HYMANS ROBERTSON

Buy-in monitoring service

Comprehensive analysis of the buy-in market - July 2017

Headlines

Pensioner buy-in pricing continues to be cheaper than gilts

Buy-in pricing has improved over the second quarter of 2017 and schemes continue to be able to complete a buy-in for less than the value of gilts that would be required to back the same pensioner liabilities. **See our "Buy-in pricing" section for more details.**

Buy-in business expected to accelerate in the second half of 2017 following slower start to the year and a new entrant

Bulk annuity business completed in the first half of 2017 was in the region of £4bn-£5bn. Activity has increased since the first quarter but this remains lower than most insurers had budgeted for. This means we expect insurers to offer some attractive pricing towards the end of 2017, to help them reach their target deal volumes for the year.

In addition, Phoenix Life have now entered the buy-in market. The increased competition over the second half of the year could create some attractive pricing opportunities for those schemes that have already identified buy-in as part of their strategy and are well positioned to transact. There are now eight insurers in the buy-in market with each looking to grow their business, although at different rates. This is good news for pension schemes as it will help maintain a competitive market and also provide extra capacity to meet what we expect will be a steep rise in demand from pension schemes for buy-in and buy-out over the next 5 years. **See our "Buy-in insights" section for a summary of the DB bulk annuity size appetite for each of the eight insurers**.

Wide range of buy-in pricing between insurers

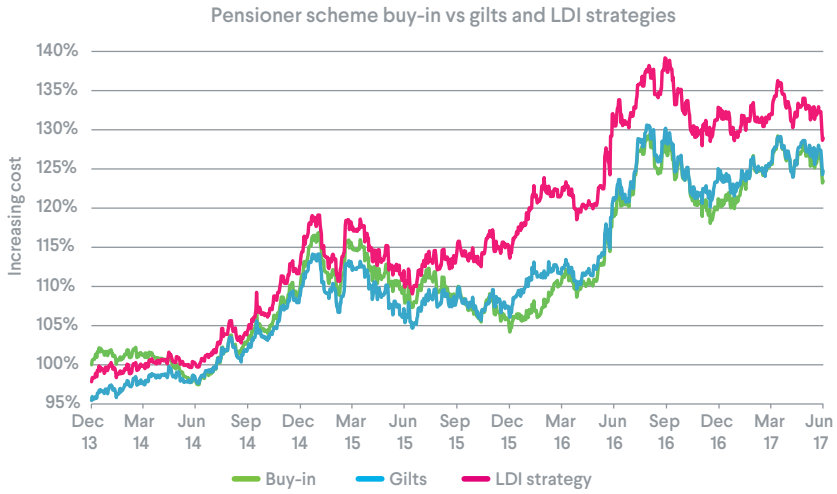
One of the implications of Solvency II has been that insurers' pricing is much more sensitive to the specific assets they will use in their reserves to back a particular transaction. This is driving a wider range of buy-in pricing than we typically saw before the introduction of Solvency II and prices on specific transactions can shift materially as different assets become available. This means that it is more important than ever for pension schemes to have accurate benefit data loaded onto the insurers' systems, as this gives them the clearest possible picture of the best price available at any time and gives them the opportunity to capture pricing improvements as they become available.

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 policy, 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.

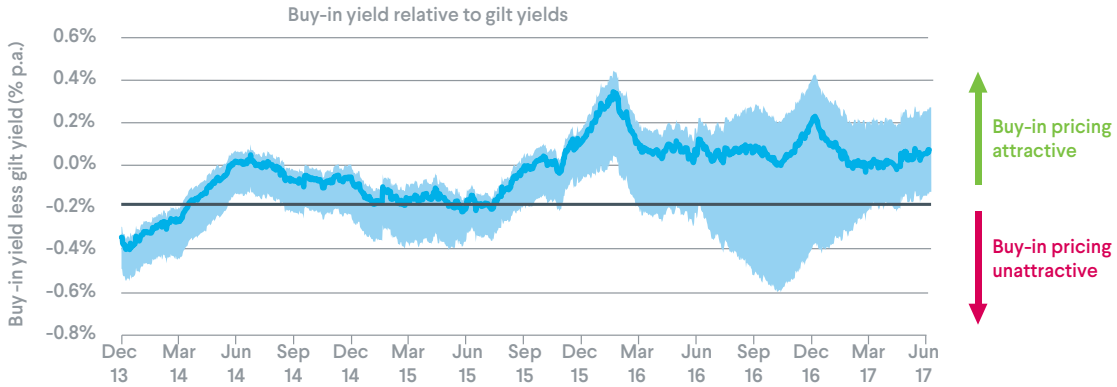


Pricing analysis

Yields fell slightly in April which increased the nominal price of buy-in, however this was reversed over the quarter when yields bounced back. Average pricing is cheaper than the value of gilts needed to match the same liabilities (the green line is just below the blue line in the above chart). This means that schemes can swap 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 remained attractive and, compared to gilt yields, improved over the quarter. It's quite possible that eagerness of the insurers to complete deals will see further improvements later in the year.

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

The past year or so has been volatile for financial markets and pension scheme funding. Despite this volatility, most schemes will find that buy-out is more affordable than 12 months ago.

The journey will have been more stable for those well hedged to interest movements through an income or protection based strategy. Strong equity returns and a bounce back in yields more recently will have helped improve the funding position of schemes with high growth asset exposures.

On average, schemes following income or growth based strategies will have fared best over the past 12 months. Improvements in funding levels of the order of 10% may have seen some schemes hit de-risking triggers and allowed them to "lock-in" to equity gains.

Buy-in insights

Competition and appetite

Every year we provide an update on the insurers in the bulk annuity market and their particular focus in terms of size of transaction. Last year we predicted that we might see another new entrant joining the market. Phoenix Life have now entered bringing the number of providers up to eight. Pheonix have actually completed one buy-in already – this was a transaction with their own pension scheme.

Given the anticipated growth in demand from DB pension schemes, we expect at least one more new entrant over the next 12 months.

	<£50m	£50m - £100m	£100m - £500m[1]	>£500m
Aviva	Target market	Target market	Target market	More selective
Canada Life	Target market	Target market	Target market	Unlikely to quote
Just	Target market	Target market	Target market / More selective	Unlikely to quote
Legal & General	More selective	Target market	Target market	Target market
Phoenix	Unlikely to quote	Unlikely to quote	More selective / Target market	Target market
PIC	More selective	Target market	Target market	Target market
Rothesay Life	Unlikely to quote	Unlikely to quote	Target market	Target market
Scottish Widows	Unlikely to quote	Target market	Target market	More selective

Target market More selective Unlikely to quote

[1]The £100m - £500m band has been split further for Just and Phoenix Life to show differing appetites for transactions under/over £250m

Although different insurers target different transaction sizes, there is competitive tension across the market. Insurers often consider individual transactions on merit, even those outside of their "target market".

Trustees will experience increased competition and ultimately better pricing by making their transaction attractive to as many insurers as possible. To help achieve this, trustees should set their objectives and then design a structure that is most appealing to the insurance market whilst meeting their aims.

Buy-in contact

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

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