UK Risk Settlement Bulletin

Q1 2021

Our Q1 bulletin looks back on the UK bulk annuity market in 2020, provides an update on the outlook for the market in 2021, and considers the opportunities in the longevity market for schemes of different sizes.

COVID-19 and the bulk annuity market

At the start of 2020, we predicted the UK bulk annuity market volume would break the £30Bn mark, following the record-breaking £43Bn transacted in 2019.

However, it was a challenging year, with unparalleled difficulties due to the COVID-19 pandemic, such as investment volatility and operational restrictions. Despite this, the bulk annuity market demonstrated significant resilience, with indications suggesting the final volumes will still exceed £30Bn. This makes 2020 the second busiest year on record.

Estimated volumes

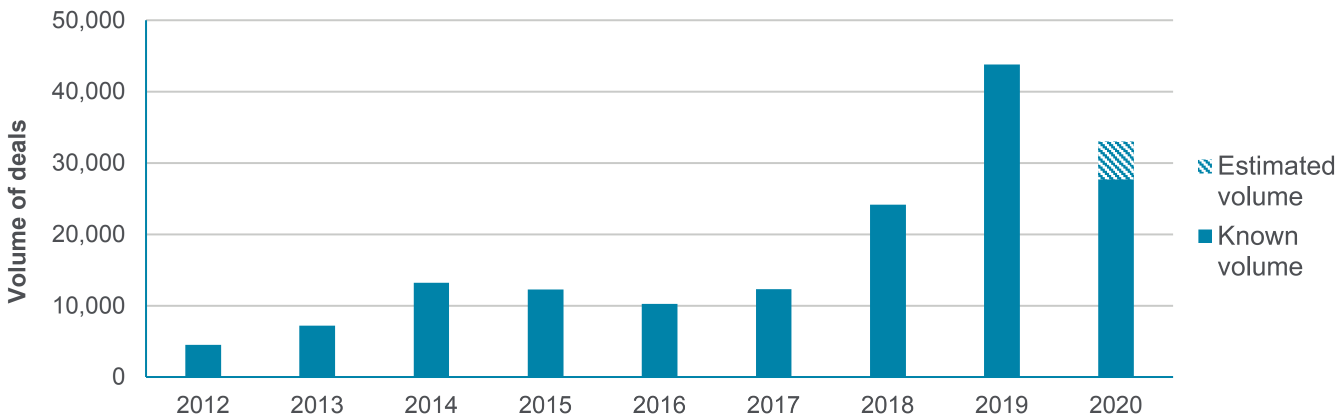
As at the end of January, there was at least £28Bn of UK bulk annuities reported in 2020, with more expected to be disclosed as insurers prepare their year-end reporting.

The chart below shows the UK bulk annuity market volumes since 2012. It illustrates the rapid growth in the market over recent years, despite some delays to transactions from COVID-19 impacts. The outlook for 2021 remains strong (see the final article in this bulletin).

Trends in transactions

In 2019, we had witnessed a number of multi-billion-pound transactions, most of which secured full schemes and dominated a large section of the market. In 2020, transactions requiring less sponsor funding or decision-making were inevitably more common. This increased the dominance of small to mid-sized pensioner-only transactions, which were often affordable without any fresh scheme funding. We expect this trend will change post-lockdown, with a resurgence in scheme buyouts.

Bulk annuity business written with UK pension schemes (£m)



Source: Aon's Due Diligence team and publicly announced transactions

Case Study – Aon Retirement Plan

In 2020, we advised the Trustees of the Aon Retirement Plan, one of Aon's own pension schemes, on securing a £510M insurance policy with Scottish Widows.

The Plan had already completed three bulk annuity transactions for scheme pensioners. Being 'transaction ready', and securing opportune pensioner buy-ins when pricing is attractive, is a key-part of the Trustees' planning, both reducing risk and improving the Plan's solvency position.

Following feasibility work, the Trustees' auction process was due to conclude in March 2020.

Timing the markets

But, as result of the COVID-19 pandemic, March 2020 was the worst month we have seen for market volatility. This presented liquidity concerns for asset trades, sharply increasing transaction costs. The Trustees agreed to pause the transaction at this time.

We monitored the return of liquidity to the markets and the project was restarted in July 2020, with the auction process resulting in a winning bid from Scottish Widows.

We agreed a bespoke 'price-lock' mechanism with Scottish Widows, to provide certainty over the way the premium would move during exclusivity and up to the point of execution. This was very important as bumpy market conditions threatened to return with the 'second wave' of the virus.

The transaction was completed in November 2020.

Nimble governance proves to be key

The project had a powerful governance structure, which included both the Trustees and Sponsor in the decision-making process. This enabled them to react quickly to market developments.

Working to condensed transaction timescales, the contract negotiation stage was concluded in under three weeks. Having accessed strong pricing, being able to move this quickly (despite adopting a new counterparty in Scottish Widows) meant that the Plan minimised execution risk in volatile markets.

Please contact your usual Aon settlement consultant if you would like any further information about transaction readiness.

Repeat buyer

This is a key example of how, having previously integrated an annuity into a scheme's operation, it can become considerably easier to plan and execute subsequent transactions. Repeat buyers appeared to have an edge in 2020 in being able to navigate the market uncertainty caused by COVID-19.

Schemes with established working procedures were able to deal with unpredictable markets, making swift and effective decisions with a robust governance structure.

Longevity market

2020 and the start of 2021 saw a very high number of deaths due to the COVID-19 pandemic. While the ultimate resolution of the pandemic remains uncertain, the overall consensus on mortality improvements over the long term has not changed significantly.

Longevity risk therefore remains a key concern for pension schemes and 2020 saw increased demand from UK pension schemes looking to hedge this risk.

Historically, the longevity swap market has been dominated by large, multi-billion-pound transactions. This trend certainly did not stop in 2020 – the table below shows over £24Bn of publicly announced deals over the year.

2020: Publicised UK Longevity Swaps

Size	Scheme
£10.0Bn	Lloyds Banking Group
£5.0Bn	The Barclays Bank UK Retirement Fund
£3.7Bn	The Prudential Staff Pension Scheme
£3.0Bn	The BBC Pension Scheme
£1.4Bn	UBS Pension Schemes
£1.0Bn	Willis Pension Scheme

Source: Publicised deals in the market

What about mid-size schemes?

While large schemes continue to dominate the headlines for longevity swaps, we have seen significant changes occurring in the longevity reinsurance market in recent years.

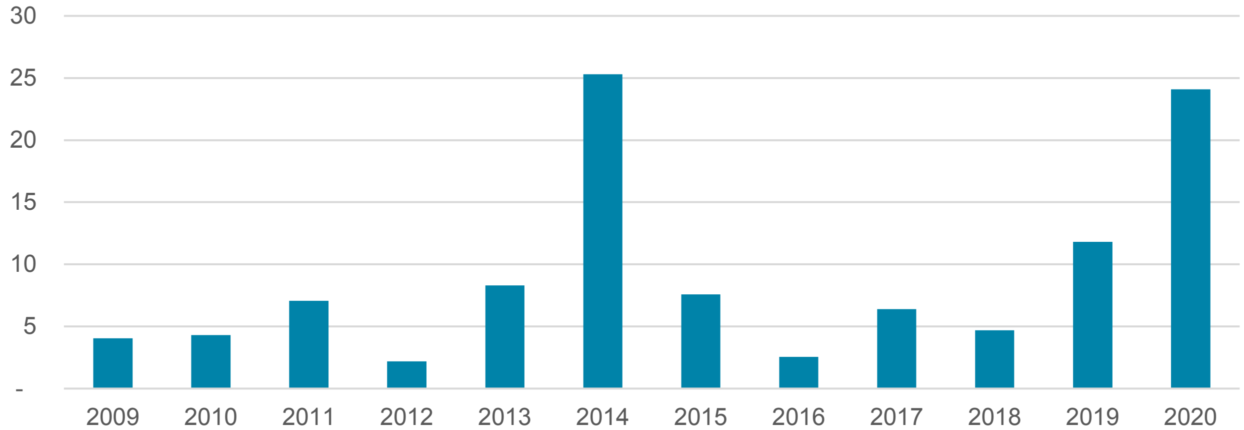
Increased flexibility and a wider range of structural options have developed. This has meant that hedging longevity risk is now an option that is beginning to open up to 'mid-size' schemes (that is, schemes with around £100M to £750M of pensioner liabilities).

Reinsurers have gained significant experience through small and mid-sized bulk annuity business. This can mean that they are more comfortable quoting on mid-sized longevity swaps where there is not substantial experience data available.

By leveraging our experience in advising pension schemes on larger longevity swap transactions, we can offer a streamlined approach for efficiently hedging longevity risk for mid-sized schemes.

Please contact your risk settlement advisor if you would like any further information.

Longevity Swap Market: volume of deals (£Bn)



Source: Estimated market volumes based on publicised deals and Aon-led transactions

Bulk annuity market outlook

The chart below shows the range of expected pricing, relative to gilts, available on pensioner bulk annuity transactions. The spike in the chart in March reflected dramatic market swings, as credit spreads ballooned then reverted, partly from Government stock purchases to support the markets. For most trades, this March pricing was hard to capture as it was also the point of greatest market illiquidity and hence trading costs.

The relative pricing stability since then reflects more subdued investment markets.

In practice, the best pricing in transactions has been a little less volatile than the underlying bond markets. This reflects the insurers' ability to vary the timing of some asset purchases, and to temporarily alter the mix of asset classes backing new transactions, at times of particularly low credit spreads.

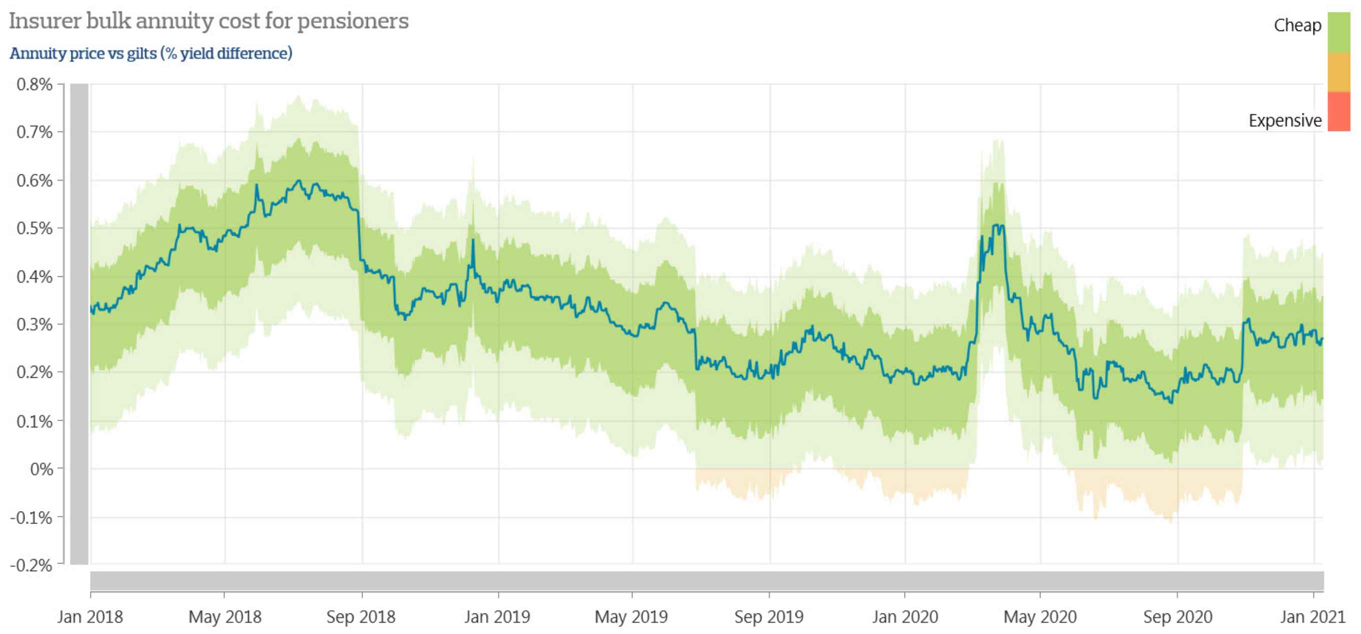
2021 outlook

In 2021, the bulk annuity market is expected to see a combination of new schemes exploring deals, alongside a backlog of 2020 auctions that were paused but may yet be restarted.

We expect that 2021 will be a strong year for the bulk annuity market, with business volumes which may well surpass the £30Bn mark for the third year in a row.

Without the hindrance of lockdowns and economic uncertainty, a stronger upturn could follow in 2022. As ever, outcomes here are difficult to forecast given the dependency on, for example, insurer capacity and the availability of specific asset opportunities.

We expect there will be opportunities this year for schemes of all sizes but, of course, in a busy marketplace, the best outcomes will be achieved by those schemes which run a well-planned process and are ready to move quickly.



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.
- A higher position represents a better price.
- 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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