty caused by the financial crisis, **by 2009 more insurance providers entered the market** of providing bulk annuity offerings with £8bn in bulk annuity activity that year.

At this time the volumes were still driven by insolvencies and corporate activity, exaggerated by the economic volatility of the financial crash. Pensioner buy-ins were becoming increasingly popular as a de-risking solution whereas, nowadays and depending on the circumstances, these might be seen as inefficient.

The first longevity swap deals were transacted, providing the **ability for the largest schemes to remove longevity risk.**

Annual volume
£5bn – £15bn

Number of insurers:
around 10

Other providers:
around 3-4 (mainly investment banks)

2015 – 2022: De-risking market continues to evolve

Pensions freedoms were implemented in 2015 giving savers more options on how to take their benefits. This resulted in a reduction in individual annuity sales. In addition, a new regulation was introduced for insurers called **Solvency II** which changed their pricing approach.

Market volumes continued to expand driven by increased competition amongst insurers and reinsurers, maturing schemes and the subsequent market focus on de-risking. This was **predominantly at first focused on pensioner buy-ins**. More recently we have seen **more full scheme transactions due to better commercial approaches and increased funding levels.**

At the same time, **capital-backed solutions and consolidators continue to drive market evolution.**

Annual volume
£10bn – £40bn

Number of insurers:
around 8

Other providers: more than 6 entering the market post-2020 (mainly capital-backed solutions)

What level of annual volume will the market demand in future, and will supply keep up?

Future of de-risking: better strategies

The challenges ahead

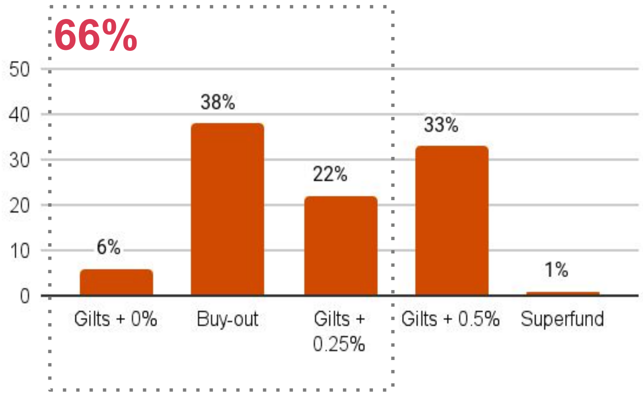
PwC's 2022 funding survey found that two-thirds of DB schemes are targeting a long-term objective with a discount rate of gilts+0.25% pa or tougher. This is a target consistent with insurance buyout cost.

Survey also indicated that 80% of schemes expect to reach their long-term funding target within a decade.

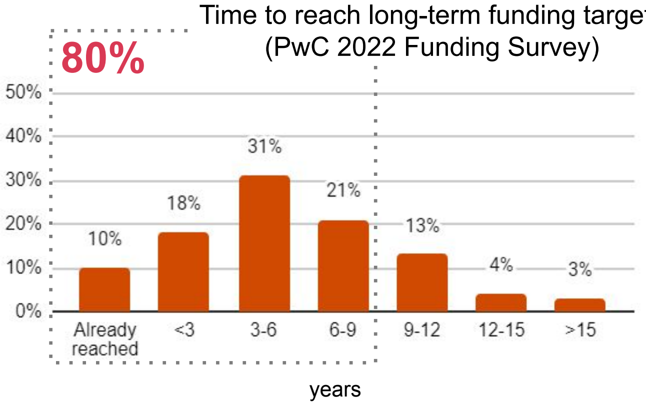
This suggests over £1 trillion of assets, in respect of more than 2,500 schemes, might want to buyout at some point in the foreseeable future.

Although possible, we believe this is unlikely in a market of finite capacity, where new entrants are infrequent, and appropriate assets to back deals are hard to find.

Long-term funding targets
(PwC 2022 Funding Survey)



Time to reach long-term funding targets
(PwC 2022 Funding Survey)



To put it into some historical perspective, since 2010, the UK market has completed transactions totalling around £200bn. In 2022, we may see £50bn of deal volume.

This highlights the potential bottleneck that is developing. Trustees and sponsors should be aware that, while they might want to and even be ready to buy out, it might not happen.

How can trustees and sponsors look to mitigate the risks of being squeezed out of the market?

Schemes close to buyout	Schemes close to buyout now should act with urgency and 'get in the queue'	• Engage with bulk annuity providers early • Be transaction ready, show conviction, build provider confidence
Schemes a long way off buyout	Schemes less well funded are expected to find themselves in an ultra-competitive buyout market, and are likely running more investment and longevity risk than others	• Re-test buyout as the primary long-term goal • Be inquisitive about alternative solutions, in particular, the use of third-party capital to underwrite journey plan risk • Assess appropriateness of consolidators • If better funded than expected, investigate possibility of buyout now as more insurers quote for 'deferred heavy' deals
Smaller schemes	We expect market to become less attracted to smaller deals as a greater number of larger schemes reach buyout	• Consider possibility of accessing cash now to buyout whilst providers are interested • Explore ways to scale up and generate economies of scale, eg DB master trust • Be smart about go-to-market timing

How PwC can help your de-risking plans

PwC’s Pensions Risk Transfer team is a group of dedicated specialists. We focus on ensuring member benefits are secured optimally, while meeting overall Trustee and Sponsor objectives. We advise trustees and sponsors of schemes ranging from £20m to £90bn in size, with lead advisers experienced in particular segments of the market.

A leading deals advisory practice

We bring the latest techniques and market understanding to the deal process. Too many deals languish because stakeholders and advisers have not thought through all the issues. Witness the number of buy-ins which have not progressed to full buy-out yet because of data challenges, which could have been identified and solved earlier. PwC has the UK’s leading deals advisory practice, well networked across all the full range of market participants.

Skills and experience

We have the skills and experience required to secure the best deal for members, trustees and sponsors. This includes FCA-approved insurance industry specialists who can give you comfort about the counterparty you are dealing with, as well as seasoned finance experts who can ensure a cost-effective deal which leads to better member benefits and outcomes. We have one of the world’s largest asset and wealth management practices with specialists who can optimise your asset strategy in the run-up to and during a transaction.

Bespoke deals

We specialise in bespoke deals, particularly when there are special features involved. Over the last year we completed several smaller “deferred heavy” deals, with a large proportion of non-pensioner members - securing the whole liability in one go. We also tackle special situations where there are legal anomalies, for example.

Innovative solutions

We have a reputation for bringing innovative solutions to trustees and sponsors who need to find a different way to get their deal done because of situation-specific challengers and blockers. This includes the market for consolidators, captives and solutions backed by third-party capital. We are one of the PPF’s panel of lead transaction advisers for PPF+ cases - they recognise the value in managing deals as a commercial process and not just an actuarial adviser led exercise.

Strategic advice

We are “journey plan” and strategy advisers to a range of trustees, sponsors and joint working groups, across the whole client spectrum spanning schemes of various sizes; FTSE100/multinationals and family companies. This gives us the context and experience to know when and how a commercial risk transaction fits within a well-run strategy.

Independence

We are uniquely independent of market solutions such as fiduciary management, administration, master trust and insurance brokerage. So clients know they will get advice which is free of conflicts, and with their best interests in mind, covering all market options without any limitation or blindspots. We are experts in oversight and review of such services, so can help you make the best decision in relation to your overall strategy, and choice of providers.

We act with pace

Some processes stall because incumbent advisers and administrators have a disincentive to act quickly. We bring pace and progress to the deal process. We can also, if appropriate, structure our fees to reward timely completion. We deploy best-in-class technology, such as PwC Insure, to accelerate timelines and manage costs.

“Through a clear strategy and collaborative approach with the Company through the joint working group, advised by PwC UK, we have managed to secure the buy-in much earlier and at a much lower cost than expected. I would like to put on record as well, how impressed I have been with the PwC team. The team have done a brilliant job of making sure that everything is kept on track and that we were in the position to be able to do a deal.”

Becky Wood, 2020 Trustees

“PwC’s understanding and approach to navigating the complex challenges associated with PPF+ cases demonstrated to us that they could deliver what we needed, and achieve the very high standards we expect of our specialist panellist firms. The PwC team demonstrated that they care deeply about relationships, can present excellent and innovative ideas, and genuinely care about the work they undertake in the pensions risk transfer area.”

Dan Collins, Pensions Protection Fund

Contact details

Swapnil Katkar
Pensions risk deals leader
T: +44 (0)7483 333021
E: swapnil.katkar@pwc.com

Raj Mody
Trustee services leader
T: +44 (0)7974 969320
E: raj.mody@pwc.com

Pete Sparshott
Data and administration
T:+44 (0)7841 563503
E: peter.x.sparshott@pwc.com

Jani Singh
Bulk annuities
T:+44 (0)7525 283107
E: jani.singh@pwc.com

Matthew Cooper
Alternative endgame solutions
T: +44 (0)7841 492483
E: matthew.l.cooper@pwc.com

Liz Ramsaran
Legal & Governance
T: +44 (0)7483 399693
E: elizabeth.ramsaran@pwc.com

Keira-Marie Ramnath
Fiduciary management oversight
T: +44 (0)7710 036915
E: keira-marie.ramnath@pwc.com

Mike Kippax
Longevity solutions
T:+44 (0)7711 562202
E: michael.j.kippax@pwc.com