HYMANS ROBERTSON

Buy-in monitoring service

Comprehensive analysis of the buy-in market - August 2020

Headlines

Window of opportunity closes, but general pricing levels remain good value
As credit spreads narrow back down, the pockets of particularly attractive buy-in pricing seen over March and April have fallen away. Although this window of opportunity has closed, pricing for pensioner buy-ins remains good value and as attractive as it has been since the middle of 2018.

With different economies implementing their paths out of lockdown, companies will be continually reforecasting their business models and assessing their needs – further volatility in the credit markets is a distinct possibility.

Pension schemes that have clear pricing targets, have their data and benefits loaded onto insurers' pricing systems and have the approvals in place to transact, will be in prime position to benefit from future pricing opportunities.

Entering a period of varied and fluctuating insurer appetite
As we approach the fourth quarter of 2020, the buy-in pricing pension schemes will see is likely to be significantly influenced by supply-side factors at the insurers. 2020 will undoubtedly see lower transaction volumes than 2019, but with volumes expected to be around 2018 levels (which was itself a record year), insurers will still be expecting a significant flow of business in the market.

Going into Q4, some insurers will be very comfortable with the business they have written over the year and their projected future pipeline, whilst some will be keen to write more before the year end. With some large transactions in the market at the moment, the appetites of different insurers has the potential to change quickly and to vary significantly between insurers. Pension schemes will have to look carefully at the quotes they are receiving and assess whether their pricing is being negatively impacted by other activity in the market, or whether they have an opportunity to transact with an insurer who is particularly keen. Knowledge of what the market looks like through the eyes of different insurers is going to help trustees make the best decisions in a period of fluctuating insurer appetite.

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Buy-in pricing

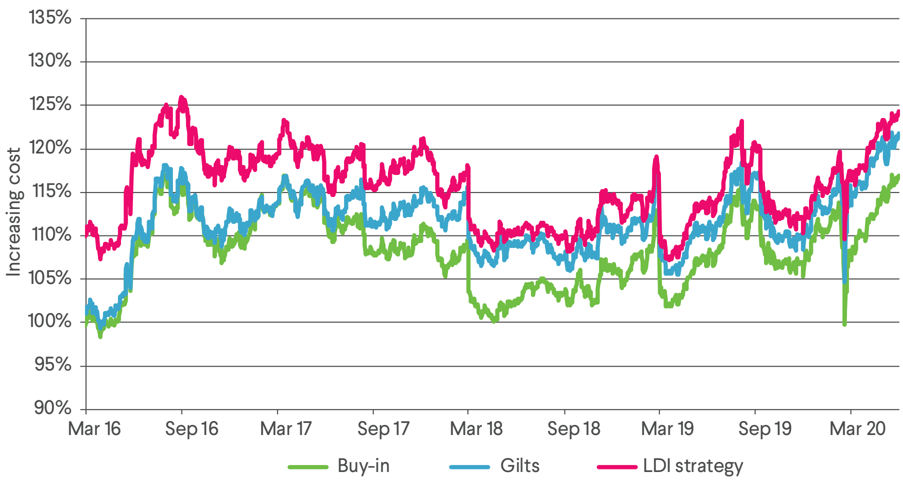
A buy-in policy insures against all risks associated with a subset of pensioner liabilities. When considering whether to undertake a buy-in, pricing is best assessed against returns on other very low risk assets.

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

Pensioner scheme buy-in vs gilts and LDI strategies

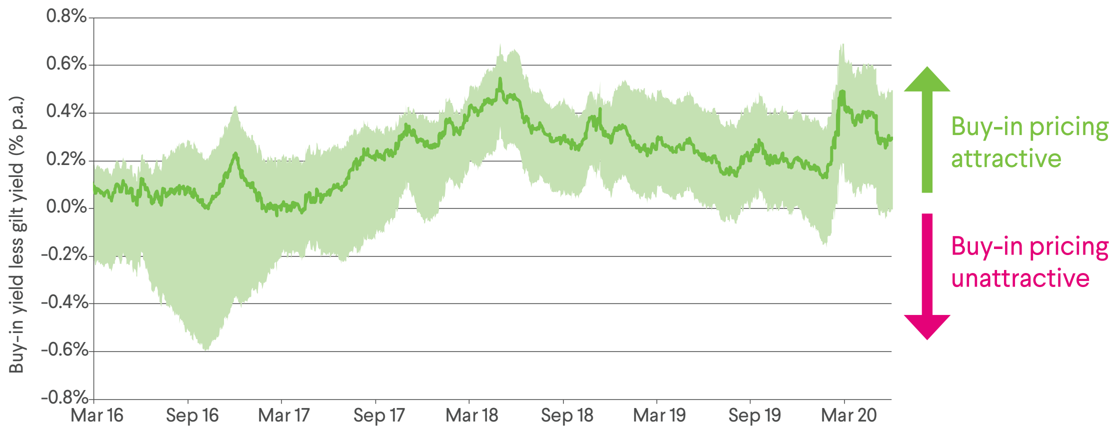


For those schemes able to secure attractive terms, average pricing remains cheaper than the value of gilts needed to match the same liabilities (the green line is below the blue line in the above chart). This means that schemes can exchange gilts for a buy-in policy, maintaining or improving the return on the overall 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.

Buy-in yield relative to gilt yields



The chart above shows the yield locked into based on typical buy-in pricing. This analysis varies depending on the schemes' characteristics and views over members' life expectancies; this variation is reflected on the chart, with the solid green line the position for the "typical" scheme.

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.

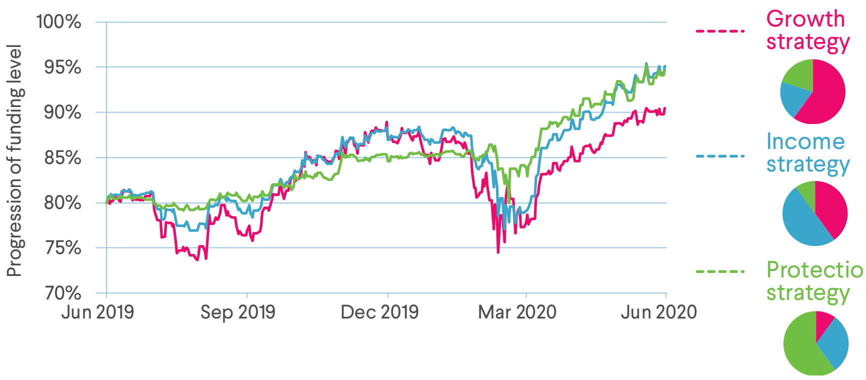
Hyman Robertson's online 3D Analytics tools allow trustees and sponsors to track buy-in pricing and yield analysis tailored specifically to their individual scheme population

Buy-out affordability

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

Buy-out affordability for different investment strategies

Affordability analysis



Schemes will have seen significant volatility in their buy-out funding level so far in 2020. Over the most recent quarter, most schemes will have seen a material improvement in their buy-out funding level as assets recovered from the lows seen in late March.

Buy-in contact

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Changes in buy-in and buy-out premiums shown are based on the cost of securing the same set of future benefit payments at each point in time.

Different insurers price buy-in differently and their prices will change relative to each other over time. The data in this quarterly buy-in monitoring service shows general trends in pricing.