UK Risk Settlement Bulletin

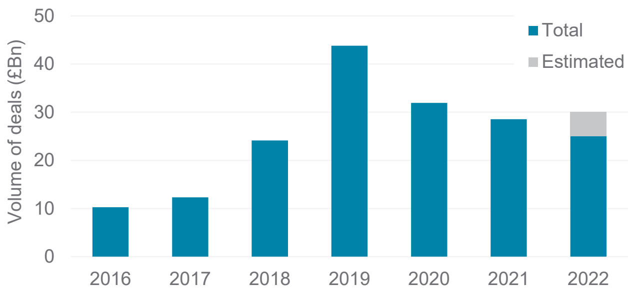
Q1 2023

The Q1 bulletin reflects on pension risk transfer markets in 2022, looks ahead at the 2023 market, and takes a look at current pricing trends for both pensioner and deferred members.

Busy bulk annuity market builds on 2022 momentum

When the dust settles on 2022, and insurers release annual reporting, it is expected that UK bulk annuity volumes will reach around £30Bn for the year. This is despite 2022 being a tumultuous year for pension schemes and insurers alike, and rising interest rates placing a lower nominal value on transactions.

Volume of bulk annuities written with UK pension schemes (£Bn)



Source: Aon's Insurer Due Diligence Service

Insurers proved their continued resilience through the LDI crisis and rising interest rates have resulted in solvency levels reaching unprecedented highs. Similarly, many schemes have experienced rising funding levels over the year, along with smaller deficits (in nominal terms) as interest rates rise.

Expected market trends in 2023

We expect that full scheme transactions will dominate the market in 2023 – a trend that we saw develop over 2022.

Pensioner only buy-ins are expected to become more challenging for schemes in a post LDI-crisis environment of stretching leverage ratios. For schemes more able to flex their investment strategies, pensioner-only buy-ins remain feasible at attractive pricing levels.

We also expect 2023 to see a return of 'mega deals' – multi-billion-pound transactions that grab the headlines. In similar fashion to 2019, we are aware of a number of significant transactions approaching insurers over 2023 that could drive volumes in the bulk annuity market towards £50Bn for the year.

Preparation remains key

With rising demand from schemes for bulk annuities, it is more crucial than ever to stand out in what is likely to be an increasingly busy market in 2023.

Alongside the key areas of data preparation and clarity on scheme benefits, the LDI crisis has emphasised the importance of having a clear strategy for the scheme's assets. This includes understanding how the premium will be paid to an insurer, but also how the assets track insurer pricing in the lead up to a transaction.

At the same time, schemes need to be flexible in their market approach, building a bespoke auction process around their objectives to get the best outcome.

If you would like to find out more about your Risk Settlement options in 2023, then please reach out to your usual Aon Risk Settlement contact.

QAS Institute and Faculty of Actuaries ®
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Longevity swaps: navigating uncertain mortality

2022 was another busy year in the UK longevity swap market, maintaining the recent trend. More than five deals were executed, hedging more than £17Bn of liabilities.

The chart below shows the volume of longevity deals for UK schemes in recent years. You can see how market volume has grown, a trend which we expect to continue alongside strong reinsurer appetite for longevity risk.

The largest deal of 2022 was the Aon-led £7Bn transaction for the Barclays Bank UK Retirement Fund, completed in December, with the Prudential Insurance Company of America (PICA) providing reinsurance. This followed the Fund's £5Bn longevity swap reinsured by the Reinsurance Group of America (RGA) in 2020.

Highly competitive market offering attractive pricing

Beyond the level of activity, the key feature of the market in 2022 was the high level of competition, with many reinsurers aggressively targeting growing volumes of business.

This drove favourable pricing for pension schemes, through a combination of demographic assumptions and reduced reinsurance risk fees.

Market for hedging deferred members longevity risk

While most of the liabilities hedged through longevity swaps in 2022 related to pensioner members, the year continued to see some activity hedging risk associated with deferred members.

This reflects increased reinsurer capability and appetite to write deferred risks, and pricing become more attractive. While much of this reinsurer capacity is targeted at bulk annuity insurers, to support full scheme transactions, there are increasing opportunities for schemes to access this directly through longevity swaps.

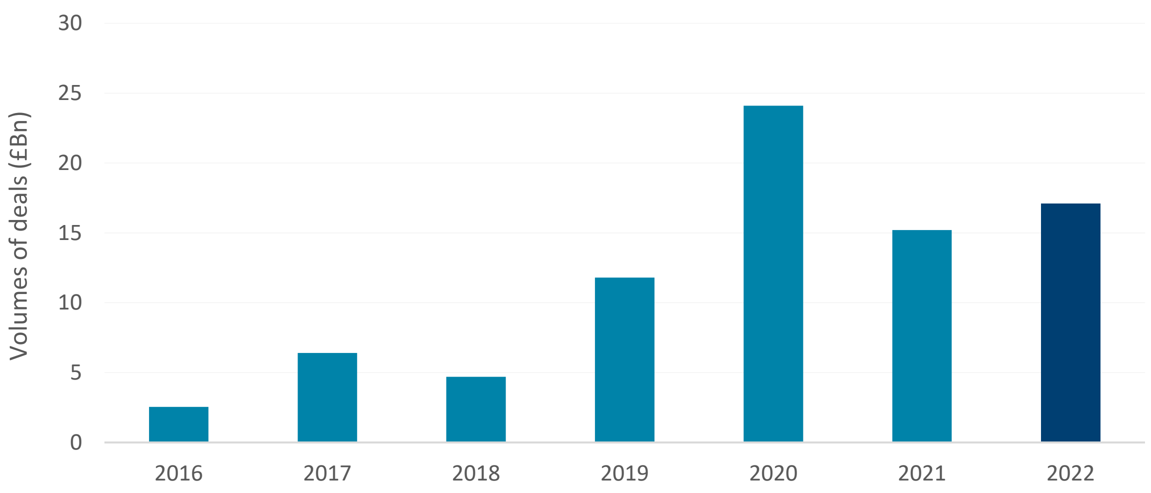
2023 outlook

While the headlines may be dominated by predictions for how busy the bulk annuity market will be in 2023 and beyond, longevity swaps will continue to be an attractive option for many pension schemes.

In particular, those schemes which have seen their investment liquidity tighten as a result of rises in interest rates may turn to the longevity swap market to hedge a key risk while retaining investment flexibility.

If you would like to find out more about longevity hedging, then please reach out to your usual Aon Risk Settlement contact.

Volume of disclosed longevity swaps written with UK pension schemes (£Bn)



Source: Aon's Insurer Due Diligence Service

Bulk annuity market outlook

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

Current Pricing Levels

On this measure, both pensioner and deferred pricing tightened over the last quarter of 2022, partially reflecting narrowing credit spreads (difference in return between corporate bonds and gilts).

In practice, a number of schemes achieved very attractive levels of pricing in late 2022, in some cases having locked-in to pricing during the market volatility observed in September / October.

As in recent years, we also saw some insurers striving to write business in Q4 in order to meet year-end targets and utilise any excess capital.

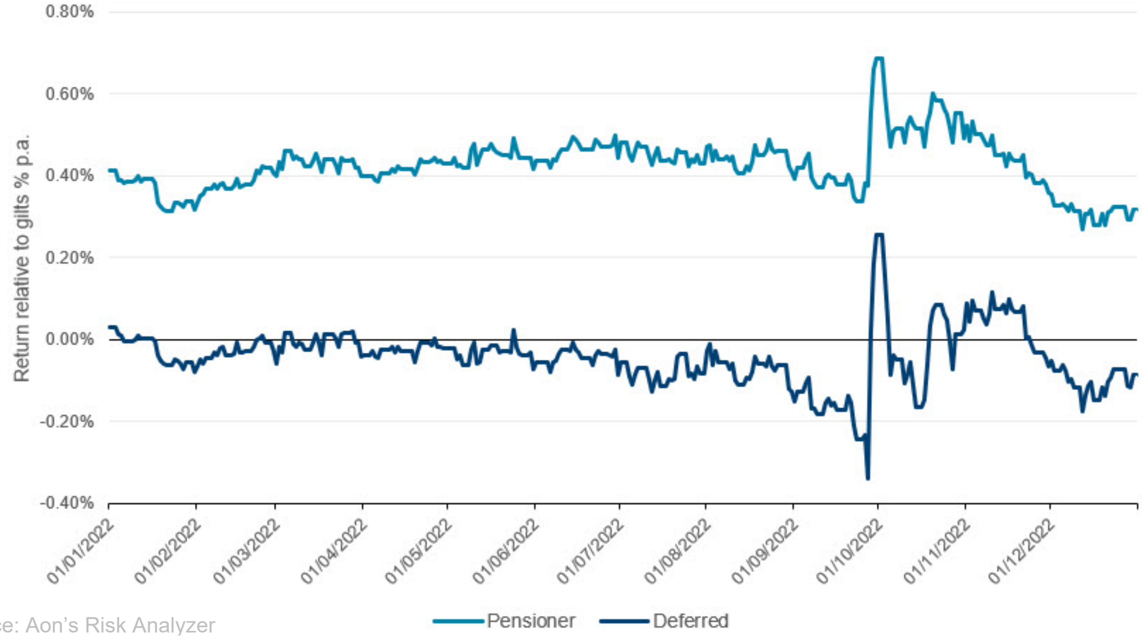
In the chart below, it is clear that pensioner pricing is more favourable than deferred pricing over time, relative to gilts. There are a number of reasons for this, including:

- Deferred members are generally younger with greater future life expectancies, leading to greater future uncertainty on inflation, mortality and interest rates
- Uncertainty on deferreds exercising possible options (such as commutation or early/late retirement)
- More difficulty in sourcing longer duration assets that match the expected cashflows of deferreds

Over 2023 we expect there to be more full-scheme buy outs and hence more transactions involving deferreds. This reflects the post-LDI crisis environment where more schemes are operating with higher leverage, limiting the assets available to secure a partial buy-in.

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

Bulk annuity pricing relative to gilts



Source: Aon's Risk Analyzer

How to read this chart

- The graph compares the estimated annuity cost with a value on a gilts basis, where the other elements of the gilt basis beyond discount rate are assumed to be exactly the same as those under the solvency basis, and the discount rate relative to gilts is derived to give the same value as the annuity cost.
- In practice most comparator gilt bases use different assumptions, in particular for determining inflation-linked pension increases, and this can mean that the discount rate on a comparator basis is materially lower relative to gilts than the level shown here.
- This graph should not be used for direct comparison with scheme funding bases without scheme specific modelling.
- There is variability in solvency pricing beyond market conditions that isn't picked up in this model. At times of high market volatility this uncertainty is likely to increase. Accurate pricing can only be achieved by going to market.

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