The de-risking journeys of large DB pension schemes

Large DB pension scheme survey 2024

A Cebr report for Legal & General

Foreword

Insurance at scale is achievable – and is happening now. In 2023 around £50 billion of retirement income was secured with insurance companies through pension buy-ins and buyouts. This record-breaking volume included several of the largest transactions in the history of the market.

We are continuing to see demand for buy-ins and buyouts increase, including from very large pension schemes. To understand this better, we worked with the experts at the Centre of Economics and Business Research (Cebr) to conduct a targeted survey of some of the UK's largest defined benefit (DB) pension schemes.

This research provides a valuable window into a moment of great change and opportunity for large pension schemes as they look to the future of providing security in retirement for their members.

Insurance at scale is achievable – and is happening now.

Foreward
continued

More than half of respondents plan to use insurance as part of their endgame objectives, with over a third specifically aiming for full buyout, underscoring the recognition of the stability and security that insurance offers.

Since our last survey of large DB schemes in 2015, the landscape has changed significantly. Nine years ago, the market had completed only seven transactions over £1 billion, and since then there have been more than forty. At that time, just 11% of large schemes were aiming for full buyout. Historically, there was a segment of the market that was sometimes considered to be too large to buyout. This survey reflects how that past belief is changing and how our industry is capable of operating at this large scale.

As we look forward it seems clear that we will witness not just a landmark period for the buy-in and buyout market, but a transformed landscape for UK pensions in general.

We recognise the responsibility that such a trend places on insurers. Pensions are at the heart of Legal & General and we've been at the centre of the buy-in and buyout market for almost 40 years. Alongside our colleagues in LGIM, our in house asset manager, we look forward to supporting many more pension schemes on their de-risking journeys, and helping to secure and protect their members' retirement income.

Andrew Kail
CEO of Legal & General Retirement Institutional

Winner 2023

BRITAIN'S MOST ADMIRED COMPANIES
2023 OVERALL WINNER

Methodology

Cebr was commissioned by Legal & General to conduct the survey. As part of this report, Cebr and Legal & General jointly developed and approved all questions included in the survey. Cebr was responsible for producing the survey and managing the data collection process, while Legal & General provided the survey link to potential participants.

Cebr surveyed 40 pension schemes, with an average scheme size of £9 billion, who are collectively responsible for over £360 billion of assets under management. They received 13 responses. All responses to the survey were anonymised. The survey accepted responses between 31st October and 30th November 2023.

The consequential aggregation of the survey data has been undertaken by Cebr. Legal & General provides the commentary that follows in each section. For some questions, the results in this report are contrasted against a comparable survey undertaken by Legal & General in 2015.

Due to rounding, percentages may not always appear to add up to 100%.

Executive Summary

Long term objectives

- **53%** of respondents plan to implement a buy-in or buyout. **38%** are aiming for full buyout, which was the most common long-term objective amongst respondents. A further **15%** are planning to implement a buy-in as part of their de-risking objectives.
- In 2015 Legal & General led a similar analysis which reported that only **11%** of large schemes were targeting full buyout. This represents a significant shift for large schemes who may have previously considered themselves too large for the insurance market.
- For those we surveyed, the **size of deficit** is now the **lowest ranking employer concern** in our study. In 2015, cash contributions and the size of deficit ranked highest. **The security of members' benefits** has moved up the agenda for respondents, ranking third in comparison to fifth.
- All the schemes that cited buyout as their long-term objective are aiming to complete a transaction **within the next 3 years**. This underlines the importance of pension schemes engaging early with advisers and insurers to achieve their objectives within their preferred timeframe.
- With the survey highlighting **administrator capacity** as a potential barrier to engaging with insurers, investment in administration and customer care services across the DB pension landscape – from technology to people – will be fundamental to achieving the best long-term outcomes.

Investment strategy

- The survey shows respondents are **increasing allocations** to government bonds and Liability Driven Investment (LDI), corporate bonds and cashflow generative assets. This clearly indicates a shift towards schemes preparing for their endgame and thinking about how to invest like an insurer, which can be useful in the context of either run-on or buyout.
- **75%** of the schemes surveyed said they were **decreasing allocations** to illiquid assets. Many schemes are now finding that they have reached full buyout funding earlier than expected but still have a significant illiquid asset holding. We have seen innovation in both investment strategies and insurance solutions to support schemes in this position.
- **46%** of respondents said that they had either already implemented or were currently investigating an investment strategy to target buyout, with a further **15%** considering it as a potential future strategy. There is a significant group of well-funded large schemes that are keen to 'run-on' for now, while keeping buyout in mind over a longer-term horizon.

Insurance solutions

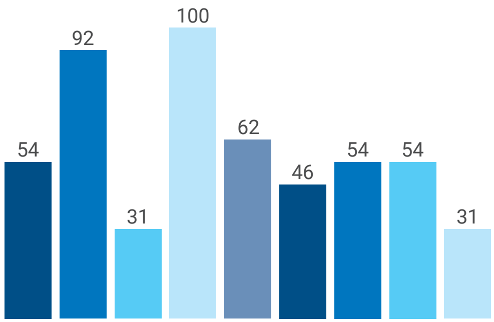
- The schemes we surveyed cited **financial strength** as the most important factor when selecting an insurance provider, reflecting the focus on the long-term security of members' benefits. Beyond price, other factors such as track record, customer service capability, and brand will typically form part of the value consideration – particularly for schemes with larger memberships.
- **76%** of schemes surveyed are monitoring their buyout funding level on a quarterly basis. Larger schemes often require additional focus given their scale. We are increasingly seeing schemes partner with a single insurer to work through any complexities. In this model, both parties can benefit from greater execution certainty and the ability to work dynamically to take advantage of pricing opportunities when they arise.
- **92%** of respondents said that the responsibility for driving an insurance led exercise would be **jointly** shared between the **trustee** and **sponsoring employer**. Joint working groups can help to agree a framework for governance processes and clear decision making up front. Our view is that when all parties actively engage with the process, these frameworks can help to align objectives and support a much smoother journey for all parties.

Long-term objectives

What is the long-term objective of your scheme?

- **23%** – Low dependency without insurance
- **15%** – Low dependency with buy-in
- **38%** – Buyout
- **23%** – Undecided or unspecified
- **0%** – Low dependency-longevity insurance
- **0%** – Capital backed solutions

What preparatory steps has your scheme taken to help you achieve your long term de-risking objectives? (Please select all that apply)



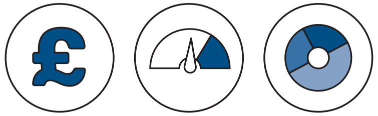
- **54%** – Member address tracing
- **92%** – Implemented LDI investment strategy
- **31%** – Data and benefit audit
- **100%** – GMP reconciliation exercise
- **62%** – Asset transitioning
- **46%** – Marital survey
- **54%** – GMP Equalisation
- **54%** – Establish joint working group
- **31%** – Other (responses included implementing an umbrella contract, member options exercise, longevity hedge and data cleanse)

More than half of the schemes surveyed plan to use insurance as part of their endgame objectives.

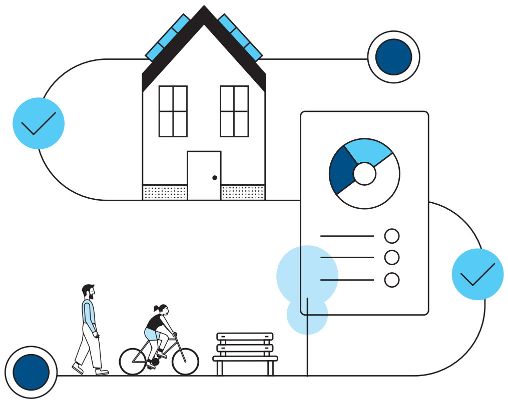
Every respondent has undertaken GMP reconciliation.

Long-term objectives
continued

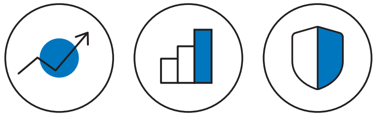
What are the main barriers to achieving objectives: most and least important factors (Ranked in order of importance, where 1 equals most important)



1. Affordability
2. Administrator capacity
3. Investment risk
4. De-risking and/or liquidating the current asset portfolio
5. Insurance market capacity
6. Governance/Trustee and Employer agreement
7. Trustee capacity

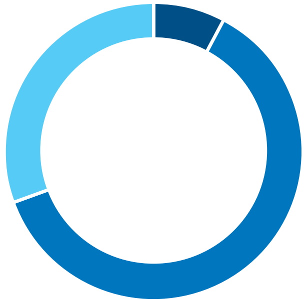


What are the highest and lowest employer concerns? (Ranked in order of importance, where 1 equals most important)



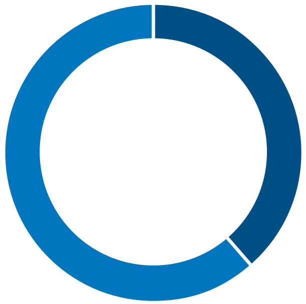
1. Balance sheet stability
2. Cash contributions – size
3. Security of members' benefits
4. Cash contributions – stability
5. P&L cost
6. Size of deficit

Do you have an agreed approach to sharing any surplus?



- 8% – Yes, to be used to improve member benefits
- 62% – No, an agreement needs to be reached
- 31% – Not yet considered
- 0% – Yes, to be used to support a DC or other DB pension plan
- 0% – Yes, to be returned to the sponsor
- 0% – Yes, to be shared between a combination of the above

Have you received a quote from an insurer for any de-risking insurance solution (buy-in, buyout, longevity insurance), and what was the outcome?

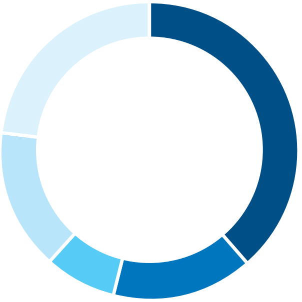


- 38% – Yes, went ahead
- 62% – No
- 0% – Yes, did not proceed

Long-term objectives
continued

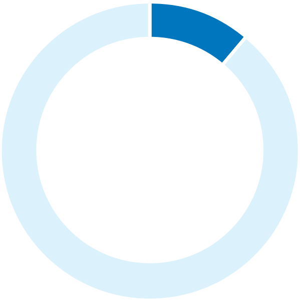
What is your time horizon for implementing insurance?

Bulk annuity



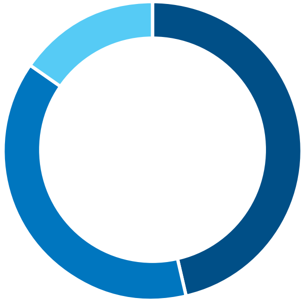
- 38% – 0 to 3 years
- 15% – 3 to 5 years
- 8% – 5 to 10 years
- 15% – 10 years+
- 23% – Not implementing

Longevity insurance

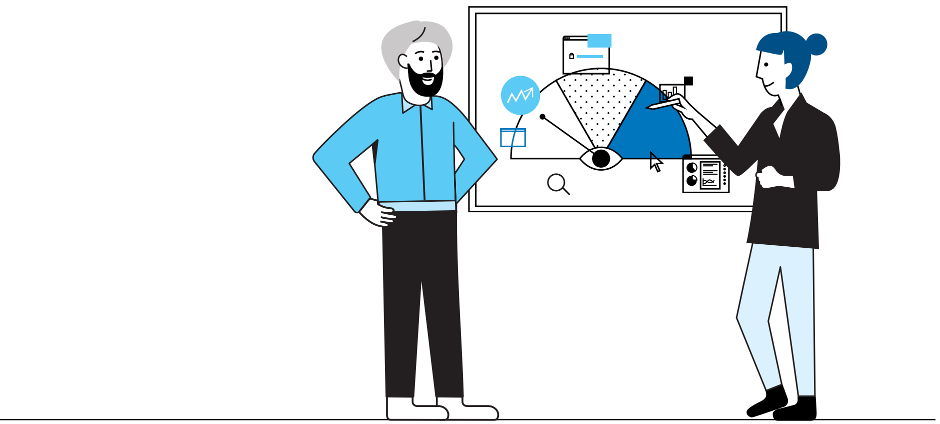


- 0% – 0 to 3 years
- 10% – 3 to 5 years
- 0% – 5 to 10 years
- 10% – 10 years+
- 80% – Not implementing

How has your time horizon changed over the last year?



- 46% – Time horizon is shorter now than a year ago
- 38% – Time horizon is the same now than a year ago
- 15% – Time horizon is longer now than a year ago



If your time horizon is shorter or longer now than a year ago, please specify by how much it has changed?

The average change for those who responded shorter is 2.6 years.

The average change for those who responded longer is 2.3 years.

Long-term objectives
continued

Majority of schemes targeting buy-in or buyout

Amongst respondents, more than half plan to use insurance as part of their endgame objectives. Over a third are specifically aiming for full buyout, which was the most common long-term objective amongst the schemes we surveyed.

With an average size of £9 billion, many of these schemes may have previously considered themselves too large for the insurance market. Indeed, when we ran a wider **survey in 2015**, just 11% of large schemes were targeting buyout. This not only highlights a significant shift in trustee and corporate focus towards securing a buy-in or buyout but is also illustrative of how demand is likely to step up over the coming years.

The capacity for the market to insure large schemes is illustrated by the fact that the two largest transactions ever (and three of the largest six ever) took place in 2023, which helped to drive a record-breaking volume of c£50bn. When we conducted our survey in 2015, the market had completed only seven transactions over £1 billion, and since then there have been more than forty.

Employer concerns

Looking back to our 2015 survey, cash contributions and the size of deficit ranked highest when it came to employer concerns. These contributions, coupled with rising interest rates, have improved funding levels for many schemes. For those we surveyed the size of deficit is now the lowest ranking concern in our study. In this world of increasingly healthy funding positions, the security of members' benefits has moved to the fore, reflecting the clear drive from large schemes to remove risk and deliver on their pension promises.

The survey shows a significant acceleration in the time horizon over which schemes are looking to come to market.

Avoiding a trapped surplus is high up the agenda for some, highlighting the importance of early engagement between the sponsor and trustee and forward planning for those with insurance as a target.

Accelerating time horizons

The increased funding levels referenced above have led to a significant acceleration in the time horizon over which schemes are looking to approach insurers for a buy-in or buyout.

All the schemes that cited buyout as their long-term objective are aiming to complete a bulk annuity within the next three years. Around half of respondents say their time horizon is shorter than a year ago by an average of over two and a half years.

This acceleration has largely been caused by unprecedented increases in interest rates, but insurers have been preparing for the increase in demand for several years.

The buy-in and buyout market has a long track record of scaling up and is well positioned to support continued growth in demand from pension schemes. The significant step up in volumes written across the market demonstrates that insurers can adapt quickly and have plenty of capital to deploy. The expected arrival of new entrants is likely to expand capacity further.

Laying the groundwork

Encouragingly, schemes are well advanced in preparing for their long-term objectives. Nearly all have implemented a Liability Driven Investment (LDI) strategy and every respondent has undertaken GMP reconciliation, marking a significant increase from just under half in our 2015 survey. This universal adoption signifies a proactive approach towards pension scheme management and a commitment to accuracy and compliance, essential factors in the context of risk transfer.

Administration and customer care

The survey highlights concern over administration capacity. Administration proficiency and capacity are both essential components of a smooth buyout transition. All transactions are to some degree bespoke, and particularly at the larger end there are often complex requirements. The industry continues to work collaboratively to deliver great administration and customer care.

Across the industry, investment in administration and customer care services – from technology to people – will be fundamental in continuing to deliver positive outcomes whether the aim is run-on or buyout.

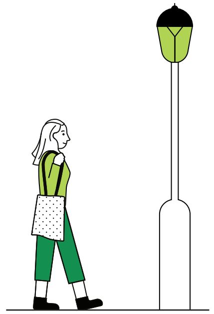
Member experience is paramount to Legal & General and is carefully managed to ensure the resource is available to maintain high standards and delivery. In order to manage increasing demand, we are focussed on expanding our capabilities through growing and developing our team and continuing to develop our technology and processes.

As well as growing our own teams, we have worked in collaboration with in-house administration teams as part of a transaction to ease the transition of administration.

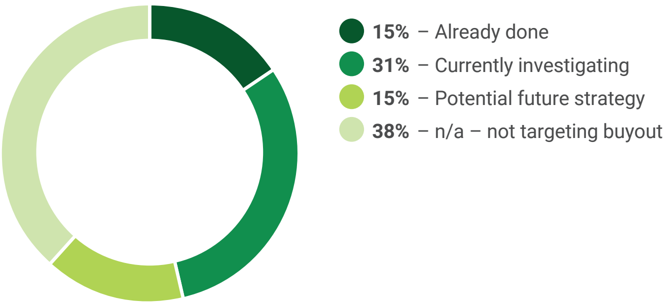
Further information

Introduction to our customer service
Our customer service ethos

Investment strategy

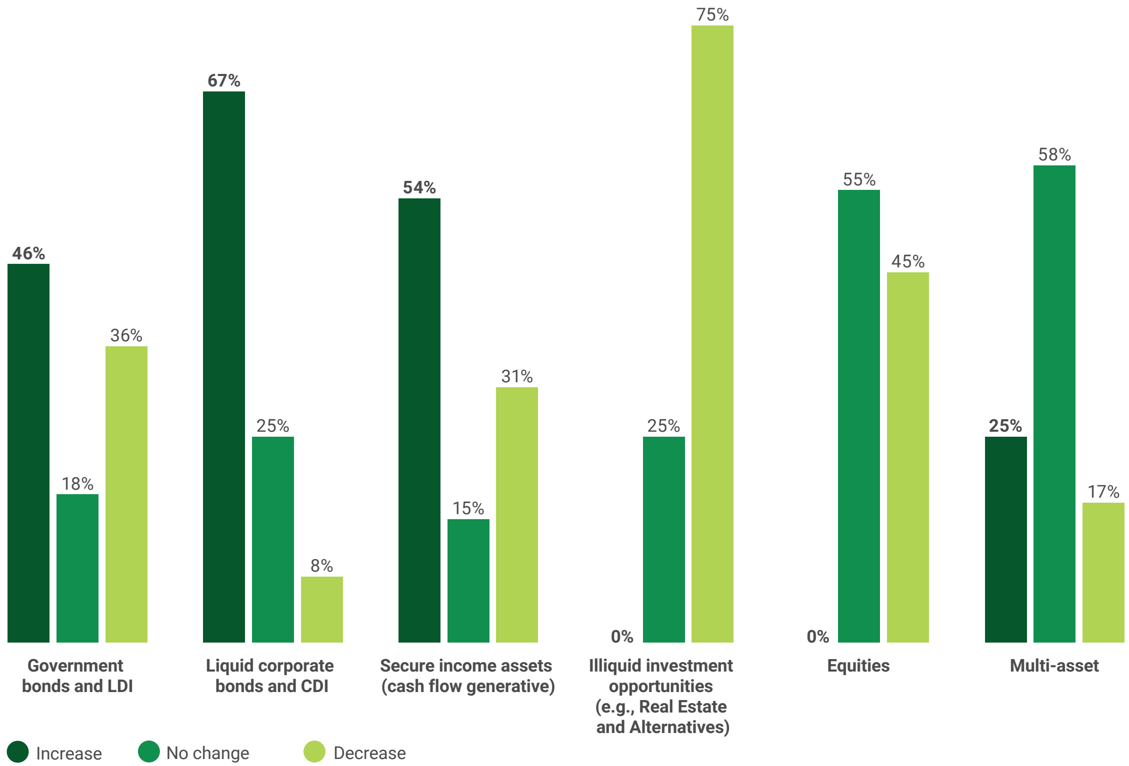


How progressed are you in implementing an endgame investment strategy to target buyout?



This reflects the discussions that we've been having over the course of the past year, where increasingly we're being asked to provide not just buy-in pricing levels but also risk sensitivities for our pricing.

How do you expect your investment strategy to evolve in the next 5 years?



Investment strategy
continued

Gearing up for endgame

In the first question in this section, schemes were asked about how progressed they are in implementing an endgame investment strategy to target buyout. 46% of the schemes are currently investigating or have already implemented a buyout investment strategy, with a further 15% considering it as a potential future strategy.

This reflects the discussions that our investment management business is having with clients, where increasingly we're being asked to provide not just buy-in pricing levels but also risk sensitivities for our pricing. In addition, we can conduct optimisation analysis for clients on how certain scheme-led investment actions could impact buyout pricing, for example, increasing hedge ratios, allocating to credit, migrating LDI portfolios towards a swap basis or restructuring assets in preparation for buyout.

The evolution of scheme investment strategies

The second question asked how schemes expect their investment strategy to evolve in the next five years. This has changed markedly since 2015 when, in a growth focused environment, schemes were typically looking for yield to close funding gaps and therefore focused on multi-asset and illiquid investment opportunities.

The responses clearly indicate a shift towards schemes preparing for their endgame and thinking about how to invest like an insurer. The survey shows increasing allocations to government bonds and LDI, credit and cashflow generative assets. We tend to find that well-funded schemes are quite closely hedged to rates and inflation, but are often underweight credit relative to insurer portfolios, so allocations to insurer eligible credit and Credit Default Swaps (CDS) can help.

The illiquid assets conundrum

The statistic that jumps off the page in this section is that 75% of the schemes surveyed said they were decreasing allocations to illiquid assets. Given the current higher interest rate environment, many schemes are now finding that they have reached full buyout funding earlier than expected but still have significant illiquid asset holdings.

We have seen innovation in both investment strategies and insurance solutions to support schemes in this position – from insurers accepting illiquid assets in-specie as part of the premium payment to allowing schemes to defer part of the premium to coincide with the redemption or run-off timeframe.

At Legal & General, we continue to expand our range of solutions in this area. Our transactions with the **British Steel** and **Boots** pension schemes demonstrated our ability to provide solutions to schemes with material illiquid asset holdings.

A seismic shift in focus for well-funded schemes

Since 2022, significant rises in interest rates have led to dramatically higher scheme funding levels, with the PPF estimating that on a full buyout basis, the net funding position of DB schemes improved from 79.2% in March 2022 to 111.9% in March 2023, with 67% of schemes being fully funded. Indeed, our survey shows that 76% of respondents have a clear long term objective in mind, underlining that endgame strategies are now front and centre of scheme agendas.

75% of the schemes surveyed said they were decreasing allocations to illiquid assets.

At the same time, regulatory change moves forward apace. The Department for Work and Pensions (DWP) has confirmed the legislative framework for the new funding code for DB Schemes, set to apply to all scheme valuations after 22 September 2024, and the government will be launching a consultation on the detail of measures to make surplus extraction easier, resulting in increased focus on options to run-on schemes to generate a surplus.

Buyout, run-on or both?

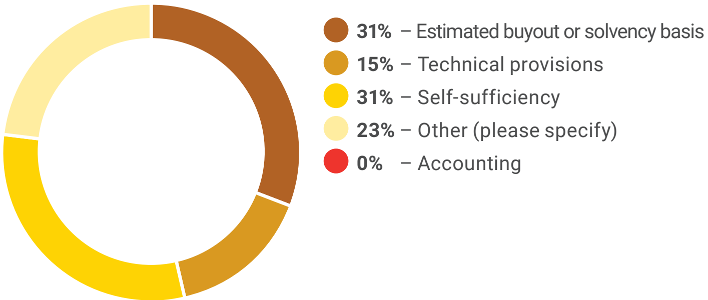
Buyout was the most common long-term objective identified in the survey. Completing a buyout enables schemes to 'lock in' the strong funding positions they currently have and secure their members' benefits. A buyout removes the risks of investment, longevity, interest rate changes, inflation and future running expenses for the scheme. For schemes targeting buyout, constructing portfolios that help prepare them for this endgame is crucial.

At the opposite end of the spectrum, a number of trustees are clear that they want to **'run-on'** their scheme. In other words, they wish to remain invested and focused on paying pensions and running on the scheme until the final member benefit is paid in full. Schemes in this group may also be looking to harness greater value for members from a potential scheme surplus.

There is also third, and significant group of well-funded schemes that are keen to 'run on' for now (and also potentially target a surplus), while keeping buyout in mind over on a longer-term horizon. For example, they may have illiquid assets to run-off, data cleansing to complete, or member benefits to enhance before they can move to buyout.

Insurance solutions

On what basis would you evaluate whether insurance pricing represents good value?



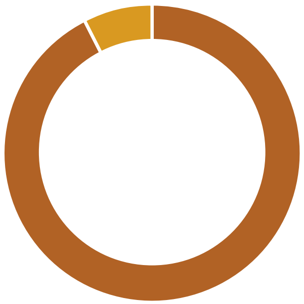
What are the most important factors when choosing an insurance provider: (Ranked in order of importance, where 1 equals most important)

1. Financial strength
2. Price
3. Flexibility of offering (for example ability to accommodate specific features such as residual risks cover, illiquid assets or additional security)
4. Administration capability
5. Brand recognition
6. ESG

Regulatory capital coverage ratios and credit ratings can be helpful to pension schemes in assessing the financial strength of an insurer. Considerations such as the quality, size and diversification of the insurer's balance sheet, are also important indicators of financial strength over the longer term. Whilst price will always be an important decision-making factor, attributes such as insurer track record, customer service capability, brand, and ESG credentials will typically form part of the value consideration.

Insurance solutions
continued

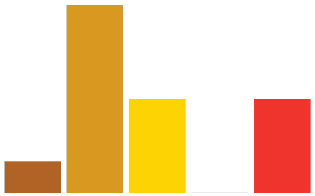
Who would be responsible for driving an insurance-led exercise?



- 92% – Joint
- 8% – Trustee
- 0% – Employer

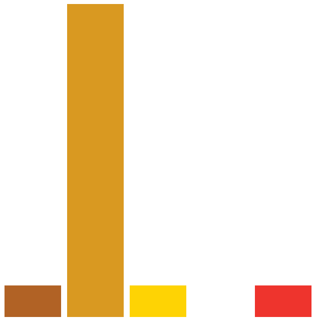
How frequently does your pension scheme monitor technical provisions and buyout funding levels?

Technical provisions funding:



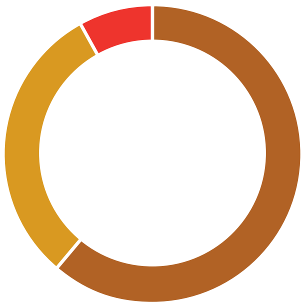
- 8% – Less regularly than annually
- 46% – Quarterly
- 23% – Monthly
- 0% – Weekly
- 23% – Daily

Buyout funding:



- 8% – Less regularly than annually
- 76% – Quarterly
- 8% – Monthly
- 0% – Weekly
- 8% – Daily

How does your pension scheme source buyout premium estimates?



- 62% – Scheme actuary
- 31% – Online analytics tool
- 0% – Price monitoring with an insurer
- 8% – Other (please specify)

Joint working groups are now commonplace which can help to establish a framework for governance processes and clear decision making up front.

Insurance solutions
continued

Selecting an insurer

Implementing a buy-in or buyout is typically the most important decision in the lifecycle of a pension scheme as the trustees pass responsibility for the members' benefits to an external provider.

Most trustees will only experience a transaction once and will want the best outcome for their members.

The schemes we surveyed said that financial strength was the most important factor when selecting an insurer.

In the vast majority of transactions, there is an increase in security to members' pensions as a result of them moving from the pensions regulatory environment to the insurance environment. Insurers hold billions of pounds of capital as a buffer against adverse events to ensure they can pay policyholders as their pensions fall due.

Regulatory capital coverage ratios and credit ratings can be helpful to pension schemes in assessing the financial strength of an insurer. Considerations such as the quality, size and diversification of the insurer's balance sheet, are also important indicators of financial strength over the longer term.

Whilst price will always be an important decision making factor, the long term security of the insurer, as well as factors such as track record, customer service capability, brand, and ESG credentials will typically form part of the value consideration.

Joined-up decision making

It's extremely encouraging to see the overwhelming majority of insurance exercises being jointly led between trustee and employer. This suggests that employers and trustees are more joined up than ever in their decision making.

Joint working groups are now commonplace which can help to establish a framework for governance processes and clear decision making up front. Our own experience reflects that frameworks with all parties working together support a much smoother de-risking journey, and it's a factor we look for when selecting which buy-in and buyout requests to quote on.

Some schemes have found working with an experienced Professional Trustee can help to bring trustees and sponsors together to align views, resulting in a more cohesive and structured market approach.

Partnering with an insurer

We're increasingly seeing larger schemes adopt a partnership model in their approach to the market, where they work collaboratively with a single insurer in an open and transparent way to achieve their buyout goal. In this model, the insurer and the scheme benefit from greater execution certainty and the ability to work dynamically to take advantage of pricing opportunities when they arise. Our series of buy-ins with the **British Steel Pension Scheme** is a good example of such a strategic partnership in action. Even if schemes opt for a traditional auction approach, in a busy market it will be important for schemes to work closely with insurers before they come to market to ensure they get the best outcome. To help schemes prepare their market approach, we offer a simple step-by-step checklist in the next section.

How to get transaction ready

Schemes that can demonstrate that they are 'transaction-ready' will be best equipped when approaching an increasingly busy market. When we speak to trustees and advisors about preparation, we typically focus on six areas: Affordability, Benefits, Assets, Data, Governance and Engagement.

A step-by-step checklist: A BADGE

Carrying out a feasibility study, with input from advisors, can help a scheme to set a target premium and understand whether a buy-in or buyout is **affordable (A)**. Demonstrating this can give insurers confidence that a transaction will go ahead if the target is met.

A legally reviewed **benefit specification (B)** helps insurers understand the benefits that they are taking on and the risks they're exposed to; any gaps will create uncertainty.

Schemes should also work with their advisors to understand how insurers invest the premiums that they receive, as outlined in the previous section.

Schemes may consider moving into **assets (A)** that better match those that an insurer invests in to reduce the costs the insurer will incur on completing a buy-in or buyout with the scheme (which should reduce the premium the insurer charges).

A scheme's **data (D)** does not need to be perfect, but it helps if some data cleansing has been carried out. Again, any gaps create uncertainty. Ideally, schemes should provide insurers with marital status data and, for larger schemes, mortality experience data, as these can help the insurer to set their pricing assumptions with more certainty.

As highlighted earlier, establishing an efficient and flexible **governance (G)** process can also be hugely beneficial to schemes ahead of a transaction process. Opportunities can be short-lived, and those schemes that are in a position to make decisions quickly will best be able to benefit from them.

In the first instance schemes will need to **engage (E)** closely with their advisors (and in some cases their preferred insurers) to help with each of the steps outlined above. It is equally important that there are clear lines of communication between the trustees and sponsor stakeholders to ensure that objectives are aligned.

Schemes that can demonstrate that they are 'transaction-ready' will be best equipped when approaching an increasingly busy market.

Resources

Read our latest PRT Monitor for analysis on market dynamics and trends.

Our Investment Management blog has a wealth of articles and reports on endgame strategies.

Our PRT Knowledge Centre features a range of information about our buy-in and buyout business.

Listen to The PRT Pod, our de-risking podcast that takes you under the umbrella at Legal & General, along with industry experts, to discuss the latest trends and market dynamics.

Contact us

For further information, please contact:
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Large DB pension scheme survey 2024

A Cebr report for Legal & General

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