HYMANS ROBERTSON

Buy-in monitoring service

Comprehensive analysis of the buy-in market - February 2018

Headlines

Pensioner buy-in pricing improving

Buy-in pricing improved over the final quarter of 2017, with prices in many cases being over 5% lower than the value of the equivalent gilt liabilities. **See our "Buy-in pricing" section for more details.**

Insurer competition and asset opportunities driving attractive pricing

With the entrance of Phoenix Life, there are now eight insurers in the buy-in market with each looking to grow their business. This highly competitive market is good news for pension schemes as it will help maintain attractive pricing and meet increasing demand from schemes. We anticipate another new entrant over the next 12 months.

In addition, insurers are improving their capabilities to source bespoke, higher yielding assets. In many cases these are long term illiquid assets which are leading to particularly attractive pricing at younger pensioner ages.

2018 set to be record breaking year for buy-in and buy-out transactions

A combination of high demand from pension schemes to de-risk and a healthy appetite from insurers to complete transactions is predicted to make 2018 a bumper year for bulk annuity deals. We predict total bulk annuity transactions will exceed £15bn for the first time ever.

2017 was a busy year, with lots of small and mid-sized transactions and many other schemes approaching the buy-in market with transactions due to complete in early 2018. As well as quantity of deals we anticipate a number of larger transactions will also take place in 2018, including some back book activity as Prudential look to sell their significant historic annuity book.

Well prepared schemes benefit as insurers manage large volumes

The surge in demand from pension schemes provides both opportunities and new challenges for insurers which trustees should consider. Insurers need to manage their own resources and well prepared schemes with a clear strategy, straightforward approach and realistic target price in mind will be favoured by insurers.

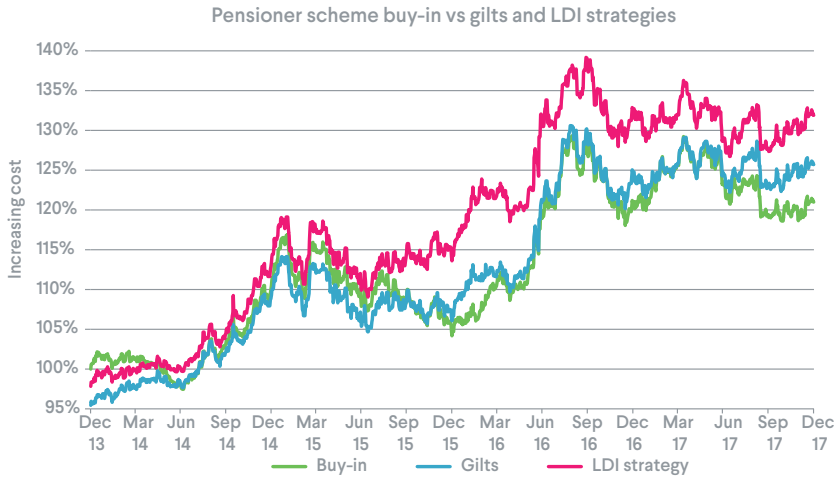
Approaching the market early is key. This gives schemes time to ride out waves of insurer busyness and if necessary engage in a collaborative price monitoring process until their objectives are met.

Buy-in pricing

A buy-in policy insures against all risks associated with a subset of pensioner liabilities. When considering whether to undertake a buy-in, pricing is best assessed against returns on other very low risk assets.

Pensioner buy-in pricing

The chart below plots the relative cost of hedging pensioner liabilities with a buy-in policy, a portfolio of gilts, or a swaps and cash based LDI strategy.

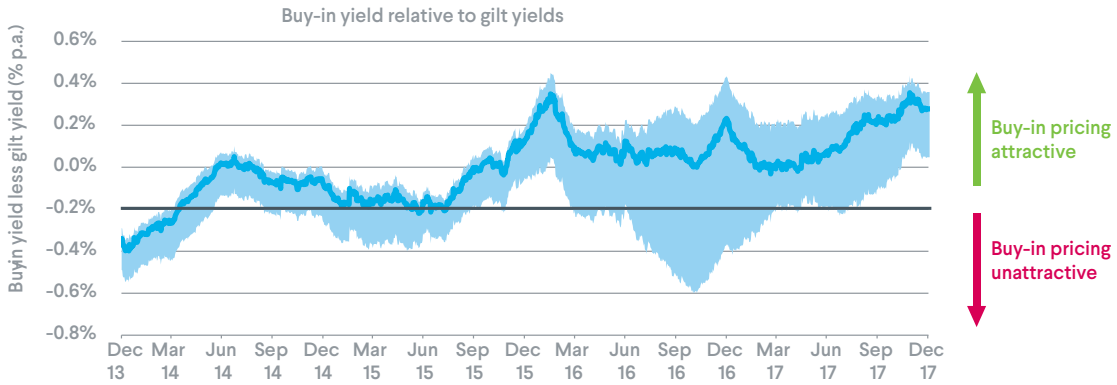


Pricing analysis

Falls in yields over the quarter increased the nominal price of buy-in. Average pricing improved over the final quarter of 2017 and remains cheaper than the value of gilts needed to match the same liabilities (the green line is below the blue line in the above chart). This means that schemes can exchange gilts for a buy-in policy, maintaining the return on the asset portfolio, obtaining a better cashflow matching asset and addressing demographic risks.

Buy-in yield analysis

Although tailored to meet the benefits of a subset of members, a buy-in contract remains an asset of the scheme. In assessing the attractiveness of a buy-in, it is useful to understand the investment return (yield) implied by the price.



The chart above shows the yield locked in to based on typical buy-in pricing. This analysis varies between schemes depending on particular views over members' life expectancies. A buy-in yield of 0.1% p.a. to 0.2% p.a. below gilt yields might be viewed as a "fair" price to pay, given the reduction in longevity risk, other demographic risks and level of cashflow matching achieved.

Average pricing, compared to gilt yields, improved over the quarter. Pricing is currently as attractive as we've seen in recent years and competitive tension between insurers is likely to lead to this continuing during 2018.

Hymans Robertson's online 3D Analytics tools allow trustees and sponsors to track buy-in pricing and yield analysis tailored specifically to their individual scheme population.

Buy-out affordability

The chart below shows progress towards full buy-out funding for pension schemes at different stages in their de-risking journey.

Affordability analysis

Most schemes will find that buy-out is more affordable than it was at the start of 2017.

Strong equity returns in particular will have helped improve the funding position of schemes with high growth asset exposures.

Improvements in funding level of the order of 10% may have seen some schemes hit de-risking triggers and allowed them to "lock-in" to equity gains. Schemes quick to act and those with a high allocation to protection assets will have fared better given falls in global stock markets so far in early 2018.

Buy-in insights

Insurance regime protections

When completing a buy-in or buy-out trustees will need to be comfortable with the protections offered in the insurance regime. In this edition of buy-in insights we summarise these protections.

Protection	Description
Low risk asset investment	Insurers are required to invest in low risk bond like assets which closely match the benefit payments they are backing.
Regulatory capital	Solvency II requires insurers to hold reserves against a 1 in 200 year risk as a minimum.
Additional capital	Insurers are likely to hold additional capital in excess of this minimum giving extra security.
Support from insurance group	The insurance entity underwriting the bulk annuity transaction will often be supported by a larger insurance group which is able to provide additional capital if required.
PRA regulation	The PRA closely monitor financial strength and future plans of insurers. The PRA has the power to place restrictions on insurers to aid security for current policyholders e.g. trustees.
Financial Services Compensation Scheme ("FSCS")	The FSCS covers 100% of benefits in the event that all previous layers of protection fail (this has never before been the case)

Buy-in contact

If you would like to discuss this quarterly update in more detail please contact your usual Hymans Robertson contact or:

James Mullins
Partner
Head of Risk Transfer Solutions
T 0121 210 4379
E james.mullins@hymans.co.uk

Richard Wellard
Partner
Risk Transfer Specialist
T 0121 210 4355
E richard.wellard@hymans.co.uk

Michael Abramson
Partner
Risk Transfer Specialist
T 020 7082 6155
E michael.abramson@hymans.co.uk

Clive Fortes
Partner
Risk Transfer Specialist
T 020 7082 6235
E clive.fortes@hymans.co.uk

Eddie McAuley
Partner
Risk Transfer Specialist
T 0141 566 7792
E eddie.mcauley@hymans.co.uk

Christine Cumming
Risk Transfer Specialist
T 0141 566 7943
E christine.cumming@hymans.co.uk

Iain Pearce
Risk Transfer Specialist
T 0121 210 4358
E iain.pearce@hymans.co.uk

Freya Williams
Risk Transfer Specialist
T 0121 210 4346
E freya.williams@hymans.co.uk

Kieran Mistry
Risk Transfer Specialist
T 0121 210 4338
E kieran.mistry@hymans.co.uk

Baljit Khatra
Risk Transfer Specialist
T 0121 210 4344
E baljit.khatra@hymans.co.uk

Harry Allen
Risk Transfer Specialist
T 0121 210 4365
E harry.allen@hymans.co.uk