Aon's Risk Settlement Market Review 2020

Helping you navigate through the bulk annuity, longevity swap and consolidation options

For Professional Clients Only

Welcome

COVID-19 and lockdown threw 2020 into turmoil. In the face of this adversity, the risk settlement market was able to adapt and function efficiently to the extent that transactions in 2020 could break the £50bn mark.

Bulk annuities

For the UK bulk annuity market, 2019 was a record-breaking year with £43.8bn of new business written, driven by several multi-billion-pound transactions over the course of the year, including the Telent £4.7bn buyout and the partial buyout for the Rolls-Royce UK Pension Fund which was over £4.6bn – both of which were Aon-led. Following this, it was expected that the market in 2020 would continue this busy trend, if not quite reaching the heights of the previous year.

That was before COVID-19 and lockdown arose. However, even with the unprecedented challenges brought by the pandemic, a substantial £12.7bn of bulk annuity business across 77 transactions were written in the first six months of 2020. Allowing for already announced and predicted transactions over the second half of the year, 2020 is on target to be the second busiest year for the bulk annuity market with around £30bn of transactions, illustrating the resilience the market has shown in the face of the challenges presented by COVID-19.

The volatile conditions experienced over the year provided more opportunities for pensioner deals, of which, one of the greatest impacts was made by the Co-operative Pension Scheme (PACE), which placed £2.8bn of pensioner buy-ins, across four transactions with Aviva and PIC, all of which were advised by Aon.

"We remain in a period of attractive pricing, where many schemes are able to complete transactions" **Pension Insurance Corporation**

Longevity swaps and reinsurance

Over the first half of 2020, three longevity swaps for UK pension schemes were publicly announced, including the £10bn swap for Lloyd's Banking Group – one of the largest publicised swaps to date. Several high-profile longevity swaps are being progressed and may complete over the rest of 2020 and early 2021 as larger schemes seek to benefit from attractive pricing available in the reinsurance market.

We are delighted to have advised NN Life, the largest insurance company in the Netherlands, on a €13.5bn longevity transaction covering a portfolio of annuity policies for over 200,000 pensioners and dependants, showing the depth of the global settlement market in addition to the £50bn of UK pension scheme transactions predicted.

Martin Bird
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Commercial consolidation solutions

2020 has seen a flurry of activity with the Pensions Regulator issuing "guidance for DB superfunds" in June, followed by guidance on the process it expects from trustees and sponsors when considering commercial consolidators in October. At the time of writing (December 2020), no transactions have completed, but it feels inevitable that this is only a matter of time.

Looking ahead

As we head into 2021, we anticipate strong appetite from insurers and reinsurers to grow the market further and opportunities will exist for schemes of all sizes, with flexibility and nimbleness being key themes for 2021. Some of the inevitable market uncertainty, driven by Brexit negotiations, the RPI/CPI consultation and the possibility of future lockdowns, will mean that schemes will need to take a robust approach to get transactions over the line.

More than ever those schemes who can correctly navigate the current busy marketplace and are ready to capture risk settlement opportunities that arise will be best placed to achieve their objectives.

If you are thinking about whether risk settlement might be suitable for your own scheme, then now is certainly a good time to start planning.

Helping you navigate through the bulk annuity, longevity swap and consolidation options

For this year's review we have directly canvassed professional trustee firms to make sure we answer the questions that are taxing trustees and sponsors currently – look out for the *Trustees Ask* feature in this review.

We have again run the Aon Insurer Survey, completed in October 2020 by all eight active UK bulk annuity providers, and share the insights from that within the bulk annuities section.

We would like to thank both the professional trustees and insurers for their valuable input.

RECOGNISED SUCCESS
across the pensions industry

UK Pension Awards
Risk Reduction Adviser of the Year - 2020, 2019, 2018, 2017

Financial Times PIPA Awards
De-risking Consultant of the Year - 2020, 2018

European Pensions Awards
Risk Management Firm of the Year - 2018

AON

2020 – a year of bulk annuity pricing opportunities

We have been able to capture very attractive pricing opportunities for our clients over all of 2020 across a wide range of bulk annuity transaction sizes and types.

To access the best opportunities in the bulk annuity market a combination of the following is needed:

(a) **an in-depth understanding of the market environment** including levels of appetite across different insurers and how their pricing is impacted by different market conditions; and

(b) **experience in using the full range of negotiation "levers"** for achieving the best pricing and terms from insurers (e.g. accelerated processes, insurer relationships, umbrella contracts, liability segmentation).

The graphic on the following page shows a selection of Aon's transactions over 2020 and highlights key features of the market environment in each period. Based on the significant volumes of transactions we place in the bulk annuity market, we are constantly in tune with market dynamics, which puts us in the best position to help develop the right strategy for each transaction, including use of bespoke negotiation levers.

Mike Edwards
Partner
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Examples of Aon led transactions in 2020 (£100m+)

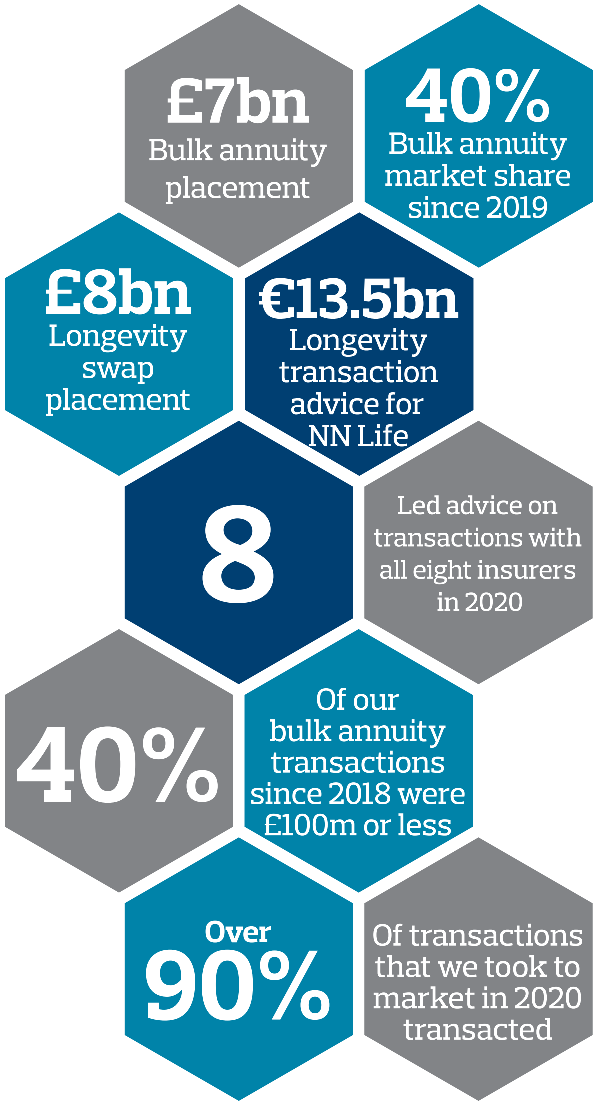
January-March	April-July	August-December
Timing flexibility and understanding insurer appetites	**Exploiting market conditions through nimble governance**	**Bespoke and accelerated processes to target excess provider capacity**
Xylem £255m; Co-op £2,410m (3 deals in Q1); Leonardo Electronics £160m	Co-op £350m; IPC Media £290m; Siemens £530m	Hitachi £275m; Smiths Group £290m (2 deals); Confidential £400m; Various transactions (TBC)
Market environment:	Market environment:	Market environment:
• Strong provider appetite for early 2020 transactions • Some transactions capitalising on this through locking into attractive pricing over extended periods from Q4 2019 using bespoke price lock mechanisms	• Pricing was particularly attractive from some insurers for pensioner buy-ins due to widening credit spreads • Those schemes that could move quickly were able to take advantage, such as by using umbrella contracts (e.g. Co-op) or accelerated processes (e.g. Siemens)	• General slowdown in market volumes in H1 2020 (to c£12.7bn) meant excess insurer and reinsurer capacity in H2 2020. • However, schemes and advisors have had to work hard to put themselves at the front of the queue by leveraging insurer and reinsurer relationships and a range of other negotiating levers.

Key: Pensioner buy-in; Full scheme buy-in / out

The hexagons outlined in red made use of phased buy-in strategies to secure additional liabilities and capture attractive pricing opportunities.

Aon's market leading risk settlement credentials

2020 in numbers



£500m+ bulk annuity transactions since 1 January 2016:

Lead adviser to transactions since 2016	Number of schemes (deals over £500m)	Number of schemes (deals over £1bn)
Aon	15	8
LCP	13	1
Hymans	2	2
Mercer	3	1
WTW	2	1
KPMG	1	1
PwC	1	1
Barnett Waddingham	1	1

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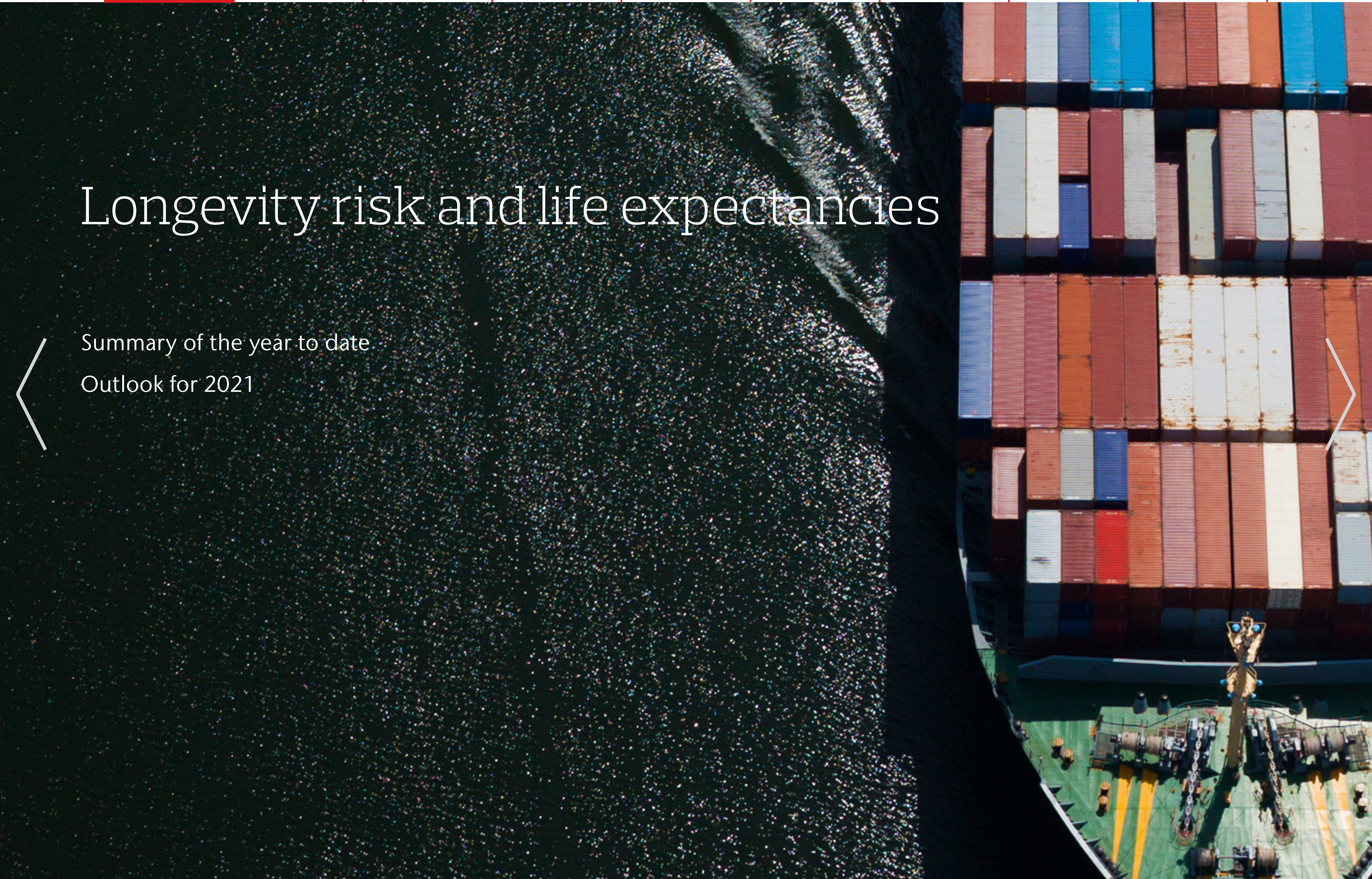


Longevity risk and life expectancies

Summary of the year to date

Outlook for 2021

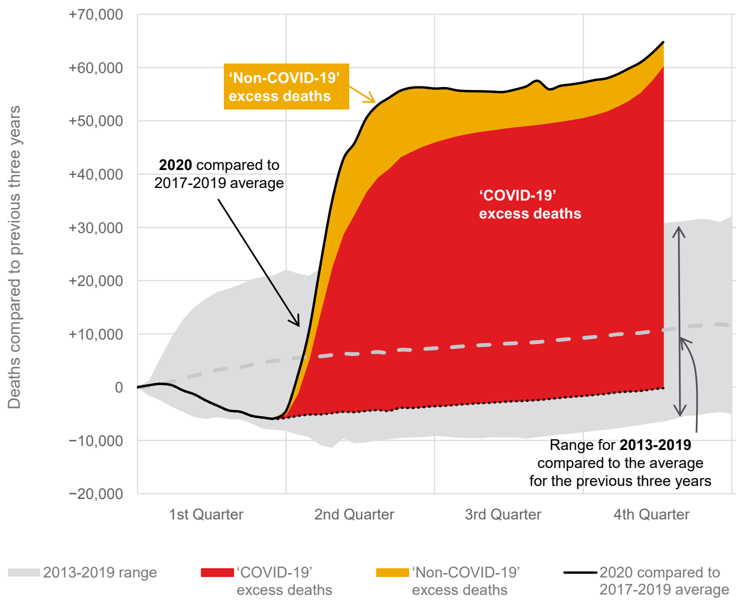
Summary of the year to date

2020 started with all eyes on the higher mortality improvements that had started to emerge in 2018, persisted through 2019 and appeared to be continuing into 2020.

However, by February it was becoming clear that the COVID-19 outbreak that had originated in Wuhan, China was spreading internationally, and March saw a rapid acceleration in UK COVID-19 deaths, resulting in the UK entering lockdown that month. Deaths from the first wave of the COVID-19 infection peaked in the UK by May 2020 and, by July, fewer deaths relating to COVID-19 were being recorded, and deaths from all causes had returned to typical levels.

At time of writing (November 2020), the lifting of the first national lockdown has led to a renewed increase in COVID-19 cases and hospitalisations. This initially led to tighter controls being reintroduced in many parts of the country and more recently a second national lockdown. Because the virus is continuing to spread, it is likely that the number of COVID-19 deaths will continue to rise in the near term, but lessons learned should mean that the peak numbers of deaths in the future isn't on the same scale as the first wave. In general, UK policy currently prioritises containing infection rates at the expense of economic recovery (although we are certainly not claiming that this is a simplistic trade off).

It is estimated that, as at 13 November 2020, there have been around 65,000 excess UK deaths (i.e. the difference between actual deaths and deaths expected in a typical year) since the start of the year. There are typically around 600,000 deaths each year in the UK, with individual years varying – higher or lower – by up to 25,000 deaths. In this context, an excess UK deaths figure of 65,000 is unprecedented in recent times, as shown on the chart below.



Source: Office for National Statistics

Matthew Fletcher
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Most pension schemes will have experienced significantly more deaths in 2020 than in previous years, although the direct impact of these additional deaths is likely to be small, reducing liabilities by less than 0.25% in most cases. It is important to note that where mortality experience is used to determine mortality assumptions, the scheme's mortality data from 2020 will require special treatment.

Q: Should we use pension scheme experience in 2020 to set *base* mortality assumptions?

A: It is standard practice to use a pension scheme's own mortality experience to estimate base (i.e. current) mortality levels. There are broadly three possible approaches to allowing for extreme mortality experience, none of which is ideal.

1. **Include 2020 data as normal**. We don't think this is a sensible approach because COVID-19 represents a very unusual event and will distort the results.
2. **Ignore 2020**. This has the benefit of simplicity and avoids having to worry about 2020 being unrepresentative of future expectations. The CMI is in effect proposing this approach for its Mortality Projections Model. This approach, however, does mean throwing away data. And although it may work for 2020, it may be hard to sustain in future years because, *even if we halt the spread of the infection itself*, COVID-19 may impact future mortality (positively or negatively).
3. **Include the 2020 data but allow for the higher population mortality in 2020**. This approach is more complex but has the advantage of utilising all available scheme data. This is the approach Aon is expecting to use.

Matthew Fletcher
Senior Consultant

Outlook for 2021

The longer-term impact of COVID-19 on mortality remains uncertain, and will be influenced by both:

- the *direct* impact of COVID-19 on mortality rates in the future, and
- the *indirect* impacts (which could be positive or negative), including:
  - The health of the surviving population, and
  - The economic, social and political consequences of tackling COVID-19

For the time being, our best estimate long-term view on future mortality improvements remains broadly unchanged. On the one hand, COVID-19 has the potential to create low longevity outcomes, particularly if there is no quick resolution to the pandemic (e.g. an effective and widely-distributed vaccine). On the other, some consequences may be positive for longevity (e.g. in the short term the surviving population may be healthier and have better attitudes to hygiene, and in the longer-term there may be increased support for higher funding for healthcare and social welfare).

Each year, the Continuous Mortality Investigation (CMI) publishes its Mortality Projections Model, which is used by almost all pension schemes and insurers to estimate future mortality improvements. This improvements assumption is combined with the estimate of a scheme's base mortality, discussed by Matthew earlier, to create an overall best estimate mortality assumption. Because the CMI Model estimates improvements, i.e. the rate of change in mortality, it is very sensitive to the additional deaths in 2020. The CMI itself estimates that if 2020 mortality remains at its current level then there would be around a 4% reduction in life expectancies if it followed its normal process. This is widely regarded as unrealistic, including by the CMI itself.

Accordingly, the CMI is proposing that the next version of the model (due in March 2021) will attach zero weight to the 2020 data while leaving the rest of the model broadly unchanged. This (plus some other tweaks to the model) means that liabilities for a typical pension scheme will be broadly unchanged or possibly see minor reductions compared with the 2019 version of the model. This aligns with both our current house view and also the current market consensus, which is that the median best estimate long-term outlook for future mortality improvements has not changed significantly notwithstanding the pandemic. Accordingly, Aon is supporting the CMI's proposal.

Tim Gordon
Partner
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Q: When agreeing mortality improvements, should we use the next version of the CMI model?

A: The next version of the CMI model, CMI_2020, will be published in March 2021. The CMI's proposal (yet to be ratified at the time of writing) to exclude data from 2020 in the model fitting process would mean that the life expectancies produced by the model would not change very much when compared to the previous model (CMI_2019). We believe that this is sensible and in line with market expectations, so our view is that the new version of the model is likely to be fit for purpose.

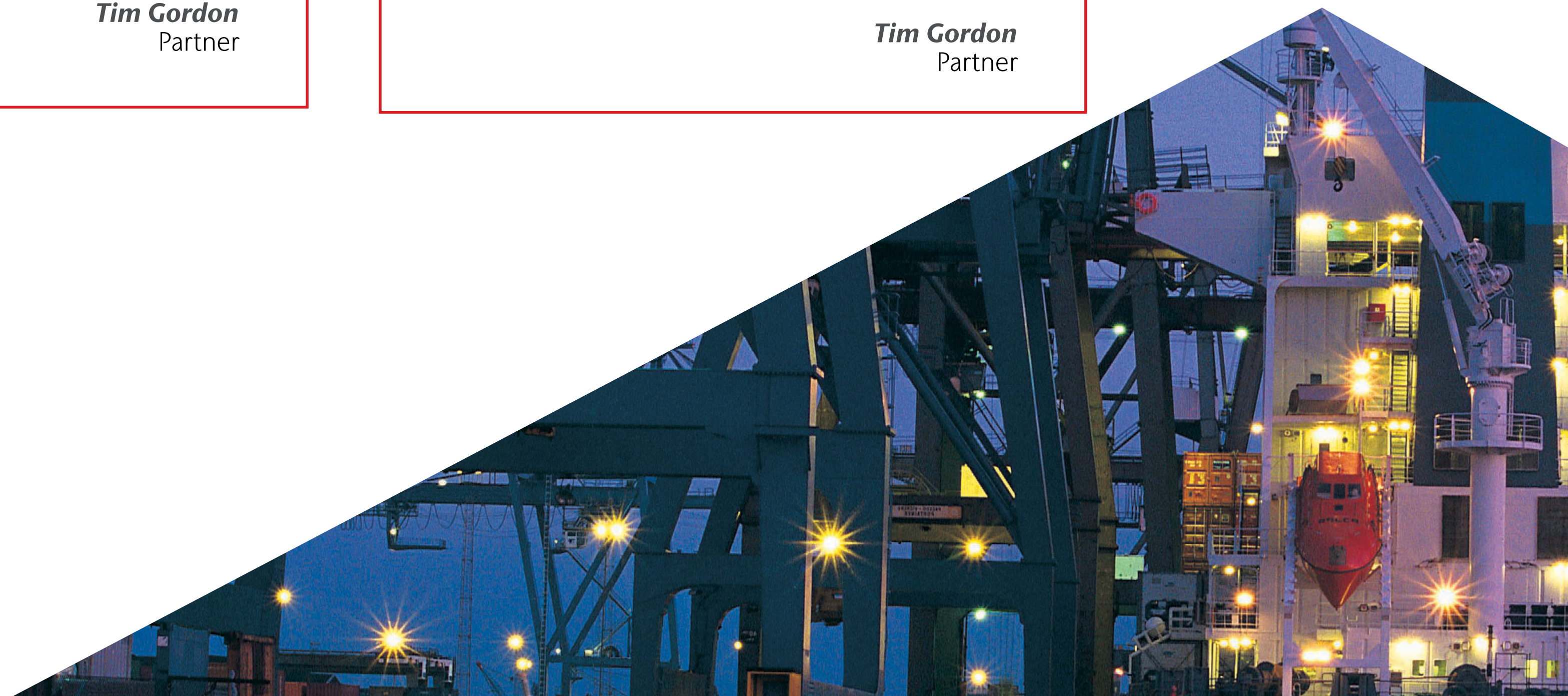
Tim Gordon
Partner

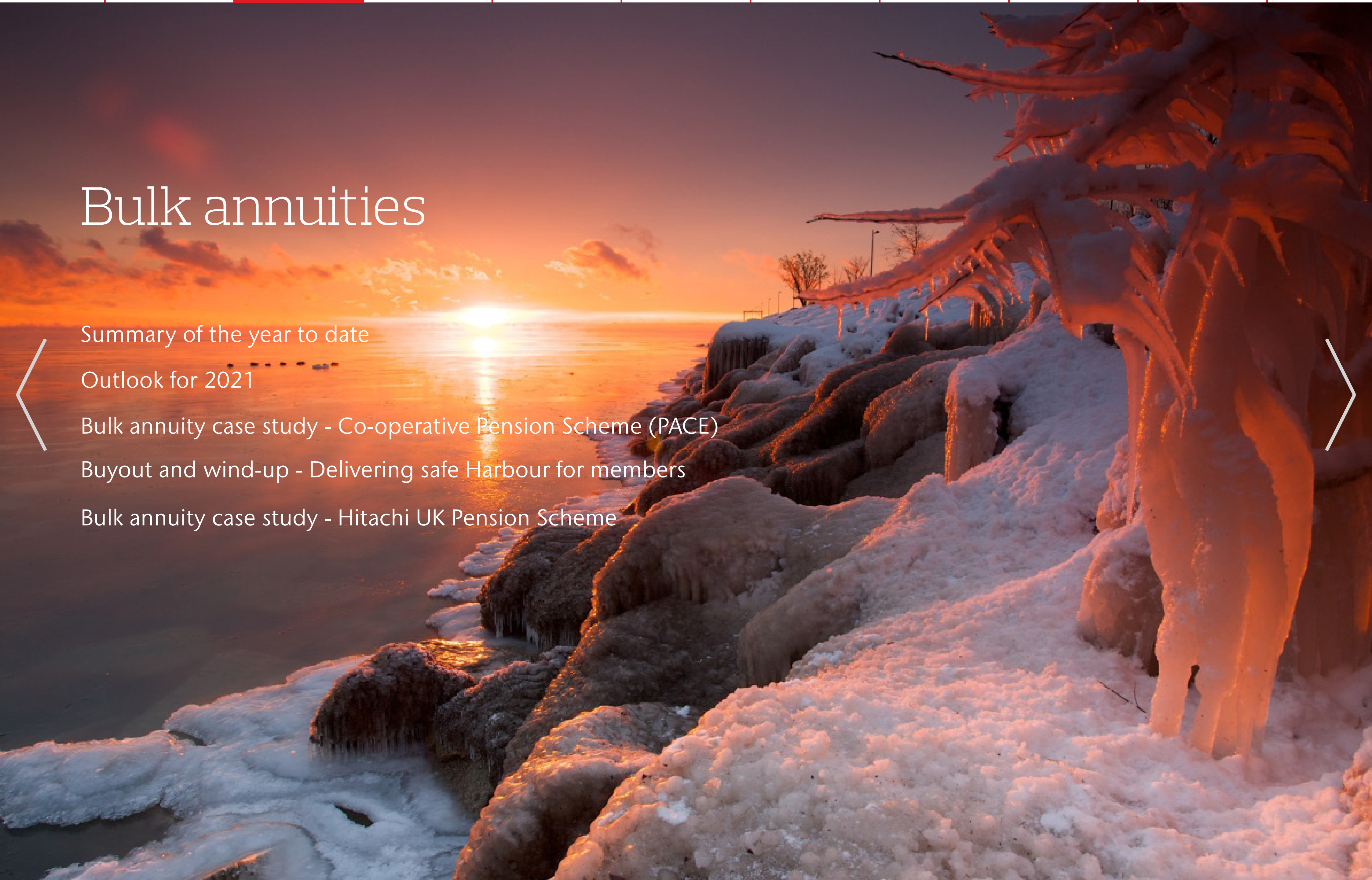
Trustees Ask – Jane Beverley, LawDeb

Q: Does it make sense to insure against longevity risks in the midst of a pandemic?

A: Longevity risk has not gone away – if anything, uncertainty has increased. If you are trying to reduce your exposure to increasing longevity, then the tools you would have looked to before the pandemic, such as longevity swaps and bulk annuities, remain exactly the same tools that you should be looking to now – they are still just as effective.

Tim Gordon
Partner





Bulk annuities

Summary of the year to date

2020 has been another fantastic year in the bulk annuity market with transaction volumes expected to reach close to £30bn, making it the second busiest year on record.

However, the market has seen far fewer of the headline-grabbing £1bn+ transactions compared to 2019 and yet has remained buoyant during one of the most turbulent markets in recent history. So, what's been driving volumes?

A key theme of 2020 has been the increase in mid-sized and smaller transactions, as schemes took advantage of strong insurer appetite and excess capacity on the supply side.

Opportunities continued to be available to those able to exploit the remaining spare capacity in the market during H2, particularly from those insurers keen to make up lost ground from a cautious H1.

Smaller schemes, particularly those adopting streamlined auction processes such as Aon's *Pathway*, also reaped the benefits of the spare capacity in the market with insurer appetite and pricing levels materially better than what was available in 2019.

2020 has been a testament to the resilience of the industry and its ability to quickly adapt to the challenges faced. For those well-prepared schemes, it has been a year of opportunity, with many continuing or even accelerating their de-risking plans as the market continues to build momentum.

COVID-19 market impacts

The dramatic market volatility in March created pricing opportunities that some well-prepared schemes were able to capture, although some transactions were put on hold, partly due to prohibitive trading costs for bonds, volatile funding positions and operational bandwidth. Normal trading returned by May and most stalled transactions subsequently resumed.

Indeed, the run-rate of new deals for 2020 remains in line with the 150 written in 2019, partly because the pace of new sub-£100m deals has not slowed during lockdown, seizing the opportunity whilst the market is less busy on larger deals. It remains true that each case must pass testing criteria from an insurer before they will commit to pricing work. To enable this, streamlined services such as Aon's *Pathway* have helped maximise interest and ensured cases are ready to trade.

Stephen Purves
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The digital deal

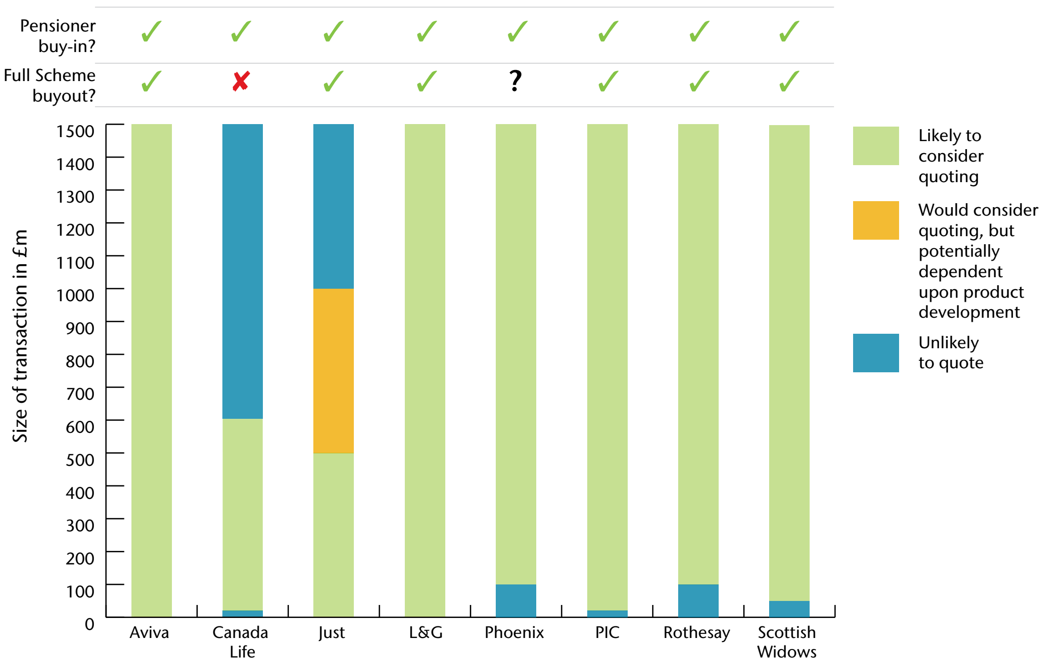
More than ever, the post-lockdown environment has demonstrated the need for rapid decisions in a very dynamic market, in order to capture the best opportunities for pricing and for a smooth asset transfer. 2020 transactions have been characterised by schemes, insurers and asset managers embracing virtual meetings and new technology and establishing clear practical decision-making processes. This positive drive forward in practices from the outset of lockdown is remarkable, and something we expect to be maintained for the future.

Repeat buyers

There has been a strong trend of 'repeat buyers' driving market volumes during these difficult conditions – they represent over half of the disclosed market in the first half of 2020. The repeat buyer trend has reinforced the necessity for schemes to plan ahead in order to move quickly and to be able to execute as opportunities arise. Repeat buyers develop nimble governance, enabling them to make swift and effective decisions. In a busy market, particularly where resource has been stretched by COVID-19 challenges, insurers have looked for transaction certainty – so a track record of successful deals also helps schemes to stand out.

Outlook for 2021

Insurer appetite in 2021



Source: Aon Insurer Survey, October 2020

Insurer appetites for transactions of different sizes and profiles change over time, even within a particular year. This may be due to external or internal commercial drivers. Going into 2021, both Just and Phoenix have increased appetite for transactions involving deferred members which should lead to even more competition for full scheme buyout transactions.

John Baines
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Trustees Ask – Martin Collins, 2020 Trustees

Q: How much of the market is open to sub-£10m schemes and is there good engagement and interest from insurers at that size?

A: As shown to the left, Aviva, Just and Legal & General all quote on sub-£10m transactions and have appetite for deferreds as well as pensioners. However, the positioning of the transaction is important to achieve the best engagement and pricing – streamlined processes are key, with standardised legal terms, thorough preparation, so that post transaction cleansing is minimised, and potentially working exclusively with one insurer rather than all three.

Stephen Purves
Partner

Anticipated bulk annuity volumes

In response to the Aon Insurer Survey, October 2020, all insurers stated a commitment to the UK annuity market, with four of the eight insurers having a desire to increase their volumes from current levels. Based on the insurer responses to our survey, overall capacity over the next five years is projected to be £30bn-£40bn a year, but a number of insurers noted that they would be happy to write more business if the market opportunity arises.

"We expect the market to remain buoyant going into 2021 and for that momentum to continue over the foreseeable future as schemes continue to move along their de-risking journey and secure more of their members' benefits with an insurance company." **Legal & General**

"There are huge opportunities for the bulk annuity market in 2021 and beyond. We expect to continue to see increased demand among pension schemes for bulk annuity buy-ins and buyouts, together with improved affordability, and with appetite from insurers and reinsurers set to remain buoyant." **Phoenix**

2021 may see the re-emergence of the numerous larger £1bn+ transactions seen in 2019, and we expect these to be keenly contested if that is the case.

"Our appetite increases with size, and we have never seen a deal which is larger than we would quote on" **Rothesay**

Potential headwinds

It seems the industry has not yet managed to mitigate the potential headwinds. The current (even lower) interest rate environment was cited by some insurers as a concern, due to the potential impact on scheme funding levels, along with the overall health of scheme sponsor's balance sheets, in light of the challenging economic outlook.

The responses to the Aon Insurer Survey, October 2020, were very similar to those seen in 2019, where concerns centred on:

- A sufficient supply of high yielding assets to support market pricing and growth
- Sufficient reinsurance capacity at a suitable cost
- The number of appropriately skilled people to do the work needed across the industry.

Canada Life noted that *"market volatility, especially when linked to the potential impact of the second wave of COVID-19"* could provide both a challenge and an opportunity to the bulk annuity market over the coming year.

Just are particularly keen to drive innovation, to ensure smaller schemes can achieve competitive pricing:

"The market needs to find a way to make the whole process more efficient, streamlined processes have helped with that but other innovative ways to improve could be considered to ensure smaller schemes can still get competitive processes without impacting insurers' capacity materially." **Just**

Opportunities for schemes

Whilst the ongoing COVID-19 pandemic, RPI/CPI consultation and Brexit negotiations could cause uncertainty and volatility in markets, it is possible that market opportunities may arise from this volatility, where insurers are able to offer outstanding pricing. To be able to capitalise on these opportunities, it is important to be actively seeking quotations in the market.

"From a scheme's perspective, the biggest opportunity is to be able to capitalise on market opportunities and accelerate their de-risking plans.
Schemes which are well-funded and well-prepared should therefore have the greatest opportunities available to them." **Aviva**

Trustees Ask – Charles Ward, Dalriada

Q: How can schemes best seize opportunities in volatile market conditions?

A: It is important for schemes to approach the market for quotations as soon as they are ready, rather than trying to enter the market when a pricing opportunity arises. Having insurers actively pricing your scheme makes you well placed to seize opportunities if they arise.

In order to capitalise on those opportunities, flexibility can be key – both in the structure of your quotation process, and in the timing of any transaction. Nimble decision making is also important, as opportunities can be short-lived, and insurers can sometimes require decisions within a matter of hours. Finally, having existing contractual terms in place e.g. through streamlined pre-negotiated contracts, or bespoke umbrella agreements, reduces the risk of completing a transaction in volatile market conditions as the time to signing the contract would be much shorter.

John Baines
Partner

Bulk annuity case study

Co-operative Pension Scheme (PACE) – £2.75bn in a series of pensioner buy-ins split between Aviva and PIC

Aon was the lead settlement adviser to a Joint Working Group (JWG) of Trustee and Sponsor and responsible for preparing and structuring its first buy-in transactions.

The JWG agreed to explore an initial £2bn pensioner buy-in as the next stage in its de-risking journey in 2019. However, as 2019 progressed, record volumes transacting in the market meant that insurer capacity was stretched, with many effectively closed to new business until 2020.

By leveraging the flexibility the JWG had on timing, the Scheme was able to offer insurers the option of a transaction in early 2020 which helped unlock insurer appetite and improved pricing levels with terms and price-locks agreed to complete two separate transactions with Aviva and PIC in early 2020.

Having completed these transactions, the opportunity arose again in March and April 2020 as the impact of COVID-19 hit markets and credit spreads widened, allowing the Scheme to add to its existing buy-ins, with additional follow-on transactions of £350m and £400m, with Aviva and PIC respectively.

"2019 was a record year in the bulk annuity market and as the year progressed it was clear that structuring and timing was going to be critical. By approaching the market in the right way in 2020, we were able to unearth pricing opportunities by firstly leveraging the flexibility we had on timing and secondly by splitting the business between two insurers. This also then paved the way for the next window of opportunity which came around quickly in Q2 2020, allowing us to complete two follow-on transactions in a matter of days and at the height of the market volatility" **Tom Scott**

Tom Scott
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Buyout and wind-up – Delivering safe Harbour for members

Since 2018, the annuity market has seen a notable increase in billion pound plus pension schemes being fully insured with bulk annuities. This reflects improved annuity pricing and stable and successful scheme asset strategies and we expect this trend will return as the market continues to mature.

However, these transactions do not mark the end of the scheme's life: key steps remain for delivering a smooth transfer of responsibilities to an insurance company, with a focus on member impact, trustee protection and a carefully planned timescale to bring the buyout to a close. This has been a particularly strong focus of the market in 2020 following several recent high-profile full scheme transactions.

We have been concluding buyouts since the 1990s, bringing over 500 schemes to their objective of full settlement. But even now, the nature of buyout continues to shift, with several market developments needing to be incorporated carefully in the planning process. For example, implementing dual records to address GMP inequalities, or ensuring overseas members retain access to compensation arrangements – the key to a successful and efficient process is seeing the overall picture.

Schemes have become more sophisticated in member servicing. Members can often draw their different pension benefits in several ways, and a growing number are impacted by tax protections to preserve entitlements. Some schemes provide at-retirement advice services, interactive websites and links to sister defined contribution schemes.

All of this needs to be considered in the handover to the insurer, as member services will be different, and some flexibilities and tax protections may be lost.

Our *Harbour* service is specifically focussed on achieving buyout in the most optimal way for each scheme. Our close working relationships with each insurer have helped shape market practice over time, including developments needed to facilitate the buyout of recent multi-billion land-mark deals, which ultimately also benefit other schemes.

In our experience, a well-run buyout is just as important and rewarding for trustees and their advisers as the broking of a bulk annuity contract and carries a similar number of interacting risk issues to be resolved. The risks may be more subtle, but they require firm dedication and strong team-working to resolve. Aon's *Harbour* has been designed with this in mind.

Dominic Grimley
Principal Consultant
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Trustees Ask - Chris Martin, ITS

Q: What are the best ways of managing the risks in a buyout process?

A: Some key tips to manage the buyout process are:

1. Day one planning to encompass the needs of all stakeholders from outset and anticipate in advance the many pitfalls that can cause delay and cost. At this point professional advisers' views can be aligned.
2. Understanding the membership, to work out which of the different routes to attaining buyout will deliver the optimal timescale.
3. Maintaining a close working relationship with the rest of the scheme advisory team but also with the insurer's own teams, to make sure all resourcing and responsibilities are clear and acted on throughout.
4. A real focus on a carefully staged communication programme, to take the members through the steps leading to their own insurance policy, and especially on decisions they need to make during the process.
5. Appropriate trustee protection so that they can hand over the reins reflecting on a job well done, without residual worries.

Dominic Grimley
Principal Consultant

Bulk annuity case study

Hitachi UK Pension Scheme – Full risk reduction in 30% of the time!

Collaboration, planning and a single-minded focus delivered the Hitachi UK Pension Scheme's full buy-in journey 7 years ahead of plan.

2017	H1 2018	H2 2018	2019	2020
10 year phased buy-in strategy agreed between Trustee and Company	£100m buy-in completed with Scottish Widows	Assets de-risked to lock in favourable funding position	Extensive data and benefit cleansing carried out for whole scheme	£275m buy-in completed with Legal & General

"Securing members' benefits is the ultimate objective for all trustees. We worked with two strong insurers to meet this objective for the Scheme and were able to take advantage of favourable market pricing due to effective decision-making achieved as a sole corporate trustee. Aon successfully led the transaction and, with legal advice from Pinsent Masons, negotiated a strong outcome, delivering financial security to members for the future." **Jo Myerson, Ross Trustees, Chair of the Trustee**

Collaborative strategy

In 2017, the Trustee and Company jointly agreed a 10-year phased buy-in strategy with insurance transactions planned to occur every 3 years as the scheme matured. This up-front agreement of the strategy was crucial in shaping the pace of early investment de-risking, the timing of data and benefit cleanse work and ultimately facilitated the rapid decision making needed to accelerate the strategy in 2020.

Michael Walker
Principal Consultant
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Initial 2018 transaction

A Joint Working Group was set up to steer the first transaction which was planned for late 2017. Initial pricing was positive, but Aon advised that insurers may be able to offer even better pricing if they were given flexibility around the transaction date. This was proved right with Scottish Widows delivering a material price reduction for an early 2018 transaction, allowing them to kick start their year on a strong note.

Planning for the next buy-in

Following completion of the first buy-in all parties focussed on getting the Scheme ready for future deals:

- Aon's investment team advised on the early de-risking of the assets, locking in the scheme's favourable funding position and reducing future transaction costs by ensuring the scheme was invested in liquid insurer friendly assets;
- Comprehensive data and benefit cleansing was carried out for both the insured and uninsured populations, utilising the experience gained from the first transaction to efficiently and cost effectively prepare for subsequent buy-ins.

Completing the journey 7 years ahead of plan

In late 2019, improved insurer pricing suggested the phased buy-in timeline could be materially accelerated. The Joint Working Group met and agreed pricing should be sought for a buy-in for all uninsured members. Despite the market volatility and uncertainty seen due to COVID-19, the Scheme was able to secure very attractive pricing and completed a £275m buy-in with Legal & General. The combined transactions provide security for all members and left a material surplus to fund GMP equalisation and wider costs for the years to come.

Longevity swaps

Summary of the year to date

Outlook for 2021

Summary of the year to date

In 2020 we have seen increased demand from UK pension schemes seeking to hedge longevity risk. This reflects, among other things, that many schemes have well established plans for managing investment risk and are now turning their attention to longevity risk as a key residual exposure. The table shows that over £15bn of pension scheme longevity swaps have closed in 2020, with more expected in 2021:

Pension scheme	Date	Size	Type / structure used
Prudential Staff	Nov 20	£3.7bn	Captive
UBS	July 20	£1.4bn	UK pass-through via. Zurich
Willis Pension Scheme	Jun 20	£1bn	Captive
Lloyds Banking Group	Jan 20	£10bn	Structured via. Scottish Widows

Hannah Brinton
Principal Consultant
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COVID-19: is now a good time to transact?

We have worked closely with a number of schemes throughout the pandemic, carrying out lots of in-depth scenario testing and analysis to help schemes understand the potential pros and cons of the decision to hedge longevity risk. We see there is a balance to be struck between concerns over heavier mortality arising from future waves of COVID-19 vs. the potential for pricing to increase as a reflection of a longer lived residual population following the initial waves. In addition, the long-term outlook will be impacted by wider factors such as the impact on the economy, healthcare and social spending and medical developments, all of which are increasingly uncertain following recent developments. Overall, whilst the risk distribution is wider and slightly more skewed towards heavy mortality outcomes, at present our view of best estimate mortality remains broadly unchanged.

"At present, we don't see any reason to pause longevity transactions specifically in light of COVID-19 but are monitoring developments closely and (as we have demonstrated in the past – through pausing over £10bn of transactions in 2016 when we were publicly vocal around market pricing becoming stale and not reflecting emerging data) we will not be afraid to advise clients to pause if it doesn't make sense to transact." **Tim Gordon**

Longevity hedge structuring: an evolving market

In recent years we have seen significant evolution in the longevity reinsurance market. Specifically:

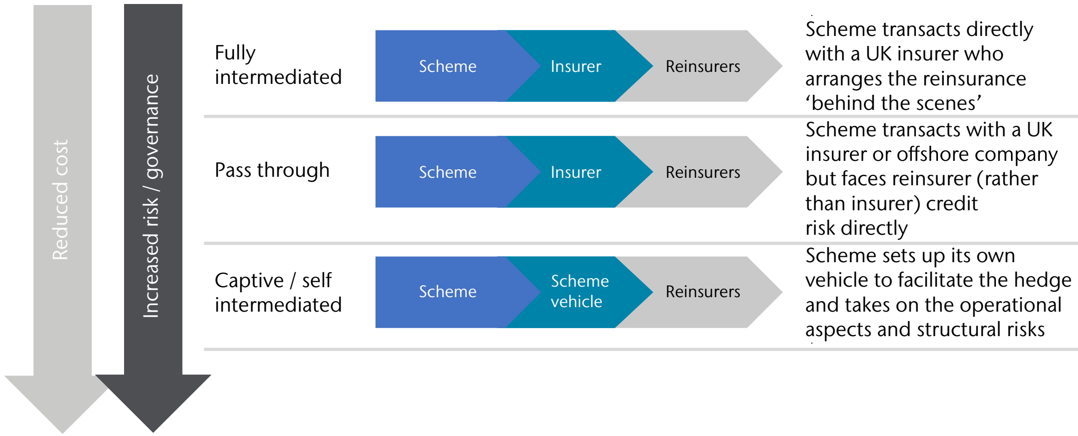
- A greater range of structural options for larger transactions have emerged, with cost savings available for schemes accessing reinsurance more directly and/or taking on operational aspects or structural risk
- Longevity hedging is becoming increasingly accessible to mid-size schemes

Can mid-size schemes hedge longevity risk?

Some reinsurers are becoming increasingly comfortable pricing based solely on socio-economic analysis (with postcode as a proxy for health and wealth) where credible experience data isn't available. This is due to the experience they have gained from reinsuring significant volumes of bulk annuity business for small to mid-size schemes and essentially means that there is now greater scope for mid-size longevity swap deals (covering between c.£100m to £750m of pensioner / in-payment liabilities). This, in combination with our ability to leverage experience from larger transactions, means that a streamlined approach can be adopted for mid-size pension schemes to efficiently hedge longevity risk.

What are the structuring options for larger deals?

The key options are:



Q: How do I decide on the right structural option?

A: There is no 'one size fits all' – we've helped schemes implement captive structures where they have sufficient scale to achieve material cost savings and appetite / resource for operation of the hedge. We've also helped many schemes structure transactions with UK insurers using either 'fully intermediated' or 'pass-through' structures. It is important to understand the options to make an informed decision on the right approach for your specific circumstances and also to have a clear view on your preferred structure *before* you engage with the reinsurance market to get the best outcome.

Hannah Brinton
Principal Consultant

Outlook for 2021

We have seen increased capacity and appetite from many reinsurers in recent months and new entrants, such as MetLife, have increased overall market capacity. However, reinsurers have finite pricing resources and are increasingly having to select and prioritise transactions (in a similar way to what has been observed in the bulk annuity market in recent years).

Compounding this 'capacity crunch' is the fact that the longevity reinsurance market is busier than ever before with bulk annuity providers seeking to reinsure increasing volumes of longevity risk. As such, pension schemes are having to compete with bulk annuity providers for reinsurer pricing resources. This begs the question of "how do you get the attention of the reinsurers?"

Structuring before you engage with the market is key. When you engage with the market, reinsurers will be looking for a clear idea of how your transaction will be structured. This provides both transaction certainty and enables reinsurers to accurately price for the envisaged structure.

As well as this, along with wider data and benefits preparation, a **cashflow model is pivotal** in ensuring that reinsurers model benefits correctly and price on a consistent basis. Further, use of a cashflow model provides a platform for more granular analysis of reinsurer pricing bases which puts pension schemes in the optimal position for negotiating and achieve the best possible aggregate pricing. In addition, **up to date marital information** needs to be collected, in the absence of this information reinsurers will charge an additional premium for uncertainty in relation to the marital risk they will be taking on and may even refuse to quote. Our handy checklist to the right highlights the key areas to focus on for success.

Mike Edwards
Partner
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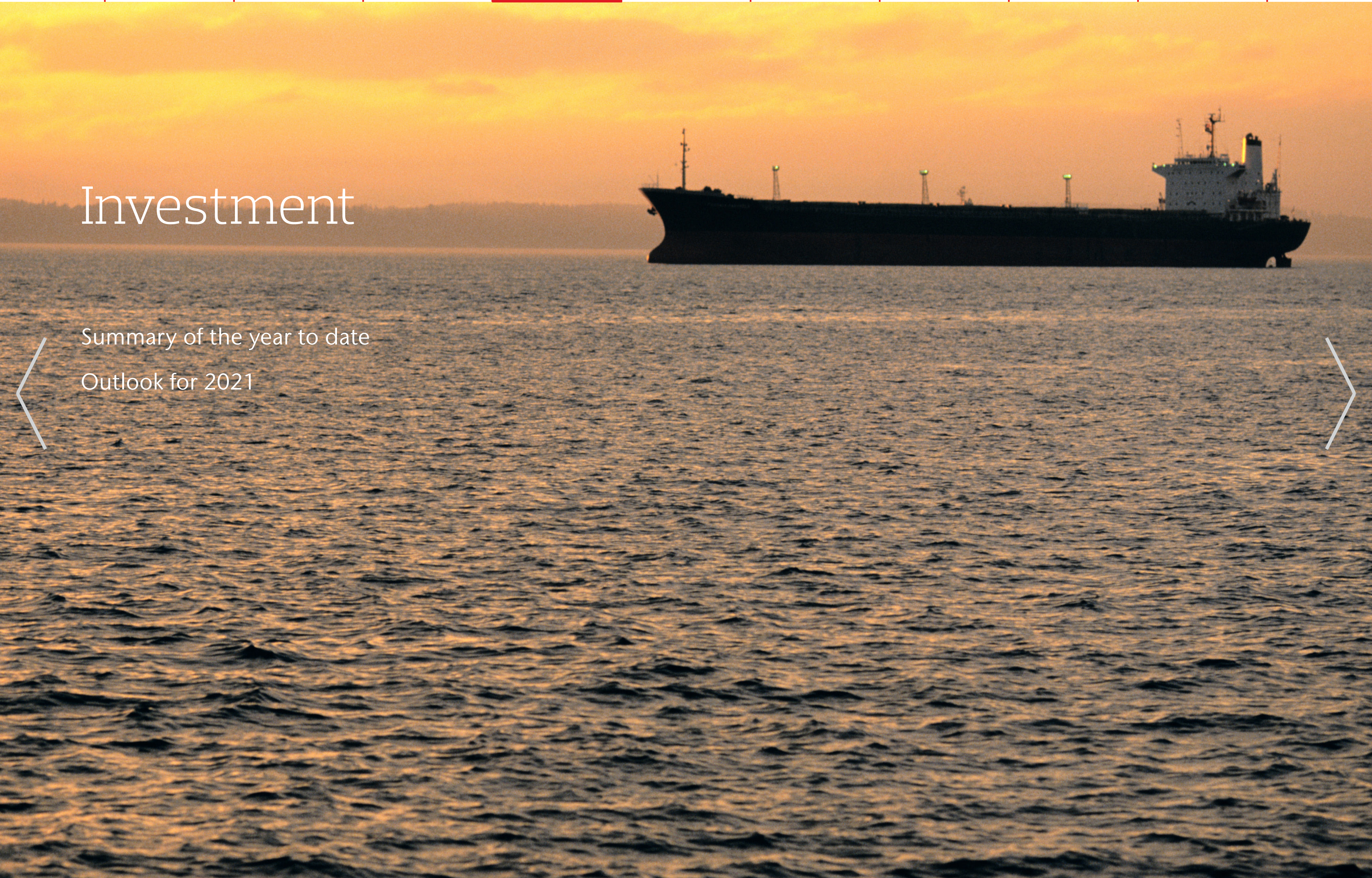
Checklist: How to stand out in a busy market

- Structure *before* engaging with the reinsurers
- Use of an experienced adviser
- Collect up to date marital data
- Obtain credible experience data
- Prepare data pack and benefit specification
- Establish governance arrangements
- Prepare a cashflow model



Investment

Summary of the year to date

The impact of COVID-19 on markets this year cannot be underestimated. While this has longer term implications for pension schemes and their investment strategy, the impact on schemes nearing risk settlement transactions is also significant.

Despite the far reaching economic impacts of the pandemic, equity markets have bounced back with force, by mid-October equity markets were back at all-time highs – seeming oblivious to the world around them. Clearly this is a sign of the quick action of central banks and governments around the world which have put together appropriately 'unprecedented' stimulus packages.

For schemes who have been looking to enter into a bulk annuity this year, illiquidity in markets has been a key concern. The uncertainty surrounding COVID-19 led to one of the worst liquidity events on record, outstripping anything seen during the Global Financial Crisis – severely inhibiting clients' ability to sell even the most 'tradable' assets such as gilts.

For schemes looking slightly further ahead, the further falls in gilt yields seen over 2020 have meant that those who are poorly hedged continue to suffer headwinds – likely delaying their ability to purchase a bulk annuity. Meanwhile schemes with high levels of hedging have likely weathered the proverbial storm well. For such schemes, funding levels will likely have risen notably in over the last 12-18 months – this may provide an opportunity to switch some of the assets from matching portfolios to a buy-in. In such cases our clients have been able to increase the yield on the matching portfolio, taking advantage of favourable annuity pricing.

Ross Mitchell
Principal Consultant
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Trustees Ask – Martin Collins, 2020 Trustees

Q: For schemes considering a transaction and possible in-specie transfer of assets to an insurer, are there any asset classes they should avoid?

A: Closed-end illiquid vehicles are in most instances impossible to transfer to an insurer – no matter how willing the insurer may be. Whilst we have had some great success in negotiating deferred premium structures for such assets, these are likely to be reserved for larger transactions.

Having a well-developed de-risking plan which incorporates your illiquids portfolio is crucial – thinking 10 years or more ahead is also key for these asset classes.

Ross Mitchell
Principal Consultant

Outlook for 2021

As with 2020, we expect the investment environment to remain volatile, ruled by both COVID-19 and stimulus measures, however some of the shorter-term distractions (such as the US election and Brexit) will have abated hopefully easing some volatility.

The volatility in markets means that the importance of preparing your assets for the purchase of a bulk annuity is greater than ever. As noted previously, protecting against changes in interest rate and inflation remains extremely important for pension schemes – we would strongly advocate the use of Liability Driven Investment given the flexibilities it brings to schemes and risk reducing qualities.

While credit spreads have fallen to levels which are close to our view of ‘fair value’, we continue to believe they have a role to play in the portfolios of schemes targeting buyout. While the range of assets insurers are using is now more varied than ever (incorporating increased levels of illiquid assets such as private debt, property debt, equity release mortgages and infrastructure), bulk annuity pricing remains strongly correlated to corporate bonds. Where possible, schemes should look to diversify their corporate bond portfolio globally which will help to improve risk adjusted returns whilst also providing a better match to insurer portfolios. Alternatively, synthetic solutions (using Credit Default Swaps within pooled funds or segregated mandates) can provide cheap and quick exposure to credit – historically these solutions have provided a good match for insurer pricing, even during stressed environments, and are lower cost to adjust and unwind as a scheme reaches the point of transacting with an insurer.

One theme from 2020 which we expect to persist into 2021 (and potentially beyond) is a renewed focus on liquidity risk. Since the Global Financial Crisis, the market seemed to become increasingly apathetic to liquidity risk, this bubble burst (with a bang) in February and March 2020.

For a scheme, a bulk annuity is likely to be the largest transition they have undertaken (or one of). Traditionally the focus for in specie transfer of assets has been solely on saving transaction costs. We believe that in the future a greater focus may be placed on other advantages of in specie transfers such as liquidity and execution risk. Planning your roadmap in advance will help to maximise the chance of successfully executing a buy-in – ensuring that your portfolio is flexible to take advantage of opportunities when they arise.

Lucy Barron
Partner
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A developing marketplace

There have been significant developments in the risk settlement marketplace over recent years, 2020 has been no exception. With the launch of a regulatory framework for consolidators and capital backed investment vehicles there are now more routes to buyout and/or risk reduction than ever before.

While many schemes will continue to target a traditional buyout route, the new possibilities do give increased flexibilities to trustees. While it's not realistic for trustees to plan for each and every eventuality, there are some things which can be done to ensure that opportunities can be exploited should they arise – or if you are unexpectedly blown off course.

We believe that carefully considering your investment strategy in the last 5-10 years before buyout is a key to success. Focusing on minimising risk while maximising flexibility will allow you to exploit opportunities as they arise. Areas such as illiquid assets are frequently overlooked and without careful consideration can cause problems. Equally having a well-prepared investment strategy can materially reduce the costs associated with risk settlement and allow insurers (and in due course consolidators) to prioritise well prepared schemes with well-matched and flexible investment strategies in what is a busy market.

Sticking to the core principles of carefully managing risk and keeping your investment strategy as flexible as possible is going to help maximise your chances of success – even if your vision of success changes through time.

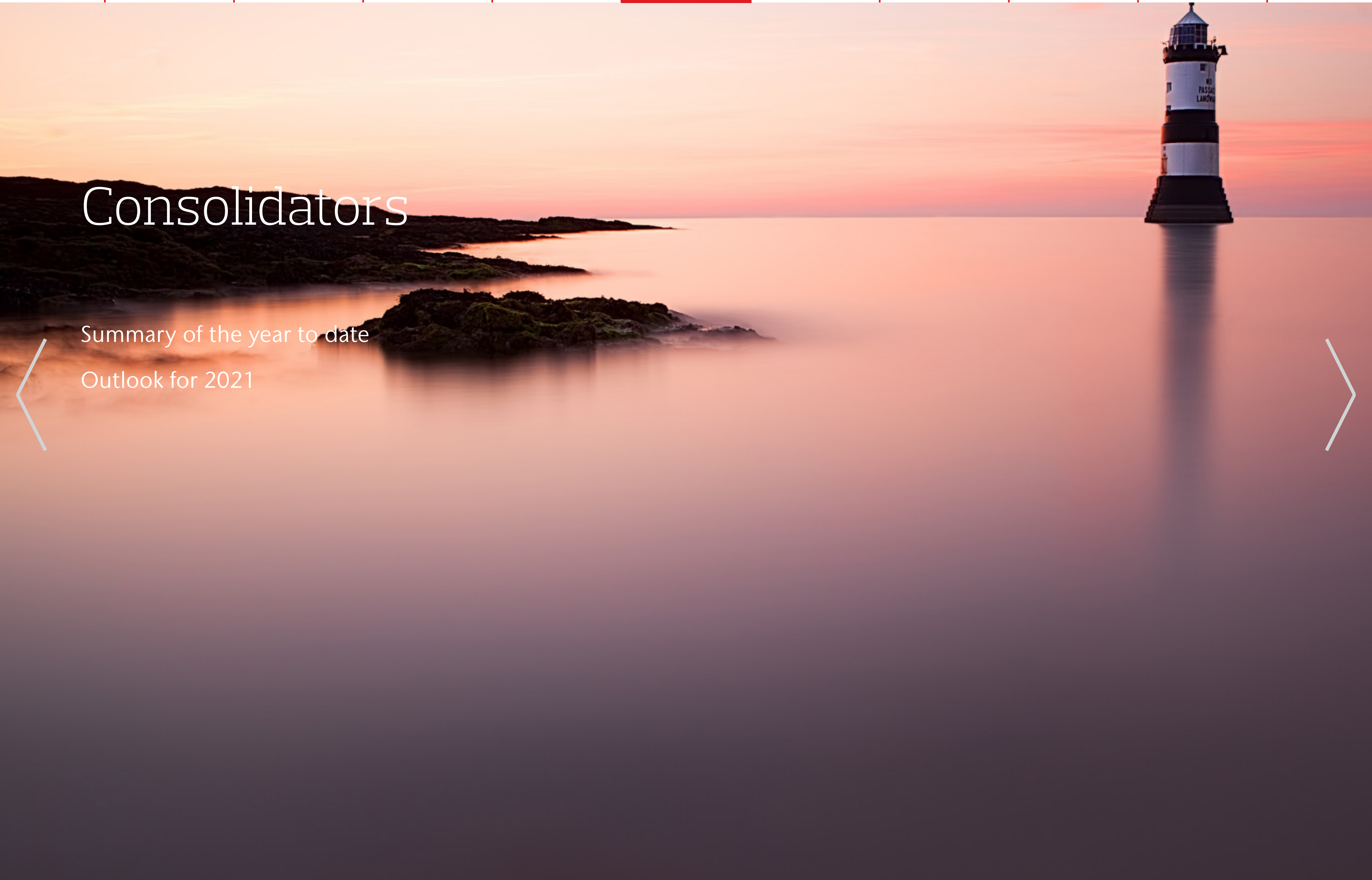
Trustees Ask – Martin Collins, 2020 Trustees

Q: Are there funds offered by insurers that can be invested in advance, in the knowledge that in specie transfer will be easier and more efficient at point of execution?

A: Several asset managers offer 'buyout ready' funds which are easier to transfer to their own insurance arm. Whilst these solutions are helpful, by their very nature their focus is narrow – naturally directing you towards their insurance arm and providing hedging based on their pricing factors.

While there is obviously no commitment to ultimately transact with their own insurance arm, trustees should consider whether their existing arrangements are able to provide the necessary range of tools while looking to the wider market to decide on how best to reduce risk.

Lucy Barron
Partner



Consolidators

Summary of the year to date

Outlook for 2021

Summary of the year to date

Finally, the starting gun was fired!

- In June 2020 the Pensions Regulator issued 'guidance for DB superfunds' so that commercial consolidators could start working through the approval process and begin planning for their first transactions.
- Then in late October 2020, the Pensions Regulator issued guidance on the process it expects from trustees and sponsors when considering commercial consolidators.

At the time of writing (December 2020), the Pensions Regulator is still to approve any consolidators, meaning that no transactions have completed, but it feels like only a matter of time. From our perspective, there are three key points that have emerged over 2020:

Education has been of real interest during the second half of 2020

The Pensions Regulator's guidance has served as a useful prompt for trustees and employers – remind me, what are commercial consolidators again, and should we be interested? Commercial consolidation solutions have complex structures, and education sessions with trustees and employers have been useful in cutting through the complexity and helping schemes decide the scenarios in which commercial consolidation solutions could be right for them. We have designed an interactive checklist to help identify if consolidation is right for you. Click here to view the checklist.

Some schemes are pressing ahead and considering commercial consolidation solutions in detail, whilst a number of schemes are adopting a 'watch and wait' strategy – they are likely to kick off a project when the concept is proven, but do not want to be 'first movers'.

Range of options

Whilst the Pension SuperFund and Clara are superfunds, and fit neatly into the Pensions Regulator's guidance, capital backed investment solutions such as Legal & General's Insured Self-Sufficiency exist which can form a half-way house. Your scheme benefits from additional external capital but does not fully transfer off balance sheet to another sponsor, meaning trustees retain the existing covenant. Any discussion around commercial consolidation solutions should include capital backed investment solutions too, in addition to insurance and DIY approaches, as comparing and contrasting options tends to help schemes articulate their risk appetite and overall objectives.

Member outcomes

Central to the assessment of commercial consolidation solutions is the modelling of member outcomes – under what approach are members most likely to receive their full benefits? Whilst additional capital from a third party can provide a buffer against poor experience, the time taken to reach fully secure benefits may be delayed, so what is right for one scheme may not be right for another. Scenario testing is important to get to grips with which risks are greatest for your members.

Karen Gainsford
Principal Consultant
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Trustees Ask – Mike Roberts, PAN Trustees

Q: Is consolidation actually well enough understood by lay trustees and sponsors?

A: Many trustees and employers have shown interest in understanding the high-level concept of commercial consolidation, but the devil is in the detail, which is generally only considered once high-level interest and feasibility has been established. It is important for advisers and professional trustees to ensure all key points are understood before decisions are made. In particular, it is important to understand:

- The risks being transferred to the consolidator, and what risks remain.
- The regulatory framework within which the transfer to a consolidator is achieved, and the differences between the UK insurance regulatory framework and that applying to pension schemes.
- The covenant available to the scheme currently, compared to the capital available through a consolidator, and what scenarios could lead to better or worse outcomes for members.
- How the assets that are transferred to the consolidator are used to provide member benefits, and the expected charges paid to the consolidator.

The Pensions Regulator recognises the important role that an independent trustee might play, and actively encourages schemes to consider appointing one where a superfund transaction is considered.

Karen Gainsford
Principal Consultant

Trustees Ask – Marcus Hurd, ndapt

Q: How does the pricing compare between consolidators and insurers?

A: As a broad indication, the assets needed to enter a consolidation solution are in the range of 85% to 95% of the equivalent insurance cost. Where the actual pricing sits within this range depends on a number of factors including the maturity of your scheme membership (more deferreds and fewer pensioners equates to a lower cost) and the consolidation solution chosen. As with insurance, consolidator pricing is subject to negotiation, and well-prepared schemes are likely to achieve the more attractive pricing.

Karen Gainsford
Principal Consultant

Outlook for 2021

We fully expect the first commercial consolidator transaction will take place in 2021 and anticipate that there will be a significant fanfare and interest when it does.

The bigger question is how successful the consolidators will be at achieving scale and how quickly this may happen. We predict broadly £1bn to £2bn of transactions during 2021, comprising a range of scheme sizes. The number of schemes for which consolidation makes sense may increase as the ongoing economic uncertainty caused by the COVID-19 pandemic continues with an increased focus on covenant from many trustees and the Pensions Regulator. Consolidators are well placed to move quickly if needed, for well-prepared schemes.

The role of commercial consolidators in PPF+ cases could be important and, in our view, are likely to make up a significant proportion of early transactions. In these scenarios, members could expect to receive higher benefits than under the normal insurance approach. However, where full benefits cannot be secured in the consolidator, individual member consent would be needed to allow the reduction to member benefits on entry to the consolidator, so clear communication will be important.

Schemes who do not view commercial consolidators as being right for them may still benefit from understanding the innovation and applying to their own scheme.

- Clara's business model of acting as a bridge to buyout has brought to the fore the option of schemes "doing it themselves". Running a low risk investment strategy whilst non-pensioners mature and become pensioners, should lead to buyout funding increasing and buyout potentially becoming viable.
- The Pension SuperFund's business model centred around economies of scale could prompt schemes to reconsider scheme mergers or harmonising trustee boards and advisers.

All in all, it is set to be a really interesting year for the commercial consolidators, and we expect many schemes will be keeping an eye on developments.

John Baines
Partner
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Trustees Ask – Huw Evans, BESTrustees

Q: What factors should be taken into account in deciding whether or not a capital-backed solution is a good option for a scheme? In what scenarios would a capital-backed solution turn out to have been a poor choice?

A: The scheme's key objective is to pay the benefits as they fall due, and so member outcomes are central to deciding whether or not a capital-backed solution is a good option for a scheme. Would the members be more likely to receive their full benefits under the status quo, compared to a capital-backed solution? And importantly, does the answer vary by member – with some being better off and some worse off? Scenario testing should be completed with stresses applied to key assumptions, such as employer viability and investment experience.

With the benefit of hindsight, a capital-backed solution would turn out to have been a poor choice if, for example the scheme could have mirrored the capital backed solution's investment approach and achieved full buyout funding before the sponsor suffered any sort of distress event. This is no different to any other investment de-risking event where the pros and cons need to be considered.

John Baines
Partner

Insurer resilience

Insurer resilience

The disruption to our economy from COVID-19 has been a stern test of the insurance model and, so far, it has held up well.

Annuity funds are required to be run in surplus. The regulatory system effectively compels the insurer to tightly match assets and liabilities, so interest rate and inflation risk in liabilities is largely hedged. It also encourages reinsurance of longevity risk, so most annuity providers are currently hedging this key risk too for new business.

Challenges faced by annuity funds over 2020

However, the extreme recent conditions do create challenges for annuity funds.

Interest rates have become particularly low, partly because of the necessary Government support to asset markets – including Government purchase of significant volumes of bonds. Low interest rates act to increase annuity reserves required and – at such low rates – most existing hedging programmes do not completely protect solvency coverage, partly because surplus' may not be hedged, and partly because of side impacts on reserves required for any retained longevity risk.

Annuity assets include corporate debt, where the market has experienced downgrades (which can also increase required reserves) and – looking into 2021 – there are fear of defaults and hence losses on debt holdings, at least in some sectors.

Other annuity assets are typically linked to property markets in one form or another, and there are also COVID-19 driven concerns over future property values and gaps in rental income.

Reaction to the challenges

Insurance providers have reacted quickly to these challenges – portfolios are already highly diversified and overwhelmingly investment grade, and solvency coverage and liquidity are actively monitored, while reserves are held against asset default risk.

Several providers have now taken further steps, including management actions to increase the risk protection in their portfolio, and portfolio trading to further limit exposure to more at-risk sectors.

Most have recently raised material capital to bolster reserves, and to allow business to be written without taking their solvency coverage outside of their target operational level (which typically requires the insurer to hold 130%+ of the contingent margins specified in regulations).

Some have temporarily cancelled dividend and share buyback programmes and reduced or retargeted new business activities.

Dominic Grimley
Principal Consultant
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The choice of new backing assets to support new annuities has in some cases been partly deferred post deal, with premium payments temporarily placed into a holding strategy such as gilts, giving flexibility to capture asset pricing opportunities and address gaps in the supply of preferred assets.

These activities have allowed insurers to disclose relatively stable solvency positions at different points in the post-COVID-19 environment, and insurers are now adopting a close focus on their end 2020 position, to be reported in the spring.

Simultaneously they are closely watching the Government's review of solvency requirements alongside Brexit, to lobby for less helpful aspects of the insurance regime to change. This could make a stable solvency position easier to maintain in future, without as much active intervention as has been needed in 2020.

Overall 2020 has shown how annuity funds are able, from a starting position of surplus, to react to events and continue to protect the contingency margins backing their commitments.

Trustees Ask – Huw Evans, BESTrustees

Q: Are there any lessons for trustees to learn from the way in which insurers responded to the market conditions experienced over 2020?

A: Closed DB schemes have been moving to more sophisticated hedging strategies, and a greater distinction between rewarded and unrewarded risk-taking. This has followed the practice of annuity funds. Two areas of practice in 2020 specifically that may encourage trustees to review their strategies are:

- Like pension schemes, insurers are assessed against a range of funding and performance measures, and it is impossible to be fully hedged against all of them. In 2020, several insurers considered their hedging strategy dynamically, hedging more of the surplus as well as hedging their liabilities as market conditions became more volatile, as a short-term position to accept less upside in exchange for a more stable position.
- Insurers closely monitor their exposures to different geographies, credit ratings, sectors, individual companies and even individual Governments. At times of market stress, they add extra safeguards such as minimising exposure to at-risk sectors (e.g. leisure, airlines, high-street retail in 2020) and providing public reassurances over their limited resulting exposures. This combination of active re-assessment of risk and early disclosure provides a useful reference for trustees.

Dominic Grimley
Principal Consultant

GMP equalisation

GMP equalisation

Schemes reaching buyout have always been early adopters – out of necessity – of GMP equalisation solutions. Several have been tackling the new more involved approaches required following the Lloyds judgement. As we describe below, the annuity market is quickly adapting to this new norm.

Dual records

HMRC guidance has been supportive of adopting a "dual records" approach. Under this approach, separate information must be tracked for a male and equivalent female member, to actively consider if the pension needs adjusting to remove any emerging inequalities over time.

Dual records was feared to be a major administrative hurdle to tackle, but administrative solutions are now emerging. We expect all of the annuity providers to have access to dual records administrative infrastructure over the next two years. Six of the market's eight providers are doing this by working alongside their external administration suppliers to make use of their IT solutions, and the other two will instead build on their own internal IT systems, which have recently been modernised.

"Whilst our preferred approach is GMP conversion, we are comfortable with any method of GMP Equalisation as long as it has been carried out in accordance with suitable advice." **Scottish Widows**

In 2020, we constructed dual record histories for several of our buyouts, to then allow the insurer to adopt dual records administration in 2021 at the conclusion of the buyout.

GMP conversion

The alternative approach is 'GMP conversion', whereby GMP is completely replaced, which avoids the complexity of dual records. So far this has been the normal approach on smaller new (sub £500m) buyouts. This differentiation by size reflects two points, and it is too early to say whether this will be a lasting feature of the market.

- Firstly, dual records solutions are initially being built following landmark large buyouts, by particular insurers focussed on these cases.
- Secondly, conversion carries some potential tax implications – perhaps only for a very small minority of members, but the impact is difficult to completely measure in advance. It can hence be easier to agree conversion where there are comparatively few members involved, and so fewer potential tax issues, and more of a focus on simplicity afterwards.

Dominic Grimley
Principal Consultant
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Some schemes not considering buyout in the near term are adopting conversion at retirement, so members' GMP is converted individually rather than in a bulk exercise. Insurers cannot currently offer this – partly as conversion is seen as an act performed by trustees, and partly because post-buyout benefit changes can offend both reinsurance treaties and regulatory compliance. Hence these schemes may adopt a different equalisation solution, for their remaining unretired members, on buyout.

Overall equalisation is returning to being a 'can do' on buyout, thanks to the market's significant progress in 2020.

Lloyds ruling November 2020

The new data challenge

Whilst most schemes are currently contending with rectifying or equalising Guaranteed Minimum Pensions (GMPs), a new strand to this work arose on 21 November 2020, when a new court case relating to the Lloyds schemes set out actions required in respect of transfers.

Schemes to make thousands of new small payments?

The ruling suggests reviewing most transfers paid since 1990, with a view to making a top-up payment in respect of any GMP inequality. Many top-ups may only be sufficient to secure a few pounds of monthly pension.

Trustees Ask – Colin Richardson, ptl

Q: How do you think insurers can help schemes with GMP equalisation in getting ready for buyout?

A: Bulk annuity providers have found practical ways to make both dual records and conversion viable options on buyout over 2020. Most use outsourced administration solutions, and the annuity market and its advisers are driving the pace of dual records solutions from administration firms. This has an impact on the wider pensions industry, as it gives more pressure on administration solution development, and these solutions can then also be adopted by DB schemes.

More conviction is also building over future administration costs, after initial fears that dual records would lead to simply unmanageable work levels. On the negative side, the increased can-do attitude to dual records does put less pressure on the Government to deliver a more supportive tax framework for conversion. However, conversion at retirement, before buyout, and dual records post buyout, look set to increasingly be seen as viable solutions.

Dominic Grimley
Principal Consultant

There are material challenges sourcing data, tracking down receiving schemes and making small payments. For commercial pension products, there will often be no right to add to the policy, and charges for policy amendments. The pensions and insurance industries will need to consider how to accommodate this new need as practically as possible.

This need not prevent a scheme for securing an annuity for all or part of its remaining membership. However, it does need addressing before it is wound up.

What will come in?

Your scheme may also receive top-ups itself, in respect of past incoming transfers. However, this would take time – likely to be several years, given schemes are at different stages in cleansing.

We would not generally expect schemes to wait long for these receipts once the trustees have otherwise secured benefits under an annuity and are ready to cease operations.

We are working with the legal community and insurers to agree a pragmatic way to finalise benefits in the absence of receiving these small top-ups, and for these top-ups to be utilised if they do arise.

Residual risks cover – Unknown unknowns

What are the risks for trustees and sponsors post buyout and how can these be mitigated?

What are the risks for trustees and sponsors post buyout and how can these be mitigated?

The ultimate objective for most UK pension schemes is to secure members' benefits with an insurer and wind up the scheme. But does wind-up truly mean trustees and sponsors have discharged the scheme's risks in full?

Michael Walker
Principal Consultant
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Risks

A buyout insurance policy covers specified benefits calculated using the data provided to the insurer for the bulk annuity transaction. If there are errors or gaps in this information (despite cleansing), the risks relating to these errors potentially remain with the trustees and the sponsor. These risks can materialise as:

- **Data errors**
  Data has been incorrectly recorded (individually or systemically).
- **Benefit errors**
  Benefits have been misinterpreted or administered incorrectly historically.
- **Deeds and Rules**
  Amendments to deeds have not been properly executed, or there may be insufficient evidence of this.
- **Member expectations**
  Member communications may have given rise to a reasonable expectation of a different benefit.
- **Missing members**
  Beneficiaries missing from administration records.

Ways to mitigate – pre-buyout

All buyout transactions involve significant effort in ensuring the right benefits have been insured. Steps carried out often include:

- *Review and cleanse of data* pre and post buy-in
- Carry out a *benefit audit* to ensure pensions have been calculated correctly
- Obtain *legal advice* on the benefits secured relative to the Rules and member communications
- *Write to members* asking them to validate the data held in respect of them

Ways to mitigate – post-buyout

However, the above steps don't guarantee to remove all risks. There are three sources of additional mitigation post buyout:

- Trustee Indemnity Insurance – policies are available providing run-off cover against member claims and missing beneficiaries
- Residual risks cover – extends buyout policy to cover data and most benefit errors as well as missing beneficiaries
- Company Indemnity – sometimes offered, for example if uninsurable issues are uncovered (e.g. missing deeds), or as an alternative to Trustee Indemnity Insurance and Residual Risks Cover

Innovation

Residual risks cover can often be obtained for buyouts over £100m. It is not universally offered due to the complex nature of the risks involved and the significant cost for insurers to undertake the due diligence needed to price the risk.

During 2020 we have seen insurers provide increased flexibility with innovative structures, where a single insurer offers residual risks cover insuring benefits from multiple buy-ins across multiple insurers.

We expect further innovation in this space in the coming years as buyout and wind-up becomes an increasing focus for trustees and sponsors.

Biographies

Click on a bio>>

We hope you find the articles interesting and relevant to your own thinking.

Do get in touch if you would like to discuss your scheme in more detail – we would love to discuss the settlement market with you!

Martin Bird
Senior Partner and Head of Risk Settlement
martin.bird@aon.com

Biographies

Click on a bio>>

Martin Bird
Senior Partner and Head of Risk Settlement

Martin leads Aon's Risk Settlement team, is a qualified actuary and authorised to provide advice on insurance and capital markets transactions. Martin has led many of the industry's high profile risk transfer transactions and his extensive range of experience allows him to bring insight from both a pension scheme and investor mindset. Martin is frequently sought out by trustees, sponsors and the media and is widely recognised as one of the UK's leading settlement advisers.

Biographies

Click on a bio>>

Dominic Grimley
Principal Consultant

Dominic is a Principal Consultant in Aon's Risk Settlement team. He has a wealth of experience of bulk annuity transactions and created several parts of our service, including our due diligence offering.

Biographies

Click on a bio>>

Hannah Brinton
Principal Consultant

Hannah has extensive experience and is authorised to advise on all types of settlement transactions. Since 2014, Hannah has advised on over £25bn of risk transfer activity across many high-profile longevity swap and bulk annuity transactions. Hannah has advised on bulk annuity transactions for Thomson Reuters, Royal Mail, the Automobile Association and Bank of America Merrill Lynch.

Biographies

Click on a bio>>

John Baines
Partner

John is a Partner and head of Aon's Bulk Annuity team. John led the development of Aon's Bulk Annuity Compass platform, which was built using his experience of delivering exceptional annuity pricing for his clients.

He has advised on bulk annuity projects between £5m and £5bn, including high-profile transactions for Rolls-Royce, Telent, Morrisons and Rentokil Initial.

Biographies

Click on a bio>>

Karen Gainsford
Principal Consultant

Karen has worked in Aon's pensions practice since 2000. Karen works with clients on de-risking projects and is authorised to provide advice on insurance transactions.

Karen has advised on risk settlement projects from £2m to £2.8bn, and in the past three years has advised on transactions totalling over £8bn. Her clients include National Grid, Siemens and the CAA, and her experience covers both medically underwritten and traditional annuities.

Karen worked closely with Behave London to develop Aon's Behavioural Insights to Risk Settlement guide.

Biographies

Click on a bio>>

Lucy Barron
Investment Partner

Lucy is a Partner and qualified actuary who advises trustees and sponsors, predominantly on DB investment and funding strategies. Lucy has 20 years' experience working with a wide range of schemes, combining her investment management and consulting experience to provide pragmatic, effective and practical solutions for her clients.

Lucy also leads Aon's advice on the investment aspects of risk settlement transactions. Lucy and her investment colleagues provided investment input and advice on almost £20bn of the £43bn of risk settlement transactions in 2019. She has provided specialist investment advice on buy-in and buy-out transactions ranging from £10m up to the largest buy out transaction in the UK namely the £4.7bn transfer of the GEC 1972 (Telent) Pension Plan.

Throughout her career Lucy has had a focus on advising schemes about the design, implementation and monitoring of de-risking investment strategies. She has worked with clients implementing these strategies since LDI started to become popular in the UK in the mid-2000s, initially as an investment consultant at Mercer until 2008 and subsequently within the front office solutions teams at Insight, LGIM and AXA prior to joining Aon in 2017.

Biographies

Click on a bio>>

Matthew Fletcher
Senior Consultant

Matt is Aon's expert on drivers of mortality change, including international mortality trends and causes of death.

His recent work has included:

- Advising a major insurer on best estimate mortality assumptions for a significant longevity reinsurance deal
- Advising large UK pension funds on longevity risk, including medical scenarios, and benchmarking against longevity risk model outputs

Matt chairs the CMI Self-Administered Pension Schemes (SAPS) Committee, producing mortality tables that are used extensively in the pensions and insurance industries.

Biographies

Click on a bio>>

Michael Walker
Principal Consultant

Michael is a Principal Consultant and senior risk settlement adviser. His extensive annuity experience comes from both sides of transactions having led one of Legal & General's UK and US bulk annuity pricing teams prior to joining Aon's Risk Settlement Group in 2016.

Michael advises on a wide range of transactions, both in the UK and overseas, covering longevity swaps, buy-ins and buyouts. Recent projects include Xylem's complex full scheme buyout, Leonardo Electronics' pensioner buy-in and Hitachi's full scheme buy-in.

Biographies

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Mike Edwards
Partner

Mike is a Partner in Aon's Risk Settlement team. He has over 17 years of pensions and insurance industry experience and previously led the transaction structuring team at Scottish Widows, where he was responsible for the negotiation and completion of over £2.5bn of deals since its market entry in 2015.

Since joining Aon in early 2018 Mike has led the advice on over £14bn of bulk annuity transactions of a variety of structures and sizes, including complex multi-billion pound transactions for National Grid and Asda.

Biographies

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Ross Mitchell
Principal Consultant

Ross is a Principal Consultant in Aon's investment practice. He is a member of Aon's Investment Risk Settlement team which is responsible for assisting clients in planning for and meeting their risk settlement objectives. His expertise in transitions means he is able to provide valuable insights during this sensitive time for clients – ensuring that investment and transition risks are carefully considered during this process.

Biographies

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Stephen Purves
Partner

Stephen is a Partner in Aon's Risk Settlement Group. He has 20 years' experience advising both trustee and corporate clients on buy-ins, buyouts and pension scheme wind-ups. He also brings insurer-side experience from his time at Aviva, where he was head of new business and deal structuring for bulk annuities, and was key to doubling its market share and increasing volumes of new business by more than 300%.

Stephen has led and advised on many large and complex bulk annuity transactions involving premiums in excess of £15bn including four pensioner buy-ins totalling £2.75bn for Co-op in 2020.

He has also been involved in developing several innovations and transaction features which are now prominent in the wider market today and is a regular speaker at industry events and seminars.

Biographies

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Tim Gordon
Partner

Tim is a Partner in our Risk Settlement Group and Head of Demographic Horizons™.

Tim is responsible for the longevity and other demographic modelling that underlies Aon's advice and in particular our Risk Settlement Group's transaction and broking advice.

In addition, Tim has advised reinsurers on best estimate mortality for over £100bn of UK pensions-related transactions liability, including the largest longevity transactions on either side of the Atlantic.

Tim previously chaired the CMI, the body responsible for the UK actuarial profession's standard mortality, and in particular, chaired its Mortality Projections Committee through the revision of its mortality projections model. Tim has held other roles at the Institute of Actuaries and published a number of thought-leading papers in the areas of financial economics, pension plan funding and sponsor covenant assessment.

Biographies

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Tom Scott
Principal Consultant

Tom is a Principal Consultant and has wide-ranging settlement experience. His recent projects include the multiple buy-ins executed by the Co-op pension scheme, and advising several pension schemes on the execution of longevity swaps under various intermediation structures.

About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

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