UK Risk Settlement Bulletin

May 2019

Marital status and insurance

When assessing the feasibility of a pension scheme insurance transaction, it is important to gather an accurate view on the marital status of the members being insured.

This information – whether members are married or have financial dependants – will affect the likelihood of a contingent benefit being payable to a surviving partner in the event of the member's death. Insurers will use it to help inform their demographic pricing assumptions. It is crucial that schemes are also able to interpret the data accurately themselves, in order to assess whether insurance is competitively priced.

Gathering information

For the majority of pension schemes, it is inefficient and very costly to monitor through time which members are married. Instead, in the run-up to an insurance transaction it is now common for schemes to take a 'snapshot' by surveying members or by using a tracing agency.

The charts below illustrate how the proportion married can change substantially over time, and by other factors such as gender and wealth.

Allowing for these factors can potentially change the value placed on liabilities by up to 5%.

The impact on insurance cost

In practice, spouse (or wider financial dependent) existence and eligibility will vary from scheme to scheme. Collecting data to show this will give insurers more confidence in their pricing assumptions for the actual members being valued.

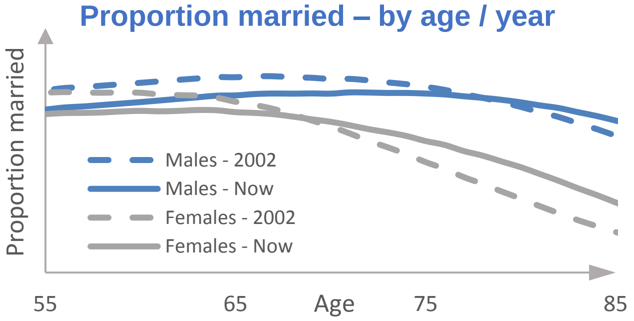
In some cases, insurers' premiums have reduced by 2-3% relative to the most competitive pricing when credible data has been shared.

Aon's solution

At Aon, we have developed the Demographic Horizons™ dependants model, which analyses *all* the available data on potential dependants. It models factors such as age, gender and wealth, as well as any available survey data, tracing results and past rates of dependant pensions commencing at death within the scheme.

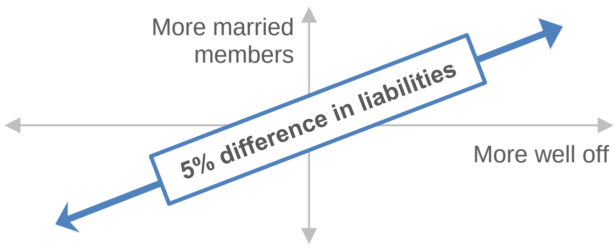
The model allows schemes to assess the marital status of their membership accurately, and so take an informed view on the level of insurance pricing.

Proportion married – by age / year



Source: ONS data with Aon calculations

Proportion married – by wealth



Source: Aon's Demographic Horizons dependants dataset

Actuarial valuations in 2019

The second quarter of 2019 will be the start of the triennial valuation process for many pension schemes. It is interesting to consider schemes' performance over the past three years.

Buy-out affordability

The graph below illustrates the solvency value (the estimated cost of insuring benefits with an insurer) for an example scheme with previous valuation at 31 March 2016.

The scheme has an LDI strategy is place, invested 50% in growth assets, but hedging 70% of its interest and inflation exposure– so not all its liabilities are closely matched. Over this period growth assets have performed relatively well.

Strong investment performance is only part of the story. Over the past three years this example schemes' solvency position may also have improved due to some combination of:

- Increasingly competitive annuity pricing (e.g. allowing for emerging mortality data);
- The impact of member options (e.g. commutation at retirement and, potentially, other 'bulk' exercises); and
- Employer contributions to repair any funding deficit.

The example projection below includes the impact of these factors also. It shows that buy-out affordability has improved for this scheme by around 20% the past three years.

Some schemes may be in a stronger funding position than they realise, with risk settlement options now affordable.

Any scheme targeting buy-out, with a solvency position greater than 90% should be seriously considering a transaction in the short-term. This deficit could easily be removed – either due to financial conditions or by a well-run auction.

Solvency position of a typical Scheme

Source: Aon's Risk Analyzer database

Insurer bulk annuity cost

The chart below indicates the range of best pensioners pricing available, relative to gilts, for a typical scheme.

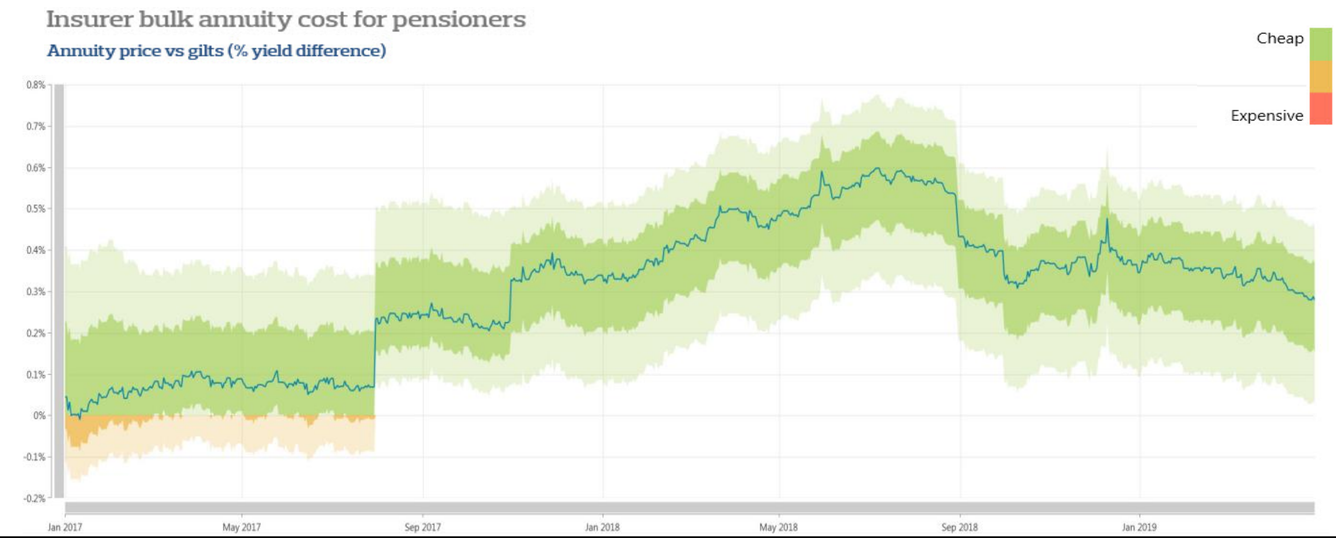
We continue to see very attractive levels of pricing relative to gilts. Although central price estimates have dropped a little compared to mid-2018, in practice final transaction pricing is still achieving historically favourable levels, with some outlier prices that are especially attractive.

Insurers are sourcing increasingly diverse assets to back their annuities. This makes it very difficult to track pricing, but means we expect there to be excellent pricing opportunities available for schemes ready to act.

To seize these opportunities, schemes need to be actively planning, and then conducting, their market approach. Sometimes a target price is not achieved as part of a competitive auction. In this situation we have helped many schemes:

- Select a preferred provider;
- Consider transactional changes to the assets to be traded to fund the premium; and
- Negotiating contract terms.

This means a transaction can be quickly executed quickly when the target is hit.



How to read this chart

- This shows the return from a bulk annuity for pensioners, relative to the yield on a comparable gilt portfolio, assuming insurer-type assumptions beyond the discount rate.
- Annuities shown as 'cheap' if giving a better return than gilts.
- This comparison ignores the material value from annuities giving a better hedge than gilts, including longevity cover.
- Expected pricing for a typical scheme is shown by the blue line.
- Prices typically fall in the darker shading, and some auctions fall in the lighter shading. Pricing outside the shading typically represents an unusual liability profile.

Chart sourced from Aon's Risk Analyzer

Contact Information

John Baines
+44 (0)121 262 6944
john.baines@aon.com

Martin Bird
+44 (0)20 7086 9027
martin.bird@aon.com

Hannah Cook
+44 (0)20 7086 8115
hannah.x.cook@aon.com

Phil Curtis
+44 (0)20 7522 8276
phil.curtis@aon.com

Mike Edwards
+44 (0)20 7086 0437
mike.edwards@aon.com

Karen Gainsford
+44 (0)20 7086 9071
karen.gainsford@aon.com

Tim Gordon
+44 (0)795 632 4415
tim.gordon@aon.com

Dominic Grimley
+44 (0)121 262 5094
dominic.grimley@aon.com

Ben Harris
+44 (0)121 230 6828
ben.harris.2@aon.com

Tiziana Perrella
+44 (0)161 687 2014
tiziana.perrella@aon.com

Tom Scott
+44 (0)121 262 5073
thomas.scott@aon.com

Michael Walker
+44 (0)1372 733027
michael.walker.3@aon.com

About Aon

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