UK Risk Settlement Bulletin

June 2019

Membership characteristics

With continued strong pricing in the bulk annuity market, more and more pension schemes are looking to progress their de-risking journey by securing a *subset* of their pensioner population with an insurer.

This option is particularly popular with schemes where the financial position isn't strong enough to allow a full pensioner transaction. Instead, a proportion of the assets may be used to fund a partial pensioner buy-in, whilst ensuring that the remaining assets can support the scheme's overall investment goals.

A key question in planning any partial transaction is, "which members in the Scheme should be insured?" There are several approaches that can be taken, such as securing the oldest pensioners (who are generally the cheapest to insure) or perhaps those members with the highest individual liabilities (who are considered as higher risk).

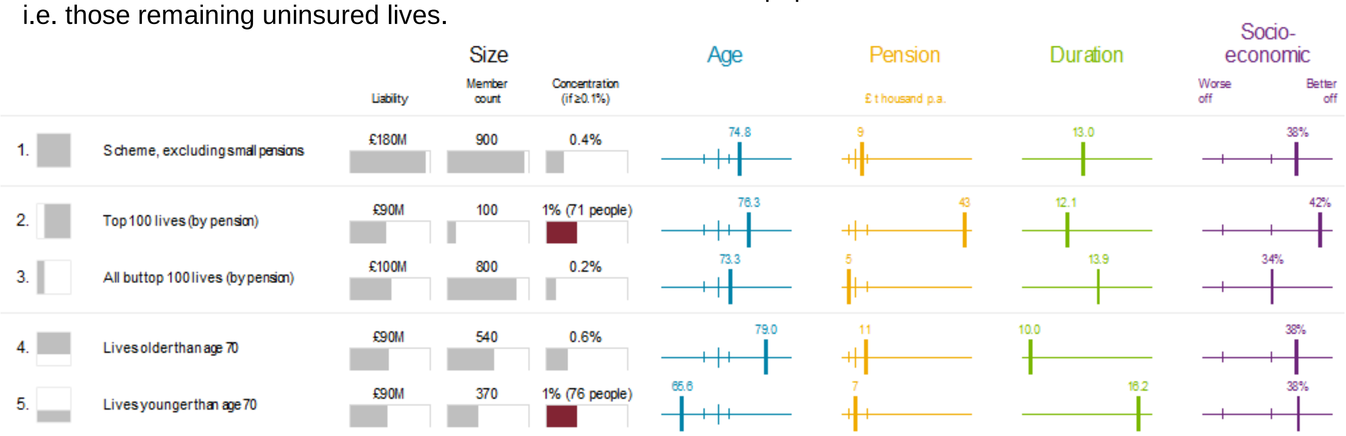
However, these options may not be suitable for all schemes due to the residual membership profile, i.e. those remaining uninsured lives.

It is important to objectively analyse the features of different membership cross-sections within a scheme and present the information to allow easy comparisons. For this purpose, Aon have developed their Demographic Horizons™ segmentation model.

The model presents the average age, pension, duration and socio-economic profile, all of which are key drivers of an insurer's assessment of price for a deal. This allows trustees and sponsors alike to make informed decisions on the best approach for their scheme.

The tool can also be used to consider lives that would be left uninsured, to check that this population does not exhibit any characteristics that may lead to difficulties when securing these liabilities at a later date.

Ultimately this tool improves understanding of membership characteristics for pension schemes and will help identify an optimal cross-section of the population for an insurance transaction.



Source: Aon's Demographic Horizons™ analysis of pension Schemes

Insurer bulk annuity cost

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

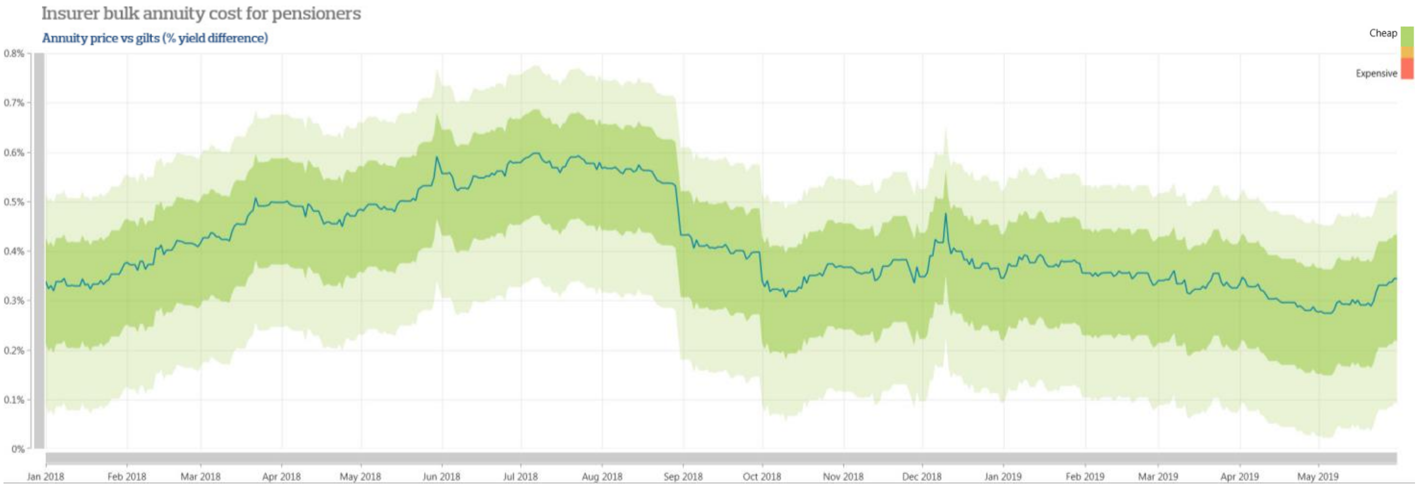
So far in 2019 we have seen pensioner pricing as high as 0.7% p.a. above gilt yields. This reflects the increasingly diverse return seeking assets that insurers are sourcing to support their annuity business, and also the substantial market capacity and demand for new business.

That capacity and demand may diminish as the year progresses, where, given the significant amount of business already written, insurers approach targets for business placed.

This is expected to lead to a 'bumpy' market, where pricing is more variable and harder to predict.

But a bumpy market also means that excellent pricing opportunities are expected. Schemes which closely monitor the market will be ready to act and seize these opportunities.

They will be in the strongest position if they have begun a transaction, obtaining accurate market pricing and identifying preferred providers – the very best opportunities arise in short time windows from specific insurers.



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

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