Can a DB master trust provide an efficient stepping stone to buyout?

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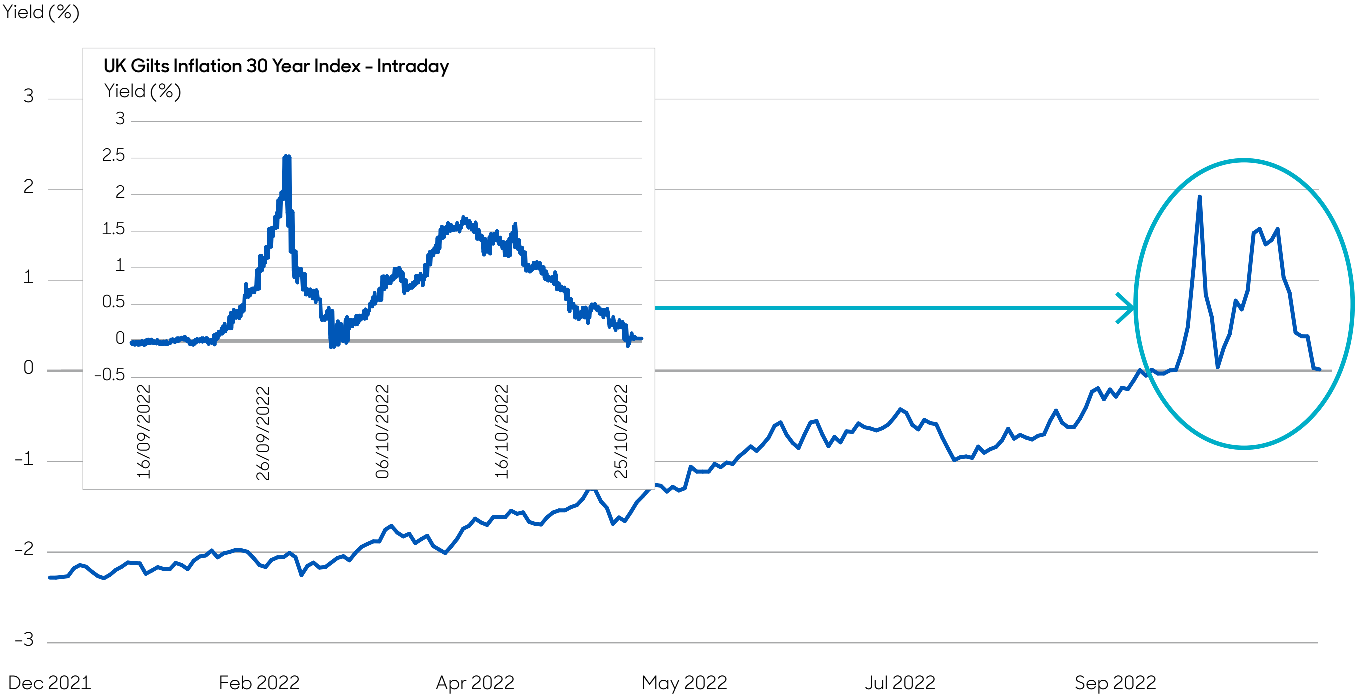
In the first of a series of articles on the impact of recent gilt market volatility[1], we consider the effect on pension schemes' positioning in terms of full buyout with an insurer.

It has been widely reported that rising gilt yields (see Figure 1 below) are good for pension scheme funding.

Figure 1 – Rising gilt yields and heightened market volatility

UK Gilts Inflation 30 Year Index



Source: Bloomberg. For illustrative purposes only. No assumptions regarding future performance should be made. As at 24 October 2022.

This is because liabilities – calculated as the present value of a series of benefit cashflows using a discount rate based on gilt yields – will have fallen (for most schemes) by more than the backing asset portfolio[2-3].

So, does this mean that we will see a marked increase in buyout activity over the coming years? Will we finally see the many companies that have been balance sheet- constrained by their defined benefit (DB) pension obligation, pass this obligation over to an insurer, securing their members' benefit promises in the process?

> **"It has been widely reported that rising gilt yields are good for pension scheme funding. Does this mean that we will see a marked increase in buyout activity?"**

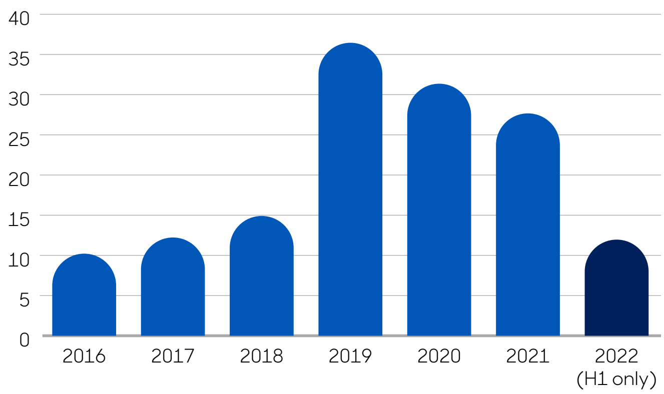
[1] At the time of writing the 30-year yield on the IL gilt curve was 0.0% (24 October 2022) having been 0.0% on the 13 September 2022 and 2.5% at its intra-day peak on 27 September 2022.

[2] In the case of most pension schemes which have a lower level of interest rate sensitivity on the asset portfolio than the liabilities.

[3] Not all schemes will be positively impacted by the recent volatility in gilt markets. The actual impact will vary from scheme to scheme and depend, amongst other things, on the level of interest rate and inflation hedging in the days before and after the mini budget and the impact of liquidating other assets in the portfolio to support collateral calls on any leveraged positions.

Probably not. Unless we see a material increase in capacity in the bulk purchase annuities (BPA) market, beyond that evidenced by recent activity (as shown in Figure 2).

Figure 2 – Annual buyout/buyin activity



Source: Hymans Robertson as at 31 March 2022.

With total DB buyout liabilities well in excess of £1 trillion it is hard to envisage capacity sufficient to meet demand for the next few years.

What factors determine "buyout readiness"?

Whilst up until now, funding level has been the only factor in determining that all important metric "timeframe to buyout", we suggest this is no longer the case. Well-funded pension schemes should form an orderly queue at the door of their favoured insurer.

With a plethora of choice, expect insurers to look at other factors like data quality, legal documentation clarity, availability of suitable matching assets and simply the estimated amount of time spent per £ transaction.

What about small schemes?

Thinking about this last point, it's not unreasonable to suggest that larger scheme transactions will be favoured over their smaller scheme counterparts. That's before we take into account quality of data and legal documentation which can often be less well maintained for smaller schemes.

"Well-funded pension schemes should form an orderly queue at the door of their favoured insurer."

How can DB consolidation help?

DB master trusts can offer a neat solution for these small schemes.

- Some schemes will want to remain in the holding pattern while their chosen insurer frees up resource to process their transaction. For these arrangements, the low expense, improved governance structure and wider investment choice of a DB master trust can offer a low risk and efficient means of circling the buyout runway.
- Thanks to scale, it is possible for a DB master trust to pool a number of sections together such that the insurer views the trust as one large scheme rather than multiple small schemes' transactions. Pre-approved transaction documentation can also expedite the process.
- Scale can also bring stronger relationships, including with insurers. Master trusts can leverage this benefit to offer their small scheme entrants access to one or more insurers that wouldn't normally quote to schemes sub £100m in size.
- Regular information flow through efficient governance means insurers are only approached when the time is right.
- Transfer into a master trust can often involve a data cleanse at low or no cost during an administration transition.

Contact us

If you would like to find out more to help decide whether transferring your defined benefit pension scheme to a master trust could help your business, please contact one of our pension solutions specialists at **DBmastertrust@abrdn.com**.

Email is not a secure form of communication so please do not send any personal or sensitive information.

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