Written evidence from the Association of British Insurers DBP0059

Executive Summary

1. The ABI welcomes the opportunity to provide evidence to the Work and Pensions Committee's inquiry on defined benefit (DB) pension schemes.

2. DB pension schemes account for a significant part of the pensions ecosystem, providing vital income for many in retirement. For the private sector, they are now mostly legacy, with 90% closed to new members, and a further 51% closed to accrual. The reduction in the number of schemes from 7,751 in 2006 to 5,131 in 2022 is partly a result of the buoyant pension de-risking market[1].

3. Insurers play a crucial role in insuring and securing the benefits of DB pension schemes' members. Insurers provide several types of de-risking services. This includes hedging specific risks like longevity; "buyins" which pay a scheme an equivalent amount to the benefits of the members covered by the policy, while liability is retained with the scheme; or a full "buyout" where an insurer takes on all the assets and liabilities of a scheme which then winds up. For the latter, the DB benefits the scheme member would have received is replicated in the form of an annuity. In recent years insurers have also stepped in and provided welcome security when sponsors of DB pension schemes have failed, most notably the BHS and Carillon schemes.

4. The buyout market is highly competitive and is set for a record year of transactions in 2023. Over £50 billion of transactions are expected per annum in the next three years, and insurers are confident there is the capacity to meet this demand.

5. We have responded to relevant questions 2, 4, 5. If there is any further information that the Committee would find helpful from the ABI and our members, please don't hesitate to contact us.

Question 2: Is there sufficient capacity in the buy-out market to meet demand from DB schemes? If not, what the alternatives?

6. Yes. Schemes, regardless of size, can secure quotes from insurers when they come to market. Our members are unaware of any schemes which have tendered for buyout in recent months which have not had at least one insurer offering a quote. There are several insurers in this market, with predictions of new insurer entrants given the anticipated level of growth[2]. Insurers operate in all parts of the market, from very small DB schemes with tens of millions of pounds, to the largest transaction to date (£6.5bn) occurring earlier in the year. Our data from 2022 shows that nearly 140,000 scheme members were insured in 2022, representing nearly £32bn worth of transactions[3]. The previous record year was in 2019, which saw £43bn of transactions, with c120,000 members insured. This year is predicted to be another record year of growth for the sector.

7. This is due to DB pension schemes' financial outcomes having materially improved in the last few months as a result of rising gilt yields and changing life expectancies, which continue to evolve post pandemic. LCP estimates that nearly 1 in 5 schemes are now fully funded to the extent that they can buy out their liabilities with an insurer, with an average funding improvement of c15% in the past year alone[4]. Their analysis suggests that the average DB scheme is estimated to be 88%

[1] Pension Protection Fund, Purple Book, 2022, https://www.ppf.co.uk/sites/default/files/2022-11/PPF_PurpleBook_2022.pdf
[2] https://www.lcp.uk.com/media-centre/2023/01/2023-set-to-be-a-record-breaking-year-for-de-risking-after-the-rollercoaster-of-2022/
[3] ABI Data, 2022

funded on a buyout basis, and two thirds of trustees now cite that their funding levels would allow them to buyout in 3 years[5]. However, being "buyout ready" is not just a question of having the funding to do so. It is also important for schemes to ensure they have gone through appropriate data cleanses, that their assets are suitable for a transaction, and that appropriate Governance structures are in place to ensure the transaction can progress smoothly. So, while many schemes' may be ready to buyout on a funding basis, they may not have undertaken the other necessary preparation to come to market.

8. For schemes who want to maintain the employer covenant, other derisking options are available, such as insurer buyins, or longevity swaps. DB schemes could also enter a DB Master trust, although this is less common. Schemes would still need to do the necessary preparations as noted above to move into a DB master trust, or indeed a consolidator vehicle like a superfund.

Question 4: What, if any, further steps should be taken to encourage DB scheme consolidation?

9. DB pension schemes are already looking at opportunities to move to their designated objective, and will be encouraged to do so through the new DB Funding Code. This end objective may be to transfer the scheme's liabilities to an insurer or run off on a self-sufficient basis. Trustees are also encouraged to de-risk through an insurer because of the schemes' financial circumstances and/or through conversations with their employer. Increasing regulation on the sector has driven appetite from trustees and their sponsors to move the scheme into buyout. This has naturally driven more DB schemes to "consolidate" through a buyout with an insurer, and this trend is forecasted to accelerate.

10. There have been some developments in recent years to introduce new consolidator vehicles, so-called "superfunds". We have been clear in the past, and with the Committee[6], about our concerns with the proposed regulation for superfunds. Based on the models so far, superfunds are likely to be commercial schemes, which would remove the employer covenant and connection with a DB pension scheme and take on the assets and responsibility for paying members their benefits. This is very similar to that of the services provided by insurers. Yet insurers are regulated by the robust regime of Solvency II, soon to be Solvency UK. This is a rules-based regime, whose framework requires firms to not only have liquidity risk and capital management policies in place, as well as a Senior Managers regime, but also requires them to conduct an own risk and solvency assessment (ORSA). As part of the ORSA, firms must undertake wide ranging scenario analysis which includes extreme market stresses. This provides robust policyholder protection to the scheme members they take responsibility for. It is partly thanks to this robust regime that insurers were able to weather the dramatic hike in gilts yields in autumn 2022[7]. Superfunds' design would mean they operate in a less stringent regulatory environment, enabling them, in theory, to be a cheaper but less safe option for schemes' members.

11. It is worth noting that there has been a material shift in scheme funding levels and buyout pricing since the superfunds consultation in 2019 was published. This means that the number of schemes superfunds could have theoretically serviced has reduced. Government is yet to respond to that consultation, and TPR have issued guidance for schemes who are considering transact in the interim. However, there have been no superfund transactions to date. If the superfund framework is further pursued, Government and the regulators should consider carefully whether transactions

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[4] https://www.lcp.uk.com/pensions-benefits/publications/future-demand-buy-in-buy-out-market/
[5] XPS Pensions Group survey of 300 trustees. https://www.pensionsage.com/pa/demand-for-buyout-expected-to-contnue-to-grow.php
[6] ABI's Work and Pensions Committee evidence session on DWP's DB White Paper (6 June 2018)
[7] ABI blog: Why insurers weathered the gilts yields hike…: https://www.abi.org.uk/news/blog-articles/2023/3/why-insurers-weathered-the-gilt-yields-hike-and-the-liquidity-crisis/

should occur before legislation is in place. This is vital to give scheme members the protection they expect.

Question 5: Are there any circumstances in which consolidation should be mandatory?

12. No. If the worst were to happen and a DB pension scheme's sponsor were to fail, they are obligated to go into Pension Protection Fund (PPF) assessment. If it is found that a scheme is able to buyout their benefits with an insurer, above the PPF income caps, then they are able to do. To some extent this is a form of mandatory consolidation. DB pension schemes are being encouraged to confirm their endgame (either self-sufficiency, buyout or consolidation), and the new DB Funding Code will make this a requirement. The rate of reduction in the number of DB pension schemes has already been significant: in 16 years the number of schemes has decreased by a third[8]. The case for formal mandatory consolidation is therefore unclear.

About the ABI and its members

The Association of British Insurers is the voice of the UK's world-leading insurance and long-term savings industry. A productive and inclusive sector, our industry supports towns and cities across Britain in building back a balanced and innovative economy,employing over 300,000 individuals in high-skilled, lifelong careers, two-thirds of which are outside of London.

The UK insurance and long-term savings industry manages investments of over £1.9 trillion, contributes over £16bn in taxes to the Government and supports communities across the UK by enabling trade, risk-taking, investment and innovation. We are also a global success story, the largest in Europe and the fourth largest in the world.

The ABI represents over 200 member companies, including most household names and specialist providers, giving peace of mind to customers across the UK.

April 2023

[8] Pension Protection Fund, Purple Book 2022