UK Insurer Survey 2023

Aon Risk Settlement Group

For professional clients only

Foreword

We are delighted to share the findings from our latest UK risk settlement research, a survey of UK Bulk Annuity Insurers carried out earlier this year.

The focus of this research is to share the perspective of the current insurers active in the UK bulk annuity market, and their approach to securing defined benefit (DB) pension scheme member benefits in this unprecedented time of market demand.

Due to increasing demand from pension schemes that are keen to take advantage of the current economic climate, insurers are becoming more selective in the transactions they are willing to participate in.

In our survey, all insurers identified capacity constraints as one of the key challenges in meeting demand. There was some variation between insurers in the type of schemes they would deem of most interest and the factors they would use for triaging. This reflects our recent experience with current high demand impacting the number of insurers quoting, but it is still very much possible to obtain attractive quotes with the right insurer engagement strategy.

Our survey also investigates steps insurers are taking in designing and implementing innovative solutions to help make it easier for schemes to secure members benefits. The vast majority of insurers indicated a continued appetite to grow business volume over the 5 years and in addition, we have already seen one new entrant with M&G announcing their first transactions in September, with further new entrants expected, which will help to support growth in overall volumes in the future.

A key message to readers of this report is that to have the best possible opportunities to ultimately secure their members' benefits, schemes should begin preparation now. This will require seeking agreement between the trustees and sponsor on the journey to settlement strategy and to develop a comprehensive plan of action to avoid missed opportunities along the way. Choosing the right risk settlement partner will bring focus to reducing key risks and allow for the most efficient execution of your plan.

We hope the findings offer practical insights to help pension schemes prepare to secure members benefit with insurers.

Martin Bird
Senior Partner

Head of Risk
Settlement

Executive Summary

There are now nine active insurers in the UK bulk annuity market

All bulk annuity insurers in the UK offer full-scheme transactions

85% of these insurers are committed to increasing transaction volumes over the next 5 years

Key headwind for the risk settlement market is the number of experienced staff across insurers, administration and advisers

Some insurers also noted the availability of quality assets to back liabilities as a potential challenge, with some of these pressures having the potential to marginally ease as a result of Solvency II reform

Economic changes over 2022 led to many defined benefit pension schemes being fully or close to fully funded on a solvency basis sooner than previously expected. This has accelerated the journey to settlement for those with buyout as their endgame, leading to a very busy 2023 with c. £21 billion worth of deals transacted over the course of H1 2023.

It is widely predicted that 2023 could be a record year for the bulk annuity market, with full year volumes potentially exceeding £50 billon, compared to the previous high of £43.8 billion in 2019, despite higher yields significantly reducing liabilities for most pension schemes since 2019. The re-entry of M&G to the market takes the total number of insurers actively writing bulk annuities to nine and we are aware of other potential new entrants to the UK market. This is a clear commitment from the insurance industry to support schemes in their quest to secure their members' benefits.

About the Research

For this survey, we invited all active UK bulk annuity insurers (prior to M&G entering the market) to participate on a series of topics, including business volumes expected in 2023 and beyond, preferences for specific scheme types, and new and future solutions to potential headwinds in the market. We also include information gathered on insurer volumes for all active insurers up to H1 2023, as well as observed insurer positions on some of the key topics affecting many pension schemes.

All references to small schemes mean those with assets of less than £100 million; mid-sized schemes have assets between £100 million and £1 billion; large schemes mean those with assets of £1 billion and over.

All of Market

c1.5M lives covered to end of 2022

c£220Bn total value covered to mid 2023

Annual Volumes

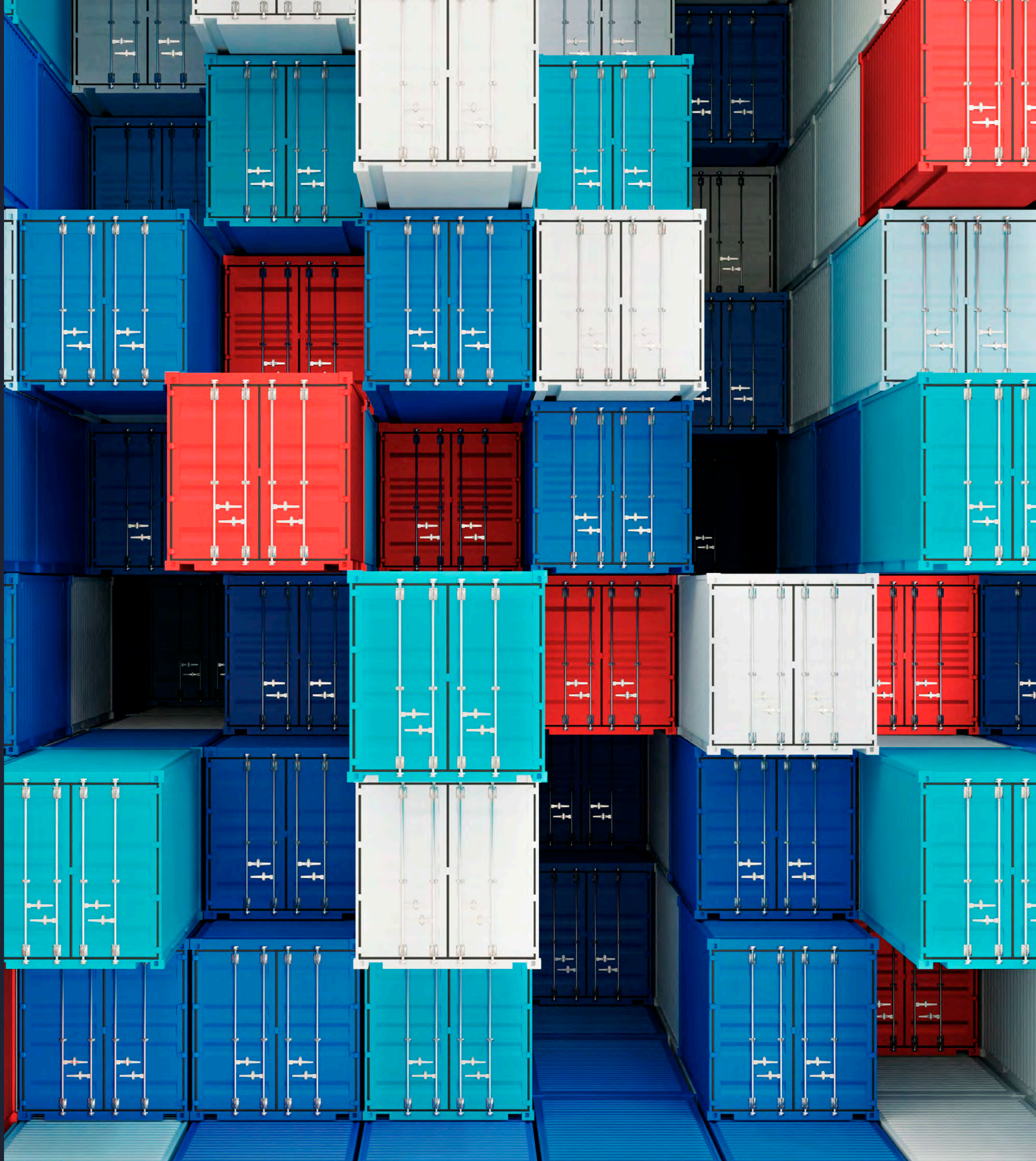
£28Bn total deals in full year 2022

£21Bn deals in H1 2023 leading to total for 2023 expected to exceed

c£50Bn

1

Business Volumes and the Market to Date



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Business Volumes and the Market to Date

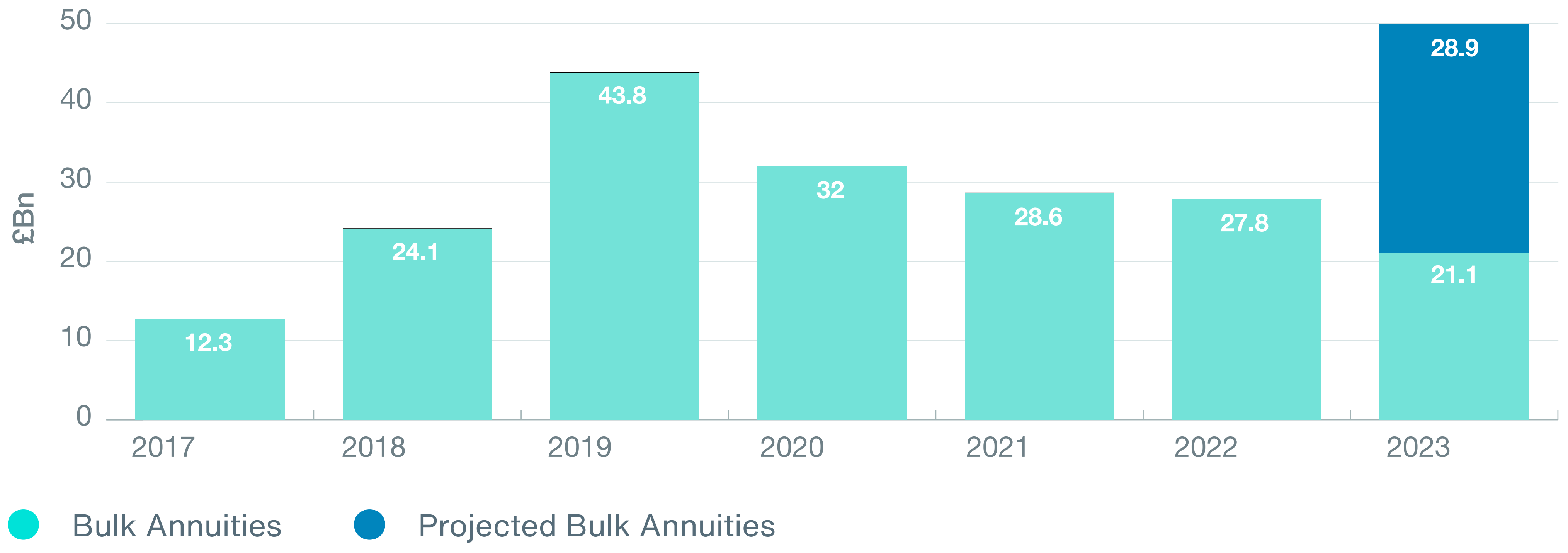
The bulk annuity market has been buoyant in recent years, with DB pension schemes steadily reaching higher funding levels on a solvency basis. In 2022, many schemes saw their funding level increase more rapidly as the year progressed due to rising yields, which significantly reduced their expected timescales to be able to achieve a potential buyout. As a result, more schemes than ever before have either begun preparations to approach the insurance market, or have already transacted to secure part or all of their liabilities.

Chart 1 opposite illustrates the total bulk annuity volumes in the UK each year, since 2017. This also includes the confirmed H1 2023 total volumes to be £21.1 billion and indicates an estimate of the potential volumes for the remainder of 2023. It is widely anticipated that 2023 could be the largest year ever in terms of total bulk annuities written, potentially in the region of c£50 billion or greater.

Focusing on 2022, shrinking solvency liabilities over the course of the year resulted in insurers having to increase the number of deals secured in an attempt to meet their individual volume targets. This meant that the total £billion volume of deals completed in 2022 was lower than the previous three years despite very high levels of activity.

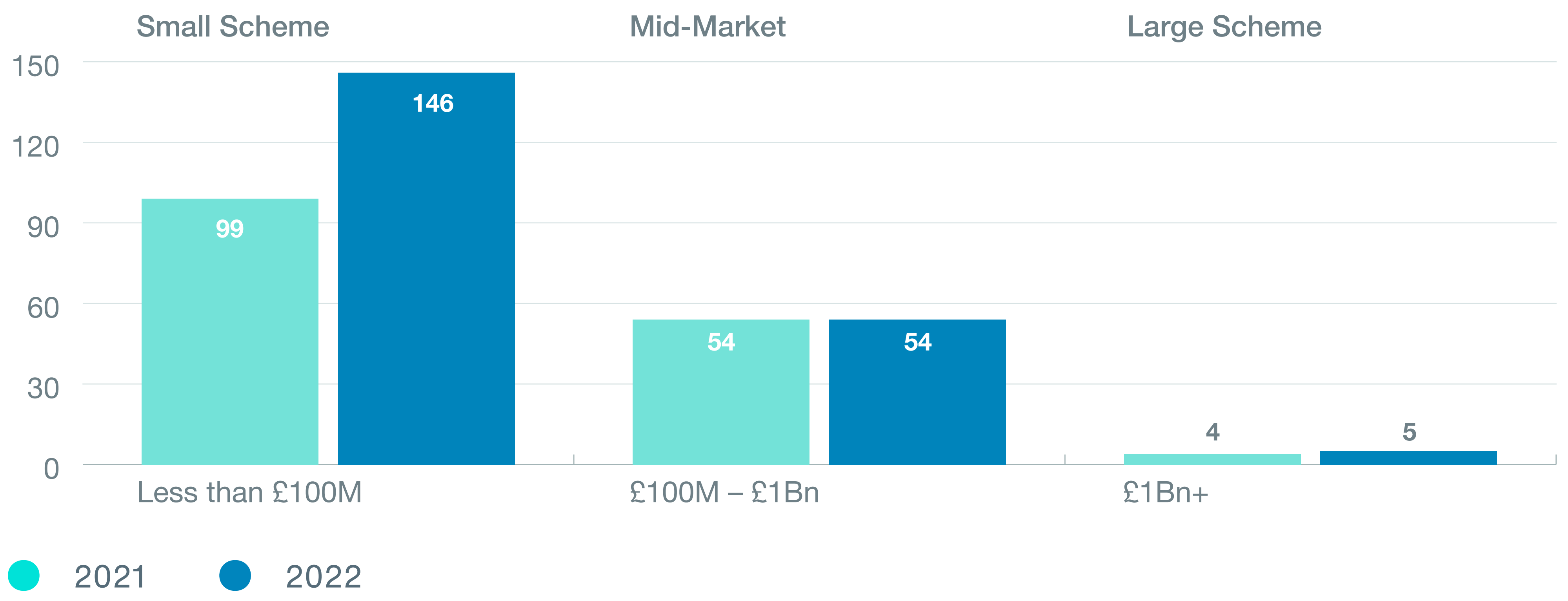
To illustrate this point, chart 2 shows the increase in the number of deals between 2021 and 2022, in particular, there was an increase of around 50 percent deals for smaller schemes taking place in 2022. 2023 has seen an increase in £1 billion+ and multi-£ billion ‘jumbo’ transactions coming to market, with the number of transactions at the smaller end continuing to increase. This in turn increased the resource requirements of insurers and advisers to complete a similar total volume across a significantly higher number of deals. If financial assumptions had remained at pre-2022 levels, we estimate that 2022 would have seen the second highest total volume of liabilities placed in any year, behind only 2019.

Chart 1 — Total Bulk Annuity Volumes



Source: Aon’s Due Diligence Team

Chart 2 — Number of Bulk Annuity Transactions 2021-2022



Source: Aon’s Due Diligence Team

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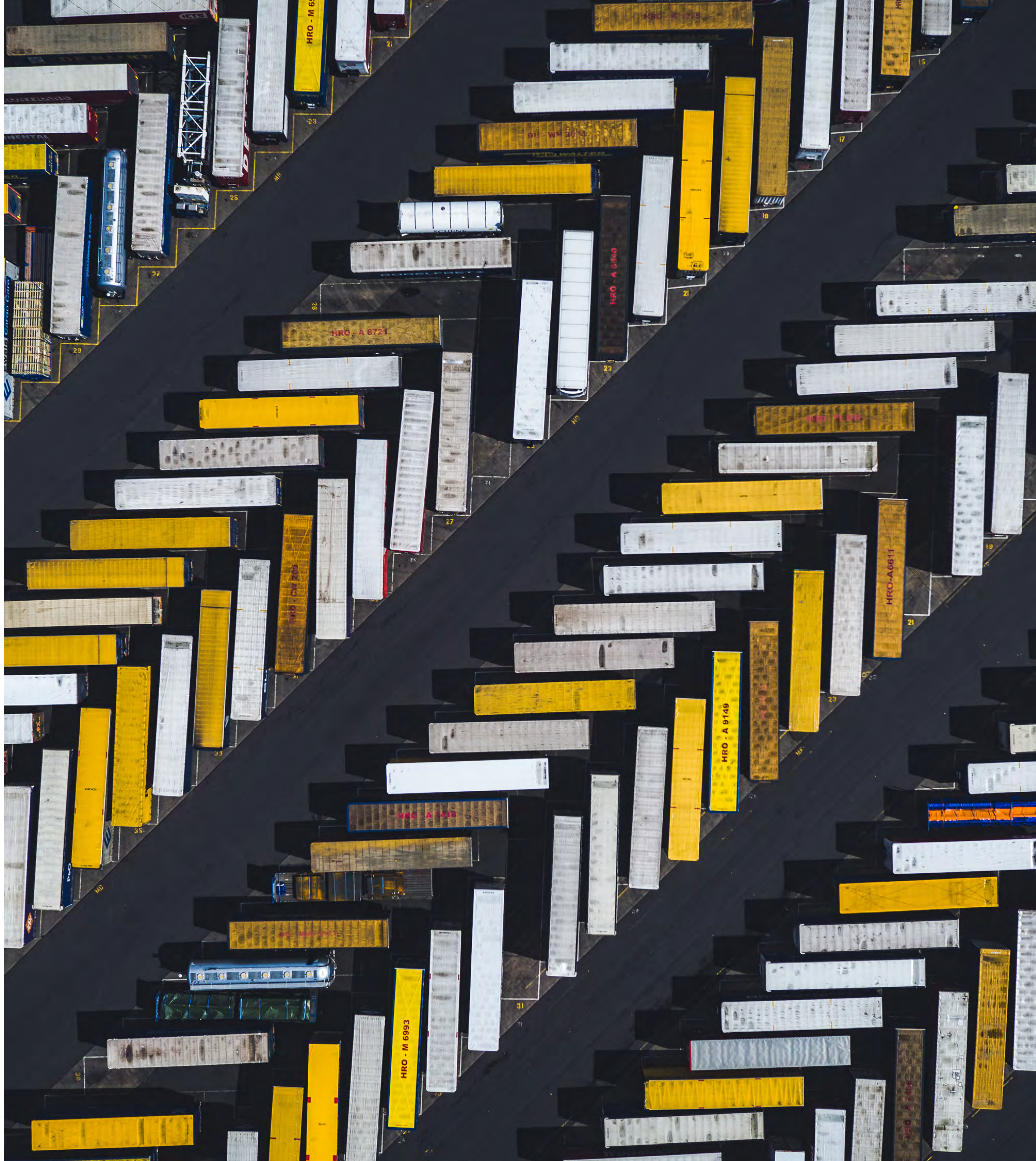
A ninth insurer (M&G) entered the market in September 2023 with Aon leading the Trustee advice on their first publicly announced deal, securing £330 million of liabilities for all deferred and pensioner members of the M&G Group Pension Scheme. While M&G have not publicly confirmed specific volumes targets, they have suggested that they will quote on a selective basis initially and we expect them to focus on the mid-market sector with deal sizes in the range £250 million to £1 billion.

As we look beyond 2023, we asked insurers to indicate the volumes of business they expect to write in the next five years. 85 percent of insurer responses received indicated that they intended to increase their business volumes in a sustainable way to meet demand, while the remainder suggested they would seek to retain stable targets.

This will be much welcomed news by schemes targeting buyout as their endgame, as it signals the intent to grow by the insurance industry as a whole to meet the demand.

85% of insurers committed to increasing volumes of bulk annuity deals over the next 5 years, the remainder will retain stable targets

9 Insurers now active in the UK bulk annuity market, all able to offer full-scheme transactions



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Headwinds and Tailwinds

2 Headwinds and Tailwinds

With a clear intention from the insurance industry to increase the volumes of liabilities written and the number of schemes supported on the path to buyout, a key question is what do insurers see as the headwinds which may derail any plans for growth and development?

Overwhelmingly, the number one response from all insurers was human resource, with a limited pool of people available to prepare schemes for market and execute a transaction — whether that be administrators, advisers, or even at the insurers themselves reacting to approaches from schemes considering a buy-in or buyout. This resource is facing even greater pressure as a result of the rapid acceleration of funding levels and increased appetite from pension schemes to make inroads on their endgame.

Resourcing Solutions

In response to this, insurers are focusing on recruitment to increase their headcount, enabling them to increase the number of schemes they can quote on and provide solutions for.

Additionally, they are investing time and resources into streamlining processes both internally, and for Trustees and advisers, to allow efficiencies to be created, in turn creating higher capacity. This is particularly true at the smaller end of the market, where processes are being created to maximise the likelihood of deal execution.

This includes time saving efforts such as the requirement to use templates for providing data to minimise time spent analysing data. At Aon, we are also continuing to innovate and streamline processes on the broking side to ensure that schemes we take to market are top of insurers' priority lists.

Perhaps, more crucially there is a notible increase of requests to work exclusively from the outset with a single insurer to negotiate terms of a potential deal. Interestingly, insurers' opinions vary on the idea of early exclusivity with some suggesing it can provide optimal solutions for pension schemes, while others suggested it would never be in the best interest of a pension scheme to work with one insurer exclusively without approaching the whole market.

This difference in opinion underlines the importance of working with a specialist risk settlement adviser, with each insurer having a different outlook and ethos on how to best help pension schemes with their endgame strategy. Understanding these differences can enable your scheme to develop a targeted insurer engagement strategy and ultimately achieve the best outcome for your members.

Number of Insurers Citing This Headwind

7

Pricing Resource

Administration Resource

6

Adviser Resource

Asset Sourcing

2

Reinsurance

1

Technology Developements

Pricing Impact of Potential Headwinds

Of the other headwinds identified by insurers over the next five years, two directly relate to the pricing they may be able to offer — namely asset sourcing and reinsurance.

As the demand grows from the pension scheme industry for assets which are desirable for the long game, such as investment grade credit, it may become more difficult to source the assets insurers need to back the liabilities taken on as part of any transaction.

While some schemes will be able to pay their premium with assets which may be desirable to insurers, there will also be types of assets which insurers cannot invest in due to strict requirements on capital and reserving, meaning insurers may need to source appropriate assets elsewhere. The availability, and price of these assets will directly drive the price insurers can offer pension schemes for any transaction.

There are some changes expected shortly which will potentially ease this for insurers via the Solvency II reforms in the UK.

As part of the draft regulations released in June 2023, changes were announced to the asset pool available to insurers, widening the asset classes for use to back liabilities, as well as a reduction in the Risk Margin of around 65 percent for long term life insurers (this is an extra reserve for risks that are harder to hedge, mostly longevity risk for annuity funds).

The reforms will come into force over 2023-24, with the key change to the Risk Margin being implemented by the end of 2023, meaning greater investment flexibility for insurers, and overall positive outcomes for insurers and pension schemes to continue to secure members' liabilities.

While not covered in the draft regulations, we do expect further changes to reduce the reporting and administration burden for insurers, which may pave the way for other insurers to find it easier to enter the bulk annuity market.

Are There Tailwinds From Solvency II Reform in the UK?

We asked insurers what they thought the impact would be on the risk settlement market and their strategy to back liabilities. Unanimously, insurers welcomed the changes and the additional flexibility it would provide to their business. It would be a natural conclusion to reach that increased flexibility might lead to reduced pricing, however, the majority of insurers suggested there would be no cliff-edge in pricing with prices being slashed overnight. Instead, all insurers thought the impact would be minimal, with one insurer suggesting the expected outcomes are already embedded in their pricing strategy.

This may be unexpected or disappointing news for some schemes hoping to see a step change, but much like the wider economy, the risk settlement market is quick to react to anticipated change and smooth the effects over time. As indicated by insurers, it is too early to know the impact of the reform but at this stage the impact on pricing is expected to be limited.

Reinsurance Pricing

While not a visible part of the puzzle for Trustees and members, this can influence the pricing of any transaction.

The mechanics of this involves insurers sharing the risk involved in any transaction with a reinsurer, who will take on a proportionate share of the risk or seek to take on some of the tail risk for the direct insurer of the scheme (e.g. claims beyond a certain level if members live considerably longer than expected). By the insurer seeking out this reinsurance, they are able to reduce the amount of capital they need to hold against the risks taken on, and in turn reduce the price quoted to a scheme.

Under Solvency II regulations, UK insurers are often required to reinsure longevity risk on transactions they write. This can be done either alongside or after the bulk annuity transaction, and insurers employ differing approaches to this.

Reinsurers don't only provide services to bulk annuity providers, and are also a key party involved in longevity swaps. This type of deal often removes the longevity risk for schemes worth several £billion, which can lead to further capacity constraints in the market while longevity swap deals are negotiated. A good test for the reinsurance market was during H2 2022 and H1 2023, when £13 billion of longevity swap deals were being negotiated. During this period, Aon were lead adviser for £10.4 billion of this total via the £7 billion longevity swap for Barclays, £1.7 billion for Balfour Beatty and £1.7 billion for Nationwide.

The reinsurance market remained strong throughout this period, and we saw large transactions continue to achieve attractive pricing in line with their required timescales.

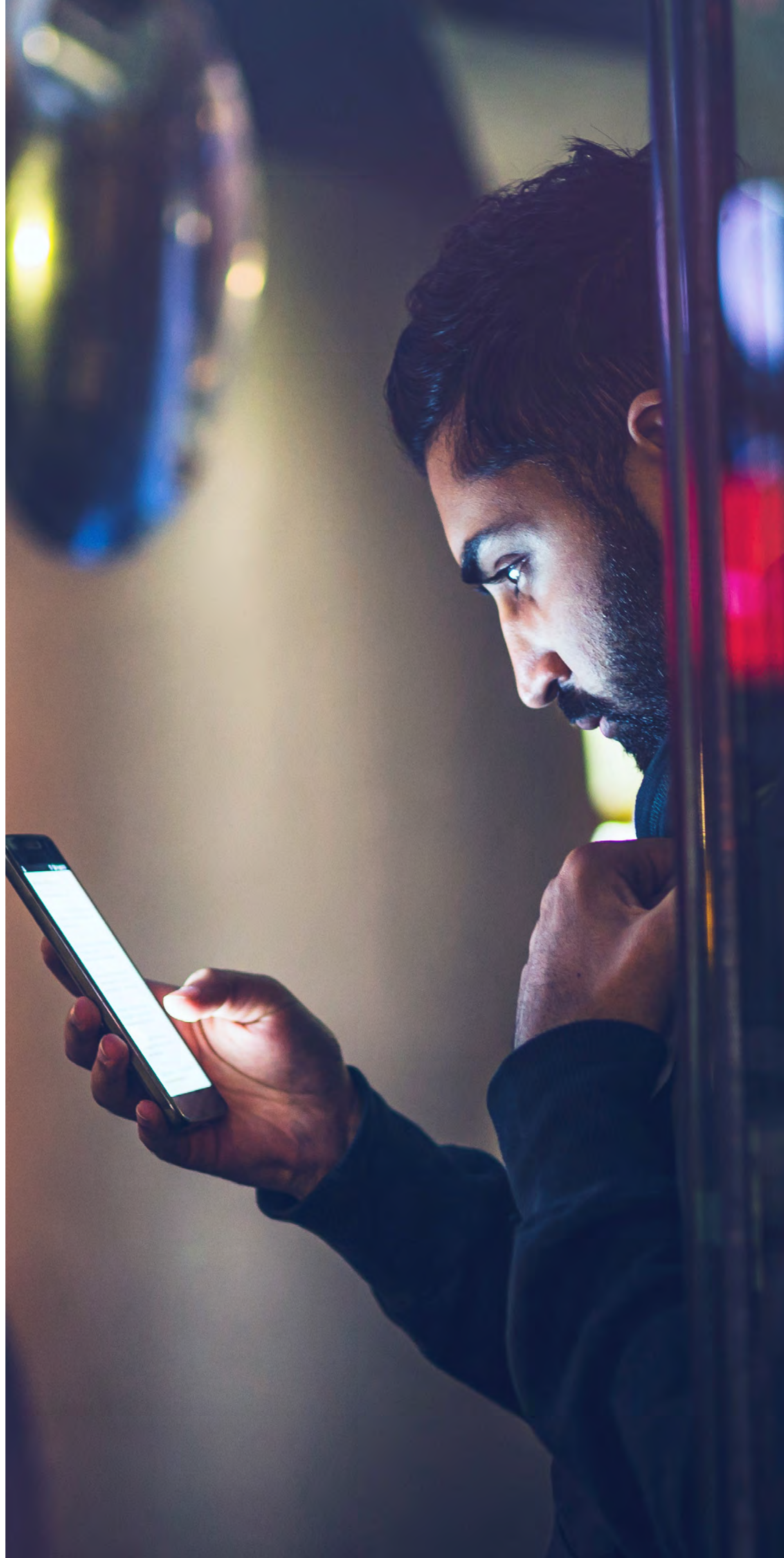
Some insurers in our survey identified reinsurance as a potential headwind in the coming years as the market continues to expand, noting that whilst reinsurers are confident in their ability to support increasing demand in the market, capacity will remain an ongoing challenge.

As with insurers, reinsurers are reacting positively to the demand and seeking to recruit to enable more reinsurance to be provided both to insurers and those seeking to consider longevity swaps. With significant interest from overseas reinsurers participating in the UK bulk annuity market, this is an issue being tackled globally.

Technology

While only being specifically called out by one insurer in our survey, our view is that technology will have a big role to play in the future of the risk settlement market.

The online capabilities for member quotation modelling are expected to be increasingly commonplace with instant access to retirement quotations and transfer values being hugely beneficial for members in their retirement planning. With great member experience being an increasingly common objective for Trustees when considering an insurer to partner with, insurers will need to move with the times and provide online modellers with increased capability direct to members.



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Insurer Transaction Preferences and Pricing

3 Insurer Transaction Preferences and Pricing

Within the eight insurers in the market active at the time of conducting the survey, their preferences for choosing which schemes to quote on vary according to transaction size, scheme membership profile and benefit characteristics, among other things.

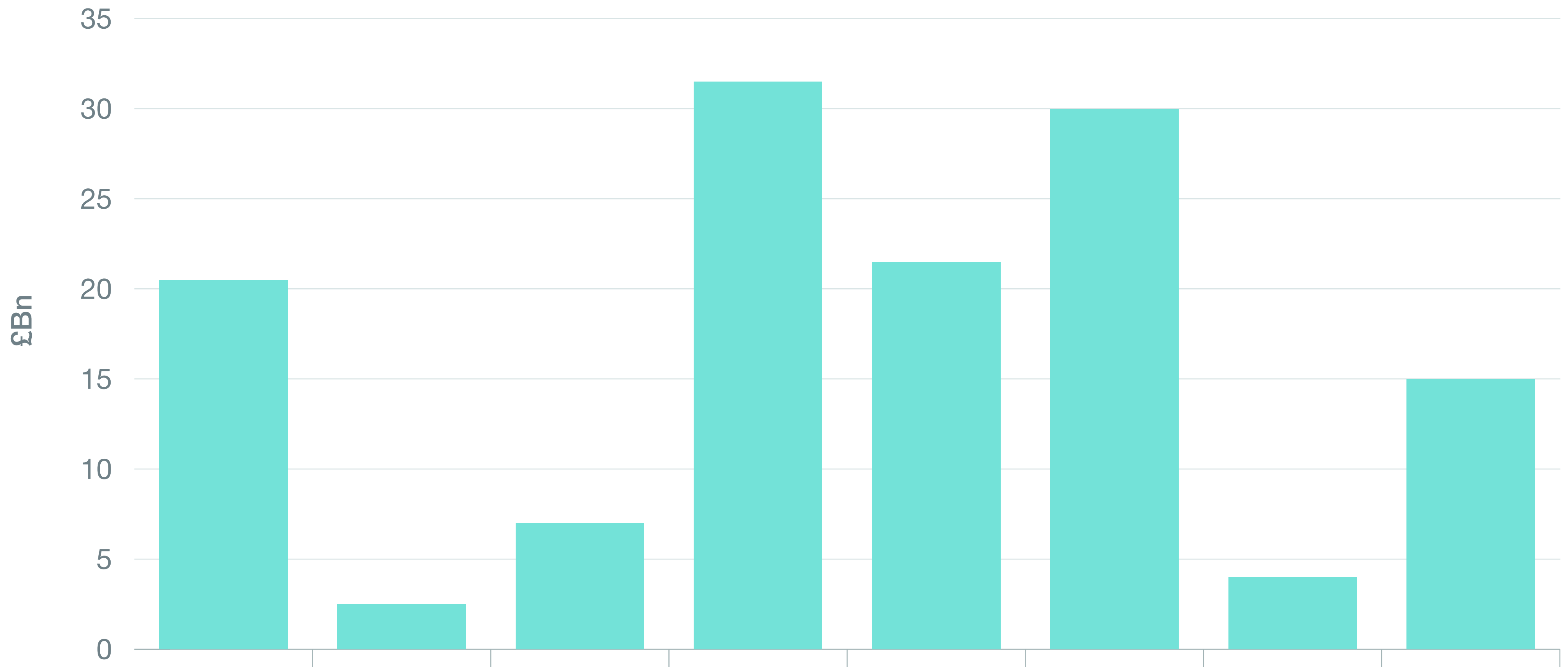
Looking at the volume of completed deals alone for each insurer in the last 3 years doesn't tell the whole story — instead, considering the average deal size by insurer is more revealing.

The chart opposite shows both the total volumes by insurer between 2019 and 2022, as well as providing average deal sizes during that period. As can be seen from the chart, there are insurers which have completed much greater deal volumes than others, with Aviva, Legal and General, PIC, Rothesay and Standard Life all exceeding £10 billion in total volumes over the period.

Within this, however, is a large variation between average deal size, ranging from Aviva at £110 million to Rothesay at £710 million. This illustrates that Aviva wrote the highest number of deals, operating towards the smaller end of the market. L&G were a close second in terms of number of transactions, and despite the much smaller total volumes, Just was the third busiest in terms of number of deals completed, and the only other insurer to complete more than 100 deals over the period. These three insurers are also the ones most focused on using streamlined processes to be able to continue to support small schemes in high numbers.

What is clear from this is that different insurers have different operating models to suit their business. Prior to 2023, Canada Life and Scottish Widows had been less active in the market than some of the other insurers and more selective on the transaction characteristics they quoted on, though both have relaxed this position over the course of 2023. While in prior years, some insurers only quoted on pensioner-only transactions, all active insurers in the market have now built a deferred member proposition, meaning full-scheme liabilities can be secured with any insurer. This includes Canada Life, who confirmed their first full scheme transactions in July 2023 as well as new entrant to the market M&G. We expect that M&G will operate in the mid-market deal size, and will watch with interest the number and type of future deals they complete going forward.

Chart 3 — Total Volumes by Insurer Between 2019 and 2022



	Aviva	Canada Life	Just Group	Legal & General	PIC	Rothesay	Scottish Windows	Standard Life
Number of deals	189	22	131	164	60	42	14	32
Average deal size	£110M	£110M	£55M	£190M	£360M	£710M	£290M	£470M

We asked insurers for the top features of a transaction they consider in the decision-making process on whether to quote, and asked for these based on scheme size. Unsurprisingly, the top three features across all scheme sizes were quality of data, benefit structure and timescales to transact.

Small Schemes

For small schemes there are few other factors which insurers consider beyond this, as these three areas will drive the most efficiencies for any transaction. With the number of transactions increasing, creating streamlined processes is critical to insurers, particularly at the smaller end of the market, to allow decisions to be made quickly on which cased to quote on. As a result, schemes on a journey to buyout should seek to structure their preparation to ensure maximum insurer engagement by focus on having the best quality data and insurer-ready benefit specifications before going to market.

Some of these streamlined processes being built by insurers involve providing data in a standardised format to allow quicker review, for example those requested by Just, Aviva and L&G. While this benefits the insurer, it can involve preparing multiple versions of the data to populate their templates, which will increase the preparation required by schemes, as well as the potential for discrepancies to creep in between insurer if presented in different ways.

Insurers expect their standard templates to work for the majority of schemes, but schemes with unusual benefit features that are not covered by the template may need to consider how this affects their approach to market.

Chart 4a — Key Factors Insurers Consider as Part of Their Triaging Process for Small Schemes

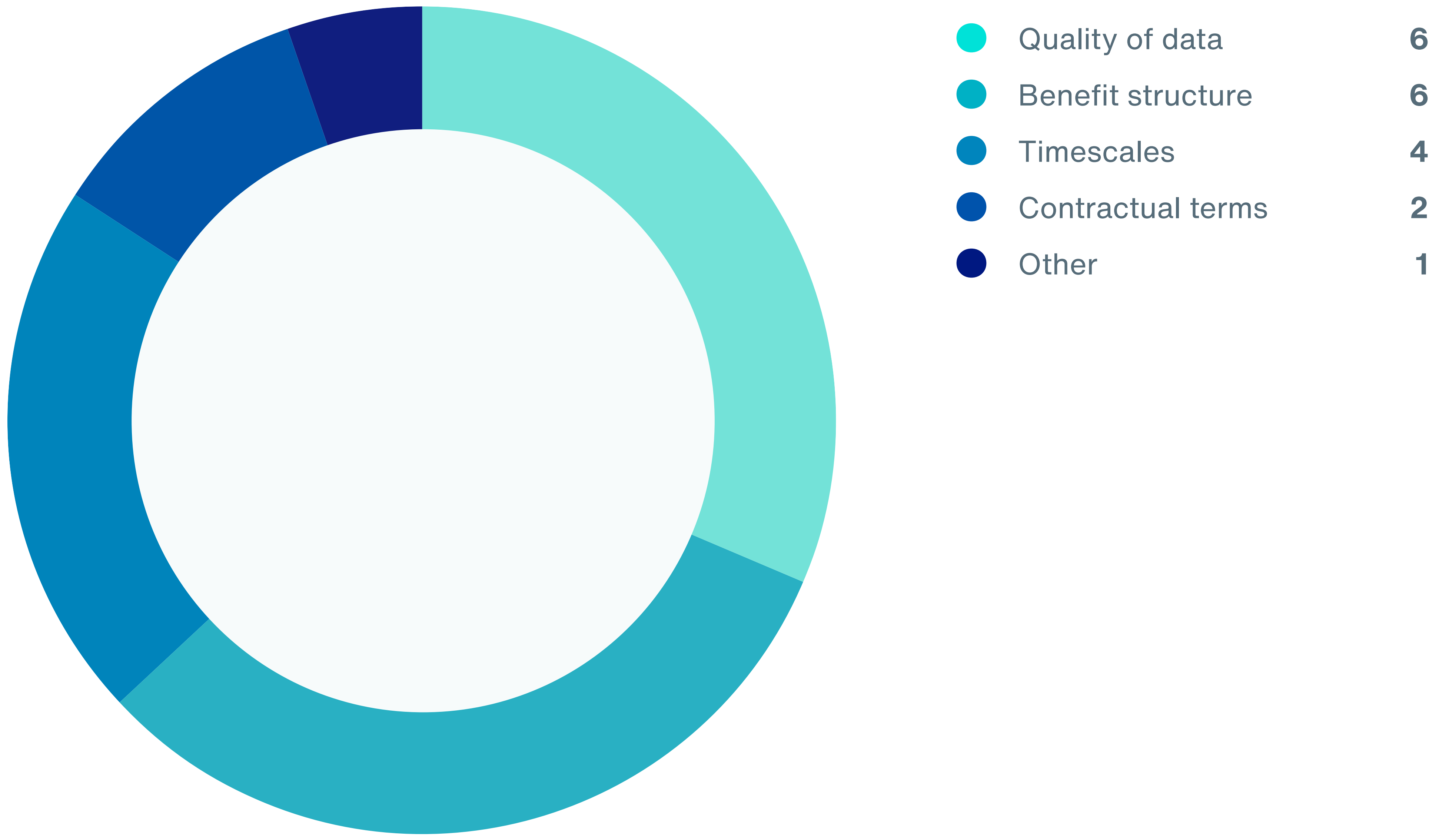
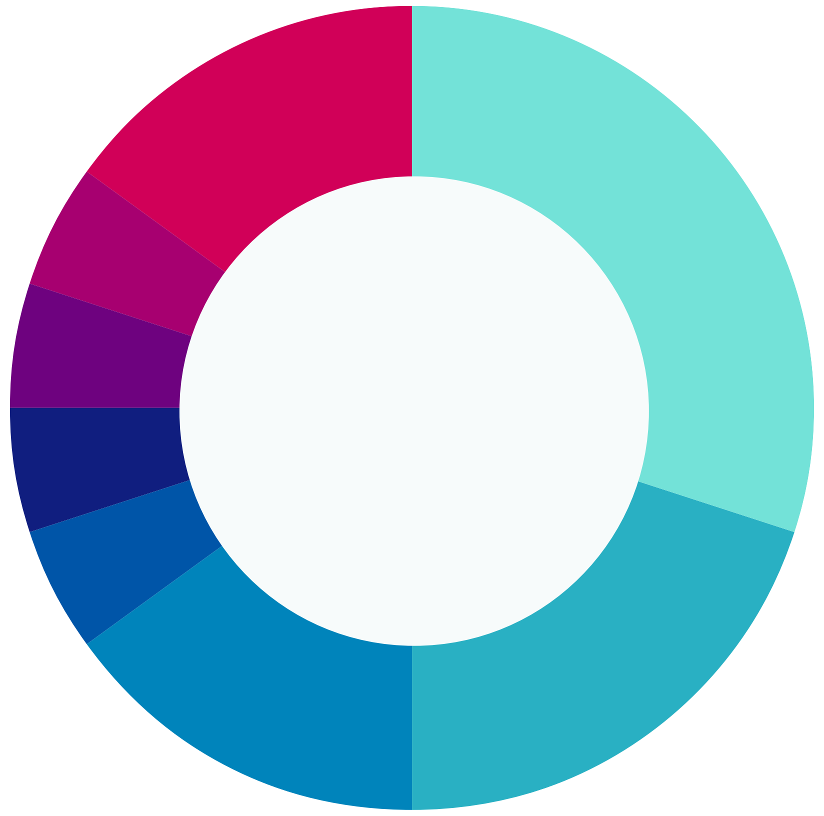


Chart 4b — Key Factors Insurers Consider as Part of Their Triaging Process for Mid-Sized Schemes



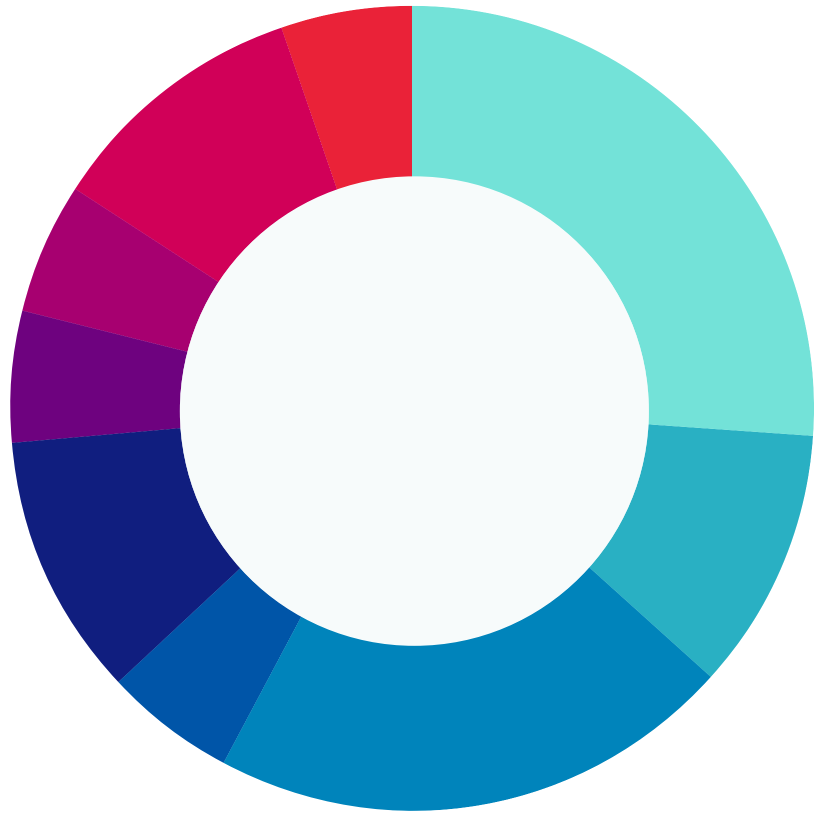
Quality of data	6
Benefit structure	4
Timescales	3
Settlement adviser	1
Additional security requirements	1
Contractual terms	1
Type of transaction (buy-in v buyout)	1
Governance arrangements for decision making	3

Mid-Sized Schemes

For mid-sized schemes, the most commonly considered additional factor was the governance arrangements for decision making by Trustees and sponsors. It is critical to the success of a project that the Trustees and sponsor are aligned, and insurers will want to understand how this will work in practice.

Without alignment between key stakeholders there is an increased risk of costly delays or even the transaction not proceeding. Insurers are therefore more reluctant to allocate scarce resource to price such cases. Similarly, there is a risk to schemes that an aborted market approach can make it more difficult to obtain insurer engagement at a later stage unless any differing views between Trustee and sponsor can be clearly demonstrated as being resolved.

Chart 4c — Key Factors Insurers Consider as Part of Their Triaging Process for Large Schemes



Quality of data	5
Benefit structure	2
Timescales	4
Settlement adviser	1
Additional security requirements	2
Contractual terms	1
Type of transaction (buy-in v buyout)	1
Governance arrangements for decision making	2
Other	1

Large Schemes

Building on the factors affecting decision making for mid-sized schemes, one additional factor insurers consider when deciding to quote on the largest schemes is additional security requirements. For large schemes, with the large sums of money at stake, and the number of members impacted by the decision, it is relatively common for Trustees and sponsors to request additional security requirements for the transaction. This may take the form of collateralised annuities, or more commonly, increased termination rights under specific circumstances such as reduced solvency ratios or failure of the insurer. These will be negotiated on a case-by-case basis and generally do not feature on small or mid-sizes schemes. Insurers will consider how onerous any additional security terms requested are when deciding whether to engage in a process.

3

Top Features by Size

Small Schemes

Timescales to transact

Benefit structure

Quality of data

Mid-sized Schemes

As per small schemes, PLUS
Governance for decision making

Large Schemes

As per mid-size schemes, PLUS
Additional security requirements

Contractual Considerations

While not a highlighted as a key consideration by all insurers, contractual terms feature across all scheme sizes. As insurers seek to streamline their contracts, any unusual requirements from schemes may cause insurers to pass on quoting for a scheme — in the interest of focussing on simpler cases to transact with.

This suggests that how any contractual ask is positioned is important. Whilst it is unlikely to be the sole reason for a go/no-go position by the insurers, stretching commercial terms (along with the reasons why they are being requested) will be factored into considerations around whether to quote on the transaction.

However, as noted by some insurers, the risk settlement adviser taking schemes to market is also a factor they consider, particularly for the mid-size and larger end of the market. Picking your risk settlement adviser should therefore play an important role in setting your endgame strategy to help your scheme achieve optimal contractual terms and overall outcome.

Membership Profiles

As noted previously, all insurers can now offer annuities for deferred members and hence support full scheme transaction. Interestingly, the preferences vary for each insurer as to the relative proportion of deferred versus pensioner liabilities as part of any transaction, with insurers at each extreme. One insurer indicated a preference for longer dated buyouts, meaning deferreds fit better with their objectives, while another insurer indicated a distinct preference for pensioner transactions, with simple benefit structures, and a further insurer suggesting shorter dated transactions were optimal for them, meaning a mixture of pensioners or older deferred members suit their strategy best.

The remaining insurers surveyed suggested they would consider a mix of transaction types, with a variety often acting to balance their existing back book of annuities. This again allows schemes to focus on the insurers most suited to their scheme profile.

GMP Reconciliation and Equalisation

Across the country, schemes are at various stages in reconciling and equalising GMPs, and so we asked insurers for their views on schemes approaching the market with some of this work still to resolve.

Across the board, all insurers confirmed that both reconciliation and equalisation can be completed post-buy-in. Of course there will be a preference to remove uncertainty in having this completed prior to transaction for both the Trustees and insurer, but where this is not possible, insurers are generally flexible on whether this is completed in advance or not. The only stipulation from all insurers is that these steps be completed before issuing individual policies to members upon buyout, as would be expected.

In terms of methodologies each insurer would support for GMP equalisation, the overwhelming majority of insurers confirmed that they could support any method chosen by the Trustees with one insurer supporting the most commonly used methods (including dual records and conversion).

Longevity Expectations

We also asked insurers about their view on future longevity assumptions. Some indicated that their modelling is reinsurer-led, and therefore will depend on the prevailing basis offered by reinsurers at the time of transaction. Regardless, insurers and reinsurers are constantly monitoring longevity assumptions and experience to ensure that there would be no step changes in pricing each time a new model for improvements is issued by the Continuous Mortality Investigation (CMI).

High Inflation Environment

A topical question of late has been how to deal with the problem of high inflation. A large proportion of schemes have capped inflationary increases in place but in a high inflation environment, many Trustee boards are considering their discretionary increase powers to compensate members for the higher levels of inflation experienced beyond the caps in place. As such, we asked insurers what their appetite would be to offer uncapped inflationary increases or whether they would consider top-ups at a later date to provide uplifted pensions to members.

All insurers confirmed this would be possible in the same way as any other benefit augmentations under their standard contracts, but any changes would be subject to their prevailing pricing basis (and insurer consent) at the time of the request.

Member Option Exercises Post-Transaction

With some Trustee boards offering their members a variety of options to suit their specific circumstances and retirement needs, we asked insurers what their appetite would be to incorporate any such exercise as part of the transaction.

There was a clear preference from insurers that these be executed prior to transaction, although some suggested they may consider a concurrent exercise as part of a larger deal. With such a clear position from the insurers, particularly for smaller schemes, the early planning of any member options exercises on the journey to settlement will be key to their success.

How Might Insurer Preferences Evolve?

As the industry grows, we expect the capabilities of each insurer to grow in tandem as they develop new solutions. With the upcoming changes expected from the Solvency II reform, we expect that increased freedom on the investments available to meet reserving requirements could lead to a widening of their ability to provide bespoke solutions for schemes, or alternatively to a larger range of transaction sizes.

Some insurers operate within a distinct area of the market, while others cover the whole market. We asked insurers how they thought their appetite may change over the next five years in terms of transaction size. The majority suggested their target market would remain unchanged, but three insurers suggested they would like to increase the upper transaction size they were prepared to consider (over £1 billion), paving the way for more of the mega deal trend we have observed in the last year or two. With this increase in competition for larger transactions, and with all insurers operating in the mid-market space, these sections of the market are currently the most competitive. As such, being clear on your preparation and transaction strategy up front will increase insurer engagement.

4

Investment Considerations for Transactions

4 Investment Considerations for Transactions

A key workstream for schemes considering a risk settlement transaction relates to the investment strategy. This falls into two stages: firstly, the portfolio of assets held during the preparation phase and secondly, aligning as closely as possible to your chosen insurer's price tracking mechanism during exclusivity to optimise the outcome.

While there are guidelines for the assets in which insurers can invest, each insurer positions their portfolio differently to suit their back book of liabilities as well as their plans for future business. This can mean that structuring a portfolio in an attempt to match insurer pricing can be difficult, and often will depend on which insurers a scheme intends to approach. This can mean either investing closely in line with a scheme's preferred insurer, or instead a more common approach is to invest in line with an 'average' insurer portfolio. For this, it will be important to enlist the help of a risk settlement investment specialist who understands the underlying insurer portfolios and can advise accordingly.

Another area in which the risk settlement investment specialist can add value is by positioning a scheme's portfolio to enable the scheme to pay the premium using assets (as an in-specie transfer), rather than disinvesting and paying the premium in cash. The appetite for accepting in-specie assets across a variety of asset classes can vary, and as such, we asked insurers this question as part of our survey.

Chart 5 on the next page provides the responses received from insurers regarding the asset classes they would consider as part of a premium payment. Typically, insurers prefer gilts, high quality investment grade credit and cash, but are increasingly considering other asset classes too. A hot topic in the risk settlement market over the last 12 months has been the unexpected position many schemes have found themselves in whereby the proportion of illiquids they hold has suddenly increased due to the rapid reduction in value of gilts and LDI assets following the mini-budget in September 2022. With many schemes now much closer to full funding on a solvency basis, the problem of how to dispose of their illiquid holdings is suddenly high on the priority list of hurdles to jump before going to market.

Helpfully, more than 80% of insurers suggested they would consider illiquid holdings as part of a transaction, and many of them are creating solutions to allow this hurdle to feel much easier to overcome. Having said that, we expect it would be unlikely that insurers will accept large proportions of these on every deal as these assets currently don't align with the reserving requirements placed on insurers. Additionally, it may also mean accepting a reduced price for illiquid assets if an insurer takes them on as part of a transaction.

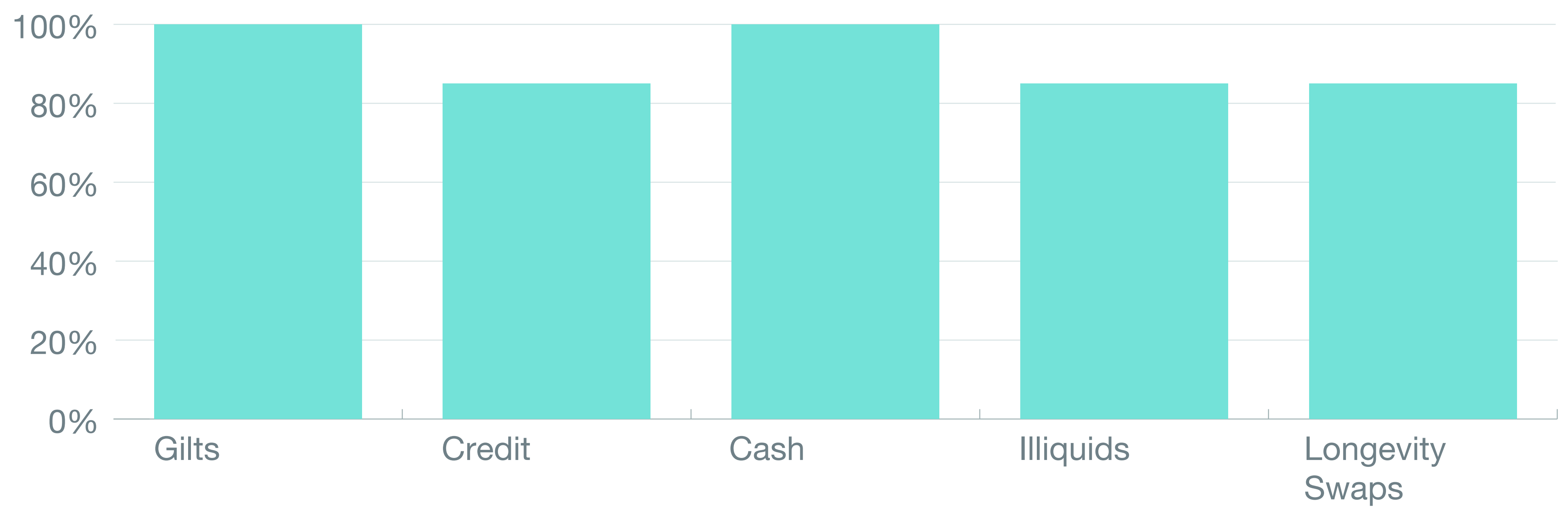
4

While the problem of dealing with illiquids can affect schemes of all sizes, longevity swaps being passed to insurers as part of a premium payment will usually only impact the largest schemes, since it tends only to be schemes at this end of the market who have these in place. This can be a material part of any project to pass these to insurers, but since they do seek to hedge the longevity risk for any transaction, it can be beneficial for them to take on and remove the need to consider this separately in the background.

These preferences for asset classes may marginally change over time as the changes are embedded following the Solvency II reform, so watch this space!

Chart 5 — Insurers Appetite for Asset Classes

In-specie assets as part of premium payment



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Insurer Triage Process

5 Insurer Triage Process

A key part of any market approach will be the triage process the insurer carries out when reviewing the request for quotation pack presented by a scheme.

With the unprecedented demand for quotes, making your scheme stand out from the crowd will be extremely important. With this in mind, we asked insurers what they consider as part of this process, how they see this operating more efficiently, and most importantly, what schemes can do to sail through this process with insurers.

While the process varies by insurer, broadly, you can expect as follows:

1. Initial Capacity Review

With limited capacity to produce quotations and ultimately deliver transactions, insurers need to be realistic on what can be achieved within their teams before proceeding with a quotation response. In some cases, one large, complex deal can command greater resource requirements than multiple smaller, simpler transactions.

To maximise insurer engagement and to receive a competitive quote, the insurers should already be warmed up to the impending request by the risk settlement adviser and have already pencilled in the request within their pipeline. At Aon, we have regular discussions with all insurers in the market regarding pipeline of transactions to maximise engagement for schemes we advise. Insurers greatly value this regular dialogue, which supports their planning, as well as allowing an opportunity to field initial discussions on the potential complexity of upcoming transactions on an anonymous basis before the formal market approach. This can in turn support with the preparation phase for schemes.

2. High Level Review for Transaction Readiness and Appetite

If capacity exists within an insurer, they will then look to consider the overall likelihood of a transaction both in terms of the readiness of the scheme and the appetite to proceed with the specifics of this transaction.

Taking each aspect in turn, firstly we consider the readiness of the scheme. The usual key criteria were cited by the insurers — namely good quality data and a legally signed-off benefit specification, as well as alignment from the Trustee and sponsor on the strategy for a potential transaction.

This will include giving consideration to any potential shortfall between the assets available and the price quoted by the insurer, and the commitment of the sponsor to fund any such shortfall. Clearly the larger the gap, the less likely the transaction may be to proceed, unless there is firm commitment from the sponsor to proceed with a large contribution. Making clear up front the sponsor's position will give comfort to the insurers that the quotation provided may not solely be a market-testing strategy and a transaction is likely to proceed.

In terms of appetite of the insurer, this will depend on the segment of the market they operate in and whether the proposed transaction complements this. Typically, this would involve providing details of estimated solvency liabilities and duration or membership profile of the scheme, as well as transaction type e.g. buy-in or buyout.

Some insurers suggested additional criteria which may impact their appetite. For example, L&G commented that they would seek to consider existing relationships with the scheme either from previous bulk annuity transactions, or those with assets held with their investment arm, Legal & General Investment Management (LGIM). Further, insurers commented that they would consider whether there are any more schemes within the same parent company, as this may lead to a stream of transactions via a strategic partnership, increasing their potential volumes over time stemming from this one deal.

One final, and non-trivial factor insurers told us they will consider as part of their decision on whether to quote is the number of insurers participating in the process. This feeds into some insurers' assessment of 'likelihood of success' – the greater the number of insurers asked to quote, the lower their chance of success, and some insurers will bow out at this stage if they feel they are less likely to be competitive on this particular deal. While they don't know specifics on each other's pricing strategy, feedback is usually given after each round of quotations on their position relative to the other competing insurers. As such, they are able to form a view on their position in the market for certain deal types and can target transactions thereafter which will play to their strengths.

3. Consider Complexity of Scheme and Specific Requests from the Scheme

Some insurers have a strong preference for simple benefit structures, and therefore knowing insurer preferences will allow you target the right insurers and optimise the time spent for the quotation phase of your project.

On the other hand, most insurers are willing to work with schemes to understand the complexities before proceeding. In some cases, insurers may ask trustees to simplify benefits where possible for ease of administration.

Aside from benefits, a scheme may have specific requests in terms of the strategy of the project. An example may be a required short timescale from buy-in to buyout (though this can be considered a positive or a negative factor depending on how confident the insurer is of delivery to desired timescales) or perhaps additional termination rights or collateral as part of the deal. In the face of competing opportunities in a busy market, complexities such as this may lead insurers to choose to transact with a scheme without any such requests, unless the wider proposition of the transaction is attractive to them, perhaps as a result of scheme size or other scheme or sponsor-specific factors.

4. Review Timeframes and Current Pipeline for Delivery of Quote and Ultimate Transaction

Once insurers are committed to submitting a quotation, they will review the timescales involved in the quotation process and the intended inception date of the transaction in more detail, with a view to planning resource internally. Where deadlines are short and cannot be moved, this may limit the number of insurers willing to participate and so being flexible at this stage can often prove valuable, as insurers manage competing deadlines.

Triage process for larger schemes

As transaction size increases, we find that insurers' criteria for triaging can be more flexible than at the smaller end of the market. Similarly to increased flexibility to negotiate on commercial terms for larger schemes, the allure of writing a large transaction – particularly as you approach the £Bn+ end of the market – is enough to encourage several insurers to quote. We have seen as many as 6 or 7 insurers quoting on large transactions over the last 12 months.

As with any transaction however, regardless of size, to achieve the highest levels of engagement insurers will need to be convinced that the scheme is well prepared, and that the Trustees and Sponsor are aligned in their objectives.

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What Next?

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What Next?

Following a period of acceleration in funding levels, and a new set of challenges for schemes, including resetting their investment strategy in light of the LDI crisis and resulting higher proportions of illiquid assets in their portfolio, funding levels appear to have stabilised of late. Having edged closer to full funding on their solvency basis, schemes are increasingly engaged in endgame planning, and those who are less progressed in their plans, should now consider the actions required to optimise their route.

For the remainder of 2023 and beyond, we see no signs of the risk settlement market demand slowing, meaning insurers are having to work even harder to fight off the headwinds they see coming, with the key risk to success being well-resourced to process the demand.

We are likely to see further multi-billion pound ‘mega’ transactions emerge, with many of these likely to be full scheme transactions. This requires solutions for non-pensioner members which the insurance industry as a whole is equipped to deal with, since now all nine insurers can accommodate deferred members as part of a transaction.

Trustees and sponsors have never had more opportunity when it comes to risk settlement. Good quality preparation and being ready to transact when the opportunity arises will mean that schemes can choose partners early, achieve good value for money and ultimately make better decisions.

About Aon

Aon plc (NYSE: AON) exists to shape decisions for the better — to protect and enrich the lives of people around the world. Our colleagues provide our clients in over 120 countries and sovereignties with advice and solutions that give them the clarity and confidence to make better decisions to protect and grow their business.

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aon.com

Compliance code — A63-310524

Contact Us

Martin Bird
Senior Partner and Head of Risk Settlement

martin.bird@aon.com

Leah Evans
Partner

leah.evans@aon.com

Lucy Barron
Investment Partner

lucy.barron@aon.com