JLT Employee Benefits

LET'S TALK

UK BULK ANNUITY MARKET: ARE RECENT CHANGES A CAUSE FOR CONCERN?

Recent market developments

August 2013 saw two significant announcements in the UK bulk annuity market:

- L&G completed its acquisition of Lucida; and
- Goldman Sachs put its majority stake in Rothesay Life up for sale.

What's going on?

The Lucida acquisition follows its closure to new business in November 2012 after failing to raise additional capital.

Goldman Sachs's announcement is not the first move by the banking sector away from pension risk insurance: 2012 saw Credit Suisse withdraw from the longevity swap market (despite substantial past deals for ITV and Babcock International) and UBS and Nomura decide not to enter the buyout market.

These developments are due in part to more onerous capital requirements under Basel III; in particular on the types of investment used to back long-dated pension liabilities. Initial interest in Rothesay Life is from private equity groups, which are subject to lighter regulation. There are other factors too, not least the opportunity for Goldman Sachs to realise a return on its capital.

Does it matter?

In one sense, no...

- **Lucida** really only traded with two schemes; its integration with L&G should enhance L&G's teams and offering.
- **Rothesay Life** is still very much open for business. It raised £100m of capital in February 2013 and has completed two large deals in recent months: a £280m buy-in for Cobham Pension Plan and a £440m buyout for InterContinental Hotels UK Pension Plan.

  If acquired by a private backer, it should remain as a player in the larger end of the market (for deals of over £50m). If not, there is one less player for the larger deals.

But... we are at a point where another exit could create nervousness amongst pension scheme trustees and sponsors in terms of whether the market is truly competitive; although both can take comfort from the fact that if the price is too high then no-one will transact.

Should we expect an imminent capacity crunch?

The main danger is that the reduction in players brings with it a bottleneck in terms of the remaining players' ability to produce quotations and engage in a buy-in/buyout process.

To mitigate this, it is more important than ever that schemes prepare well in order to gain maximum traction with the insurers and ensure quotations are received by most of those playing for that size of deal. They should take steps to:

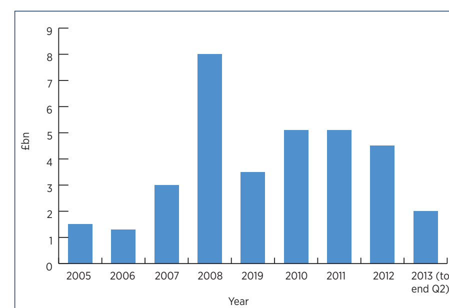
- Cleanse data and agree a benefit specification;
- Agree and monitor affordability triggers with the scheme sponsor; and
- Appoint an experienced adviser with a robust process and a good conversion rate.

JLT's Buy-inSure proposition provides one such solution for schemes with £5-60m of pensioner liabilities.

Smaller schemes can also benefit from new entrants into the bulk annuity market; Partnership Assurance and Just Retirement (individual enhanced annuity specialists) joined the party last year. This pre-empted the growth of a market in medically underwritten bulk annuities for up to 300 members.

What about the longer term?

For schemes with fewer than 5,000 members, there are potentially another £450bn* of liabilities heading for buyout at some stage. This compares with buyout transaction volumes of up to £8bn p.a. over the last ten years (see chart).



Source: JLT Buyout Market Watch

Even if there's currently spare capacity in the market, it looks unlikely that all these liabilities could be insured over the next 15-20 years. We challenge the idea that trustees will always be able to transact a buy-in/buyout when market conditions are favourable; they may struggle even to get a quotation. Again, well-prepared trustees advised by firms with strong insurer relations and proven track records should be at the front of the queue.

*Estimated based on the Pension Protection Fund's Purple Book 2012.

This Let's Talk does not constitute advice.

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