



UK Risk Settlement Bulletin

April 2019

Small scheme opportunities

There has been a recent focus by the bulk annuity market on larger transactions, with the market showing increased capacity since 2017. These deals may get more focus from insurers and from the press, but there remain significant opportunities for *all* schemes.

There are often misconceptions over insurer appetite at this level of transaction (and the pricing on offer). With the right preparation and strategy for approaching the market, positive outcomes are achievable.

2018 experience

Pricing observed in 2018 was very attractive relative to the yields available on other low risk assets, and this pricing was often just as favorable for deals below £30M, where the auction was appropriately planned. This might be surprising, but insurers like smaller transactions because:

- There tends to be a steady flow of these (in contrast to a 'lumpy' flow of potential deals more than £1Bn in size), which makes it easier to plan resource;
- There is usually a greater probability of success for an insurer (often these deals have fewer bidders), provided affordability has been considered appropriately at the feasibility stage of the project; and
- These can be written with relatively low senior management involvement from the insurer, with confidence in the affordable yield it can offer and easy access to standard reinsurance treaty terms.

Provider	Quote on sub-£30M cases?	Comments (as at April 2019)
Aviva	✓✓✓	Active in this market; appetite for buy-outs and will require data cleanse work up front for some cases
Just	✓✓✓	Keen to provide quotations; focus on pensioner deals and would look to standardise process where possible
Canada Life	✓✓	Active in this market but won't quote on every case due to available resource; focussed on pensioner deals
Legal & General	✓✓	Considering re-entering this section of the market in 2019 but will be selective; appetite for buy-outs
PIC	?	Appetite will depend on other deals closing at that time

The table shows those insurers with more consistent appetite for quoting on transactions under £30M in value.

Being 'transaction ready'

Insurers will favour the best prepared schemes where there is greater certainty of transaction.

Carrying out preparatory work advance of going to market is important. This includes having a clear decision-making framework to be able to execute quickly once a price threshold is achieved.

Aon's solution

Aon's new *Streamlined Compass* proposition is an additional option, designed to help sub-£30M schemes access the bulk annuity market. To develop this, we've worked directly with insurers to design a simplified approach. This includes advanced planning with insurers, cleaner data, built in due diligence, and streamlined annuity contracts. Maximising insurer engagement will deliver the best possible pricing.



Mortality update: CMI 2018

In March 2019, the Continuous Mortality Investigation ('the CMI') published its updated standard mortality projections model, 'CMI_2018', using mortality data for England & Wales up to the end of 2018.

Recent Mortality

2018 was another year of low mortality improvement in the national population – analysis of the deaths data shows that there was very close to 0% improvement over the year. This continues a trend of slow improvements since around 2011, which is highlighted in the chart below.

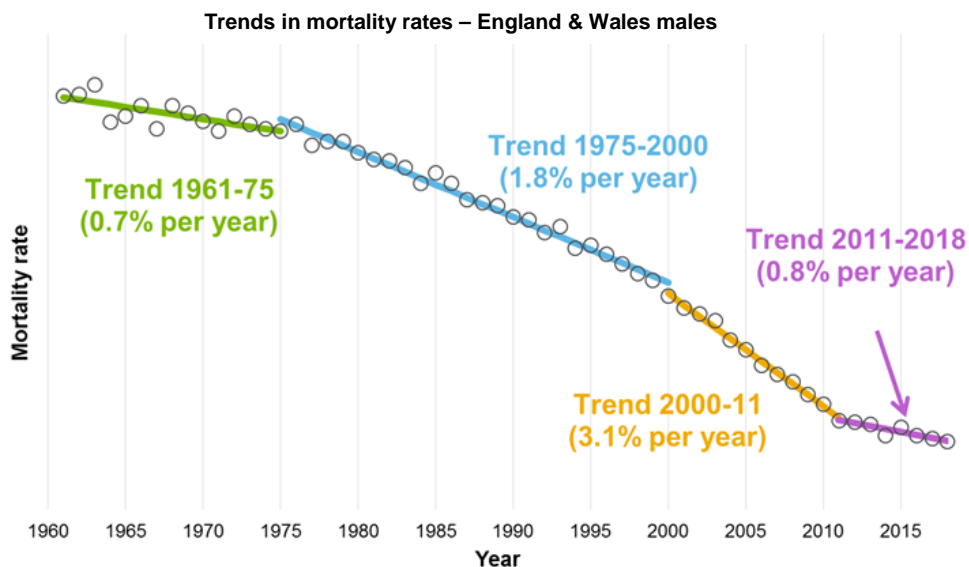
Impact of CMI 2018

The updated model projects *lower* future improvements in mortality than previous models, partly because of the addition of new data and partly because it gives more weight to the low improvements in recent years.

All else being equal, using the new model will reduce liabilities for pension schemes, compared to previous models.

The CMI model is based on mortality in the population which is not directly relevant for projecting pension scheme mortality improvements. Aon's analysis indicates that mortality improvements for pension scheme members have fallen but have remained higher than those in the general population. The new CMI model allows this difference to be adjusted for in an intuitive way.

The expected reduction in liabilities for schemes, combined with the highly competitive pricing we've seen recently from bulk annuity providers and longevity reinsurers, means that now is an excellent time for schemes to consider their options for risk settlement.



Source: Calculations by Aon Hewitt using mortality data from ONS and CMI (1961-2018)



Insurer bulk annuity cost

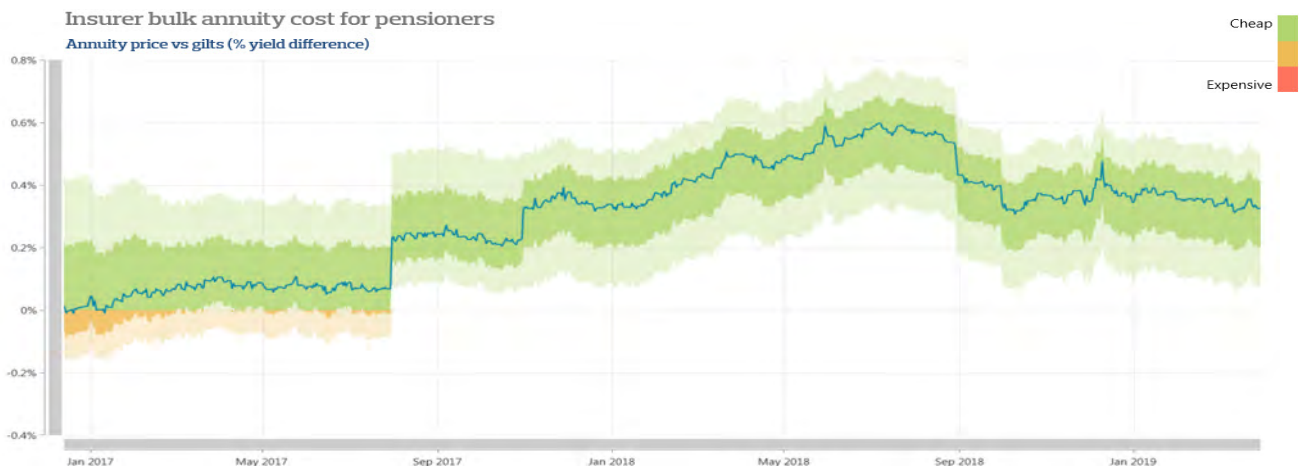
The chart below shows the implied return on a pensioner buy-in relative to gilts.

Annuity pricing has been fairly stable, relative to gilts, during the first quarter of 2019 (the longevity savings indicated in the CMI_2018 model will be feeding through subtly to reinsurance pricing, which is also influenced by other global longevity data, over time). The position was more volatile in December 2018 and March 2019, months of key Brexit activity, due mainly to fluctuations in the gilt market.

The chart shows expected pricing remains in the 'green zone'. At these levels, schemes with LDI or gilt portfolios could use their assets to fund an annuity, reducing risk and improving investment returns, at no additional cost.

The extremely busy annuity market has continued into the second quarter of 2019. More and more schemes are looking to secure annuities, as part of their long-term de-risking strategy. And these investments are now increasingly affordable, often a combination of:

- Highly competitive annuity pricing; and
- Funding improvements arising from strong investment performance.



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

Phil Curtis

+44 (0)20 7522 8276

phil.curtis@aon.com

Tim Gordon

+44 (0)795 632 4415

tim.gordon@aon.com

Tiziana Perrella

+44 (0)161 687 2014

tiziana.perrella@aon.com

Martin Bird

+44 (0)20 7086 9027

martin.bird@aon.com

Mike Edwards

+44 (0)20 7086 0437

mike.edwards@aon.com

Dominic Grimley

+44 (0)121 262 5094

dominic.grimley@aon.com

Tom Scott

+44 (0)121 262 5073

thomas.scott@aon.com

Hannah Cook

+44 (0)20 7086 8115

hannah.x.cook@aon.com

Karen Gainsford

+44 (0)20 7086 9071

karen.gainsford@aon.com

Ben Harris

+44 (0)121 230 6828

ben.harris.2@aon.com

Michael Walker

+44 (0)1372 733027

michael.walker.3@aon.com

*Copyright © 2019. Aon Hewitt Limited. All rights reserved.
Aon Hewitt Limited Registered in England No. 4396810 Registered office:
The Aon Centre, 122 Leadenhall Street, London, EC3V 4AN.*

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. For further information on our capabilities and to learn how we empower results for clients, please visit: <http://aon.mediaroom.com/>.

© Aon plc 2019. All rights reserved.

The information contained herein and the statements expressed are of a general nature and are not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information and use sources we consider reliable, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.