UK Risk Settlement Bulletin

Q1 2022

The Q1 bulletin provides an update on the latest mortality analysis, considers the importance of ESG in the risk settlement market, and looks ahead at market pricing and capacity in 2022.

2021 longevity roundup

Most experts now expect COVID-19 will become an endemic disease, with the disease circulating indefinitely in the population – likely with a seasonal pattern similar to other infectious diseases like flu.

As we move out of the pandemic phase to a future where we are to “live with COVID”, it is worth looking back to what happened over the last year – the impact of the pandemic on health and death rates, and the issues that will impact mortality rates in future.

Death rates

In the first few months of 2021, the Delta wave was causing huge numbers of infections and deaths in a population which was largely unvaccinated and without prior infection.

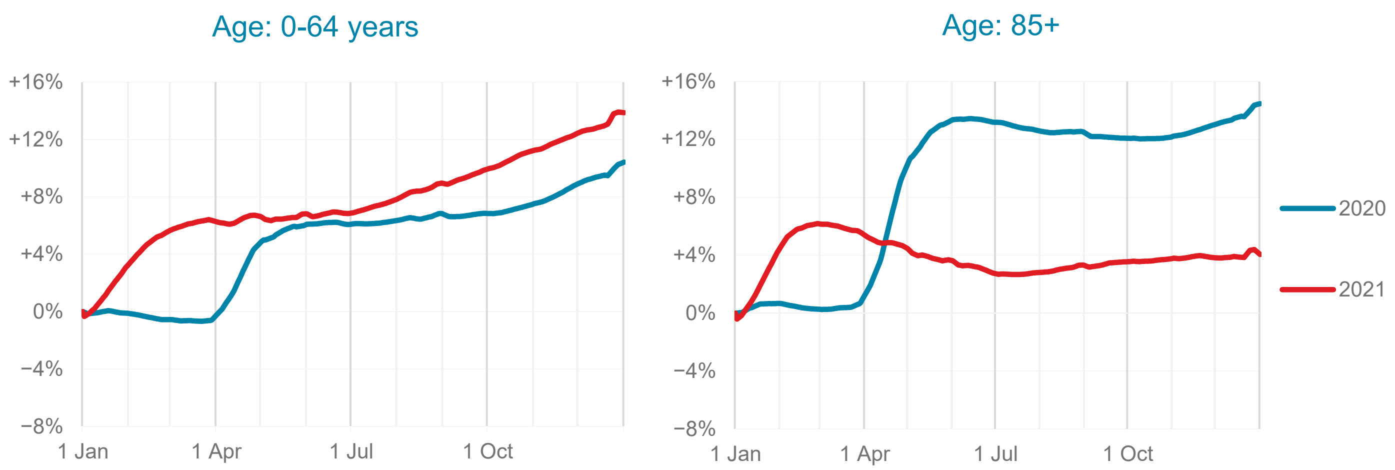
Death rates were much lower in the second quarter of the year but increased again as we moved out of lockdown in July and as the Omicron wave hit at the end of the year.

Over the whole of 2021, death rates have been significantly higher than they were in 2019 in all age groups, but there is a clear pattern by age.

The excess mortality at younger ages (0-64) rose throughout 2021, to the extent that death rates were higher in this age group than even 2020. The excess at the oldest ages (85+) fell after the first quarter of 2021 and remained relatively constant.

The death rates in England and Wales by age band over 2020 and 2021, compared to 2019, are shown by the charts below.

Mortality rates in England and Wales over 2020/21 compared to 2019 rates



Source: Continuous Mortality Investigation (CMI) Group and the Office for National Statistics

This pattern may be partly because of the positive and earlier impact of vaccines on the oldest group, as well as the impact of frailty (that is, the likelihood that some of those dying of COVID-19 would otherwise have died from other causes in the following months).

We might expect to see some evidence of this frailty effect in coming months, meaning that death rates in 2022 could be lighter than might otherwise have been expected.

Vaccinations

The UK vaccinated relatively early compared to other countries, with the vaccination program starting in December 2020 and continuing through 2021.

First and second doses have been administered to the majority of the UK adult population, followed by boosters as evidence grew that vaccine effectiveness was waning following the second dose. By the end of 2021, the UK had administered 51.8 million first doses, 47.4 million second doses and 34.1 million third doses to UK citizens.

Whilst the vaccines have not stopped the spread of the Omicron variant in recent months, they have proved very effective against severe illness and death, meaning that there have been far fewer hospitalisations and deaths in this latest wave than in previous waves of infection.

Looking forward

Despite high levels of vaccination, mortality rates in the UK over the last three months of 2021 were 8%-10% higher than might otherwise have been expected.

Most northern mainland European countries also saw elevated mortality in the winter of 2021, again despite vaccination.

We might expect these excess rates to reduce after winter 2021/22 because of:

- Better coverage from booster vaccinations
- Better understanding of how to roll out boosters in future
- Increased levels of COVID-19 improving population immunity, particularly in those who have not been vaccinated

However, we do expect a huge global reservoir of COVID-19 infections, and a susceptibility to infection and reinfection from future variants of the disease.

Estimating the impact of endemic COVID-19 is inherently difficult, with factors influencing mortality both positively and negatively.

On the positive side, measures to mitigate COVID may also reduce deaths from other sources – for example the level of seasonal flu that has circulated in the last two years has been much lower than normal.

On the negative side, almost two years of the pandemic phase of COVID has inevitably led to a backlog of other treatments in the NHS, which is bound to have a negative impact on the average health of the population – and if and when we experience another COVID outbreak, this will further impact on the capacity of the NHS to treat other causes.

There is also the fundamentally unknown long-term impact of Long-COVID on those who have been affected.

Conclusion

Overall, our analysis suggests that the expected negative impact of endemic COVID is now tipping the balance between potential positive and negative factors towards a slightly more negative outlook, and that expected mortality rates over the medium term are slightly higher than pre-pandemic projections.

This needs to be considered alongside other factors such as other pricing metrics and longevity risk appetite, when assessing transaction viability.

ESG and the Risk Settlement Market

Environmental, Social, and Governance (ESG) concerns have been gaining increased focus in recent years, with new regulations requiring trustees to take a more active approach when it comes to ESG risks.

There is a growing awareness of the materiality of ESG risks, especially the risks of climate change.

Trustees are expected to actively take steps to understand these risks and report on them on an ongoing basis.

How does this relate to risk settlement?

Trustees' investment policies must cover all financially material considerations, including ESG factors, in choosing and managing their investments.

We provide due diligence on insurers' ESG policies to support the choice of a potential provider when a new annuity is placed.

Regulatory guidance is still being developed, and may clarify the level of monitoring of annuity policies that is appropriate.

In our latest review of insurer ESG positions, there was increasing adoption of more advanced ESG policies and reporting, as well as more in depth climate risk analysis for their assets and operations.

We are also seeing increasing calls on insurers to provide detailed emissions data required by the new Task Force on Climate-Related Financial Disclosures.

Insurer investments

The assets held by insurers to back annuity funds are already restricted to those that are predictable, secure, accessible, and meet wider regulatory reserving requirements.

Adding ESG credentials to these considerations create further constraints. Some existing asset choices have clear ESG credentials e.g. solar energy, and social housing investment.

However, ESG thinking may only have partly driven the investment choice. In future it will become a much greater consideration, with increasing regulator pressure.

Environmental

Environmental factors examine how well nature is maintained and protected, and the materiality of environmental risks a business might face.

Social

Social factors encompass business relationships with employees, suppliers, customers, and the communities in which they operate.

Governance

Governance factors examine the internal business practices, governance, and procedures that companies adopt to govern themselves.

ABI Climate Change Roadmap

The Association of British Insurers (the "ABI") is a trade association across the insurance and long-term savings industry.

In July 2021 the ABI published their "Climate Change Roadmap" in order to facilitate collaboration and collective action across the insurance sector towards achieving net-zero targets.

The ABI noted that the industry's overall response to climate change remains inconsistent. The ABI is aiming to lift standards across the whole sector so that best practice is consistently applied.

The ABI's Roadmap covers four thematic pillars:

- Achieving net-zero by 2050, including an interim 2030 target of 50% reductions.
- Unleashing investment capacity in the sector for infrastructure and energy transformation.
- Sustainable industry operations – reaching net-zero in directly controlled operations by 2025.
- Helping society adapt – considering how the sector can facilitate sustainable decision making.

Aon's Insurer Due Diligence service monitors the ESG credentials of UK bulk annuity providers. Please contact your usual Aon settlement contact for more information.

Bulk annuity market outlook

The chart below indicates the expected range of best pensioner pricing available, relative to gilt yields, in the bulk annuity market for a typical scheme.

Current pricing levels

On this measure, pricing improved towards the end of 2021, partly driven by a rise in swap yields relative to gilt yields.

We sometimes see increased appetite from insurers to write business towards the year end, to meet volume targets and utilise any excess capital. This happened in 2021 and meant that some very strong pricing was available.

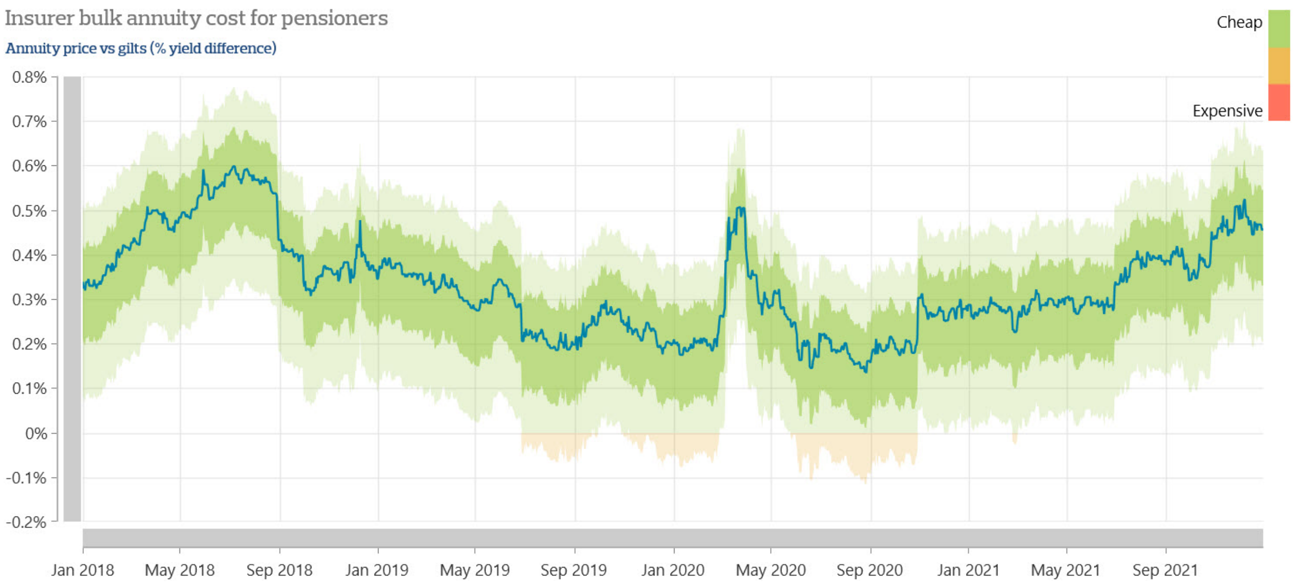
We currently expect that over the course of 2021, there were over £30Bn of bulk annuities placed by UK pension schemes, of which approximately £8Bn was brokered by Aon. This number may rise further as insurers publish results over Q1 2022.

Pricing opportunities in 2022

After a record year for business in 2019, the bulk annuity market saw fewer £1bn+ transactions in 2020 and 2021. Many schemes' funding levels did improve materially over this period, but some of the COVID-19 driven restrictions on business operations shifted trustee and sponsor focus away from settlement projects.

An especially busy Q4 2021 reflected spare capacity in the market, and we expect larger transactions in 2022, and a particular focus on full scheme transactions. The market has been preparing for this, with some insurers developing their proposition to offer large scheme buyouts.

Please contact your usual Aon settlement consultant if you would like to discuss de-risking opportunities.



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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