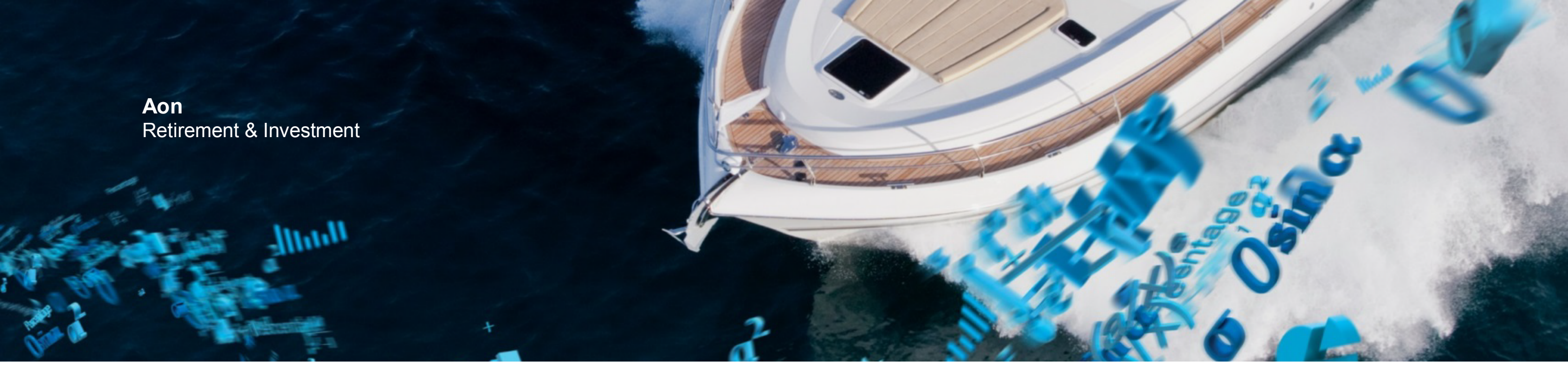

Risk Settlement: UK market update

August 2018

Headlines

- Market on track to meet Aon's prediction of a record breaking year for risk settlement
- Several providers have written their largest ever deals in 2018
- Pricing continues to be attractive but insurers are applying greater selection before deciding to quote
- Schemes that are well prepared are likely to experience the best outcomes
- Longevity swap market is back open for business

Bulk Annuities - Market Update

As 2018 began, we predicted that this would be a record year for bulk annuities and that £30bn of risk could be transferred by the end of the year.

Already we have seen large publicised deals, such as:

- The £12bn purchase by Rothesay Life of part of the Prudential annuity book;
- The largest pensioner buy-in so far in 2018 for Siemens (£1.3bn) with PIC; and
- The largest buyout so far this year for PA Consulting (£850m) with PIC.

Both of the latter deals were arranged by Aon.

Whilst there is scope for pricing to harden if high demand is sustained through the autumn, attractive pricing has still been achieved in recently completed auctions.

The improved market has attracted a new wave of pension schemes to the market. As schemes are also seeing improved solvency positions, in part due to the same favourable market conditions, this trend is expected to continue for some time. The focus on schemes achieving their goal of full buy-out is growing markedly.

There is also a large volume of further expected business where schemes have reached the final latter stages of auction processes, leading to substantial transactions expected by early autumn.

Given the level of activity so far, we remain confident that the market is well on track to meet our prediction. Driven by the attractive pricing opportunities for pension schemes, the first half of 2018 has been the busiest period since the pre-Credit Crunch 2008 market, and more fruitful in terms of resulting volumes placed.

Several providers have already written their largest ever deals, demonstrating the improving ability of the market to take on substantial amounts of risk.

The table below shows the landmark deals already disclosed in 2018:

Transaction	Insurer	Comment
Siemens - £1.3bn buy-in	PIC	Largest buy-in disclosed in 2018 (Aon advised)
PA Consulting - £850m buy-out	PIC	Largest buy-out disclosed in 2018 (Aon advised)
Prudential - £12bn backbook	Rothesay Life	Largest ever transaction by a bulk annuity provider
Littlewoods - £880m buy-in	Scottish Widows	Largest ever transaction for Scottish Widows
Marks and Spencer - £925m buy-in	Aviva	Largest ever transaction for Aviva
Marks and Spencer - £470m buy-in	Phoenix Life	First external transaction for Phoenix Life

We expect that more insurers will break their deal size record before the end of the year.

Annuity pricing remains favourable

Pricing has steadily improved since summer 2016, with some of the best pricing in recent years offered in the first half of 2018. This partly reflects increased competition with eight providers materially active for bulk annuities, all showing good access to external capital. Another aspect of the price improvement has been the better yields achievable from long-term income-bearing assets deemed suitable for backing annuities, compared with gilts (the normal reference yield measure for pension schemes).

Insurance companies measure the yield on their portfolio relative to swap yields, with excess yield earned by investing in assets such as infrastructure, mortgages, corporate bonds and private debt.

Capacity constraints have long been a concern, given the small size of the settlement market relative to the £2000-3000bn of unsecured liabilities in UK pension schemes. 2018 is the first time that this capital is starting to be tested, with constraints proving to be experienced manpower and sufficiently high yielding asset opportunities.

The sheer volume of annuity placements expected over the third quarter of 2018, including the recently announced buyout of part of the former BHS scheme with PIC, is running down asset supplies at some insurers in the very short-term. We have also seen some recent contraction in spreads on US credit yields, and a reduction in the allowance for extra yield from equity release mortgages, which are likely to challenge insurers looking to offer the best pricing.

Any asset shortages are only likely to have a short term effect that is not relevant for a client considering a new auction that is transacting into 2019. It does though demonstrate the increased significance of bulk annuities in bond-like asset markets.

Given restrictions on pricing team resource, providers are currently more selective about deciding to quote on a new auction, seeking well prepared schemes with experienced settlement advisors and clear targets.

Breakdown of bulk annuities by provider

The table below summarises bulk annuities secured by pension schemes up to 30 June 2018 compared with 2017:

In recent years volumes have been mainly concentrated in two providers, PIC and L&G, and we expect substantial placements for L&G to arise in the second half of the year. Canada Life are also expected to have substantial placements in the second half of the year, making it a successful year for all providers.

Most providers are set to place far higher volumes overall in 2018 compared with 2017 (noting Rothesay Life's back-book transaction, and also Phoenix Life's planned acquisition of Standard Life Assurance including its annuity book, as announced in the half year).

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2018 rank	Bulk annuity providers	2018		2017	
		Value (£m)	Market share	Value (£m)	Market share
1	PIC	3,257	42%	3,704	30%
2	Aviva	1,539	20%	2,045	17%
3	Scottish Widows	1,100	14%	645	5%
4	Just Group*	718	9%	998	8%
5	Legal & General	507	7%	3,405	28%
6	Phoenix	475	6%	-	-
7	Rothesay Life	170	2%	960	8%
	Canada Life	-	-	544	4%
	TOTAL	**7,766**		**12,301**	

The table excludes back-book transactions. It reflects an Aon survey of the providers.

Number of bulk annuity transactions

The table below shows the deals completed in the market. The number of deals placed by Aviva shows their important across the market, offering terms for the largest number of smaller transactions while also increasingly competing for some of the market's largest deals.

Most providers have focused on a narrower range of liability profiles, to suit their asset sourcing or operational capabilities, as well as the relative competitiveness of different areas of the market.

The substantial improvements in scheme solvency positions since 2016 has increased the number of buy-out actions in the market, with Aviva notably concluding 26 buy-out transactions in the half year and buy-out completions expected in the next few months.

2018 H1 Rank	Bulk annuity providers	H1 2018		H2 2017		H1 2017	
		Cases written	Value (£m)	Cases written	Value (£m)	Cases written	Value (£m)
1	PIC	15	3,257	16	1,829	10	1,875
2	Aviva	33	1,539	23	1,719	11	326
3	Scottish Widows	4	1,100	3	240	5	405
4	Just Group	TBA	718	15	703	7	295
5	Legal & General	7	507	16	1,901	15	1,504
6	Phoenix	1	475	-	-	-	-
7	Rothesay Life	1	170	2	555	3	405
	Canada Life	-	-	3	268	3	276
	TOTAL	**61+**	**7,766**	**78**	**7,215**	**54**	**5,086**

The table excludes back-book transactions implemented by Rothesay Life. It reflects an Aon survey of the providers.

Longevity swap market is back open for business

There was one publicised longevity swap transaction in the half-year, a very important one for this market.

The £2bn longevity swap transaction between National Grid's electricity pension scheme and the UK arm of Zurich, structured by Aon and announced in May, signalled the re-opening of the longevity swap market following a period of adjustment:

- By mid-2016, evidence had mounted that the trajectory of current and future mortality improvements in the UK had changed materially, but the reinsurance market had not corrected for this - leading to a 'dislocation' in longevity insurance pricing.
- Aon took a public stance on this, through press releases and presentations at the main industry conference – but perhaps more decisively by pausing several significant longevity swap projects.
- This pressure, and the continuing flow of new data to support change in improvement trend, brought about a 'relocation' in pricing by late 2017.

So longevity (re)insurance pricing is back in the right zone, as evidenced by £2bn National Grid transaction. This is important for schemes looking to enter into longevity swaps, but also it is relevant for schemes looking at a buy-in or buy-out – better longevity pricing means better bulk annuity pricing.

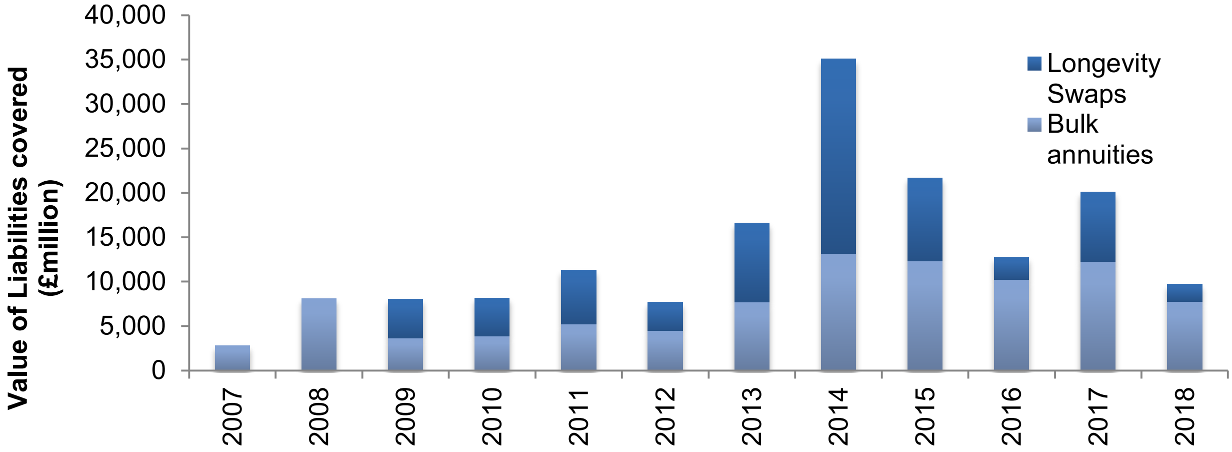
But schemes should proceed with caution – with the movement in longevity expectations over the last couple of years, it is critical to make sure that pricing is:

- Based on up-to-date scheme data, and
- Assessed against a scheme view of member's projected life expectancy that reflects the latest data and modelling (not just using figures from the latest funding valuation, which could be several years old). With continuing high demand for longevity reinsurance from bulk annuity insurers, against which schemes are competing, it is also important to be guided through the reinsurance broking process by an experienced partner, to ensure reinsurance engagement and a competitive process to drive a good price.

Alongside fair pricing for longevity risk transfer, a critical element for a functioning longevity swap market is a range of intermediation structures to meet the requirements and priorities of different schemes. The National Grid deal is on a 'traditional intermediation' basis, with the scheme not facing any risks associated with the reinsurer (Canada Life Re) who has taken most of the longevity risk from Zurich. Zurich's entry into the large-end intermediation market, which this deal marks, confirms that a wide range of intermediation options are available to schemes.

Long term market development

This graph shows the overall volume of risk settlement transactions disclosed for company pension schemes in the UK. The bars show the volume of bulk annuities and longevity swaps.



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