UK Risk Settlement Bulletin

Q4 2023

For Professional Clients Only

Working in Exclusivity

In 2023, we have started to see a rise in the number of schemes that approach a single insurer in exclusivity for bulk annuity pricing, rather than approaching a range of insurers in a traditional auction-style process.

What is an Exclusive Approach?

By ‘exclusivity’ we mean that the scheme would select a single insurer at the outset, after reviewing the market with its settlement adviser. The insurer then provides a formal quotation for the scheme to consider. However, this isn’t an agreement to transact and if a suitable price cannot be secured, the scheme is then free to approach another insurer should it wish to do so.

When Are Exclusive Approaches Appropriate?

Whilst there are many reasons a scheme may choose to work exclusively with a single insurer, such as an existing relationship or a particularly complex scheme-specific situation, it is often the case now that ‘smaller’ schemes are having to consider an exclusive approach to ensure insurer engagement.

Exclusivity isn’t a new concept in the market — in particular, it has been commonplace in recent years for sub-£20M schemes to work with an insurer in exclusivity.

Over 2023, we have seen that insurers are more likely to require an exclusive approach for a larger number of schemes in particularly busy periods. In some cases, insurers are now treating schemes up to £150M in size as ‘small’ transactions and are often pushing for an exclusive approach in this segment of the market.

From an insurer’s perspective, a smaller scheme could require a proportionately greater amount of effort and resource compared to a larger transaction, relative to the assets on offer. Given the saturated level of demand across the market, working in exclusivity allows the insurer to devote the required resources and put forward compelling pricing because it has greater transaction certainty.

Benefit for Schemes Working in Exclusivity?

The key benefit is improving the level of insurer engagement compared to a traditional auction approach. In addition, for a scheme with any unusual features this approach allows the insurer to focus its resource to accommodate scheme-specific requirements and, if necessary, work with the scheme over a longer time period to develop its proposal.

Won't Pricing be Higher in Exclusivity?

Not necessarily. Despite the lack of competitive tension in an exclusive approach, our experience to date is that pricing usually remains competitive, driven by:

1. Insurers implementing simplified pricing processes to maximise efficiency on their side,
2. Insurers desire to transact the deals they allocate resources to, and
3. Experienced advisors carefully considering the choice of insurer, and helping to robustly assess and negotiate the level of pricing relative to a range of transactions across the market.

Choosing an Insurer for Exclusive Pricing

The case for exclusivity requires an earlier decision from Trustees and Sponsors on which insurer to work with. Whilst pricing is often key, it certainly isn't the only important factor to consider when deciding which insurer to engage with and the approach to obtaining pricing:

- **Target market:** several insurers focus on specific scheme-size ranges in the market, although these ranges will vary depending on their workload.
- **Timing of the transaction:** in a busy market, flexibility on timing can be powerful to secure insurer engagement. This allows the adviser to utilise pockets of capacity as they become available and means an orderly and well-timed approach is likely to result in a better outcome for the scheme.
- **Insurer due diligence:** it is important to consider any notable differences between insurers before selecting an insurer to work in exclusivity with. For example, our Insurer Due Diligence service considers the financial strength of the provider, the member experience through the administration service offered, and the ESG credentials of the provider.
- **Investment:** each insurer can take a different view of the assets that they are willing to accept as part of a transaction, and of the price lock mechanism they are willing to offer to provide price certainty.
- **Process:** three insurers have introduced new tailored pricing processes to accommodate deals for 'smaller' schemes. These are intended to help market capacity. Each insurer process is different, and some aspects are still evolving. This has meant that the market for sub-£100M deals has been more changeable over 2023 than in any previous year. It may be the case that one particular insurer's process may be more suitable for dealing with the nuances of a specific scheme, influencing the decision of which insurer to work with. For example, certain processes may not accommodate all aspects of a scheme's benefits and may require additional work from the scheme advisers to enable the transaction. As this area is evolving quickly, it is important to discuss this area with the settlement adviser early in the planning.

It is essential to consider these factors ahead of selecting an insurer to work with, to ensure there are no surprises further into the process.

If you would like to hear more about working exclusively with an insurer and how this could impact your scheme, then please contact your usual Aon Risk Settlement consultant. Our long-established Pathway service specialises in arranging streamlined transactions and is particularly appropriate below £100M.

Bulk Annuity Volumes — Spurred On by Scheme Funding Gains

In the first half of 2023, bulk annuity volumes amounted to over £21Bn – a record for the first six months of any year to date. This reflects the high level of demand from pension schemes where buyout funding levels have often significantly improved over 2022-23.

This level of new business was achieved despite rising gilt yields over 2022-23 resulting in lower liability valuations. This meant that insurers needed to secure a larger number of members to reach the same business volumes compared to prior years.

The chart below shows the value of transactions by year in the bulk annuity market as well as some of the key events in recent years driving the market.

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

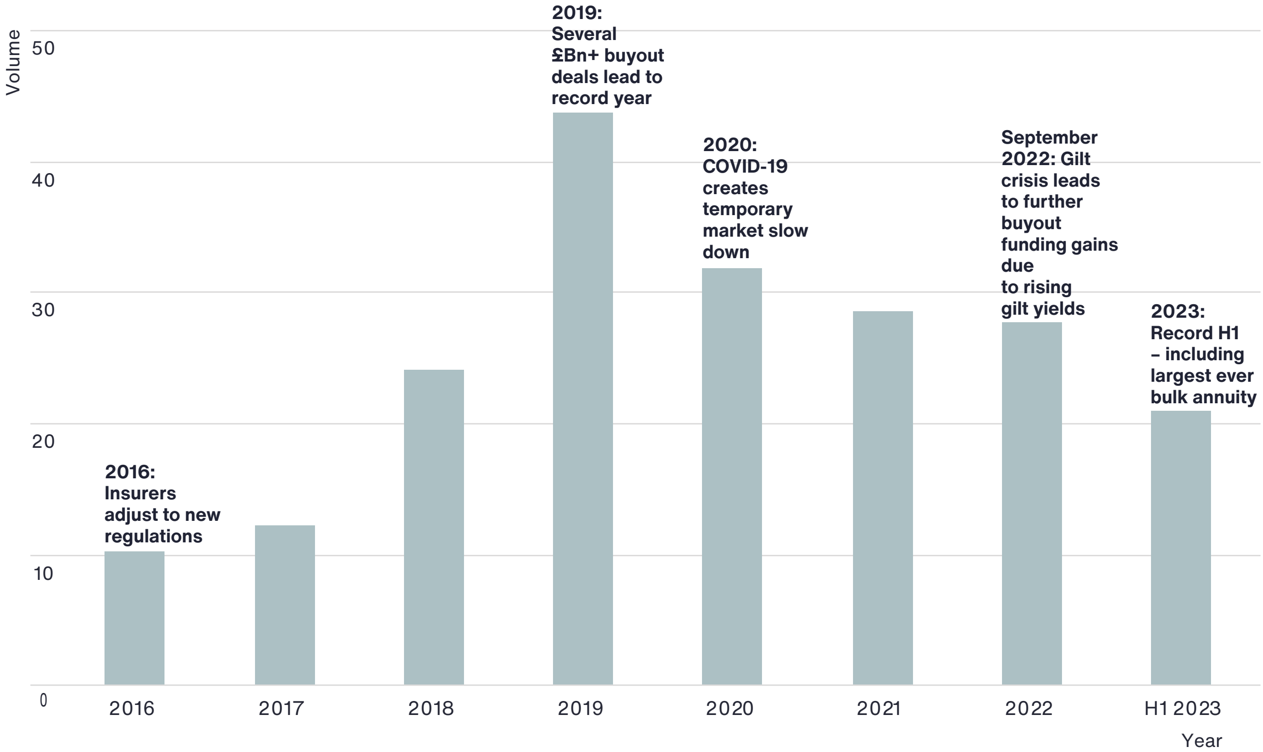


Chart source: Aon's Insurer Due Diligence Service

Over 2023 we have seen some key themes running through the market:

Return of Billion-pound Transactions

In 2023 to date, there have been six transactions in excess of £1Bn amounting to £12.5Bn in total. This included the largest ever bulk annuity policy for RSA, who completed a £6.5Bn buyout with PIC. This compared to five transactions in excess of £1Bn across the whole of 2022 amounting to £7.7Bn — although there is still some way to go to reach the ten £1Bn-plus transactions amounting to £28.7Bn that were completed in 2019.

We expect that multi-billion-pound transactions will continue to dominate the headlines for the rest of 2023 and into 2024. Depending on the number and size of such deals in any given year, the bulk annuity market could be on track to surpass the £50Bn pound mark for a single year.

Strong Capital Position

The current interest rate environment over 2022-23 has resulted in a benign environment for insurers capital positions, with solvency positions being reported at higher levels than seen in recent years. This has resulted in insurers being left with significant levels of spare capital to put towards writing new business.

M&G Enter the Market

In September 2023, M&G announced its re-entry into the bulk annuity market with the completion of two bulk annuity transactions after a hiatus: until 2016, the group wrote new business as Prudential. This re-entry, alongside existing provider Canada Life announcing their first transaction to include deferred members, now means there are 9 active bulk annuity providers, all writing full-scheme transactions.

Several other insurance entities are currently considering entry to the bulk annuity market, which could help to further increase capacity in the future.

Buyouts Prove Popular

The 2022 trend of an increase in full-buyout deals dominating the market has continued into 2023. Of the 95 bulk annuities completed in the first half of 2023, only 3 were pensioner-only deals. The proportion of pensioner-only deals has been falling substantially over recent years: back in 2019 around a third of transactions were pensioner-only. This reflects improvement in funding levels and the increased caution, at least in the short-term, over releasing assets from collateral pools for LDI strategies for partial buy-in transactions, following the 2022 gilt crisis.

We expect buyouts will continue to dominate the market, but that pensioner buy-ins become relevant again for more schemes than at present, as scheme de-risking programmes develop further.

Just Group Success for 'Smaller' Schemes

Just Group completed over half of the sub-£100M transactions in the first half of 2023 — tightening its grip on this area of the market — with Aviva and L&G writing most of the remaining deals in this market segment.

It is worth bearing in mind that rising market yields over 2022-23 lead to a material fall in scheme liabilities. This has meant that a lot more schemes now fall below the £100M mark.

In the first 6 months of 2023, around two-thirds of all transactions were sub-£100M deals. This is a slight fall (compares to 70% across the whole of 2022) despite the greater number of schemes falling into this bracket.

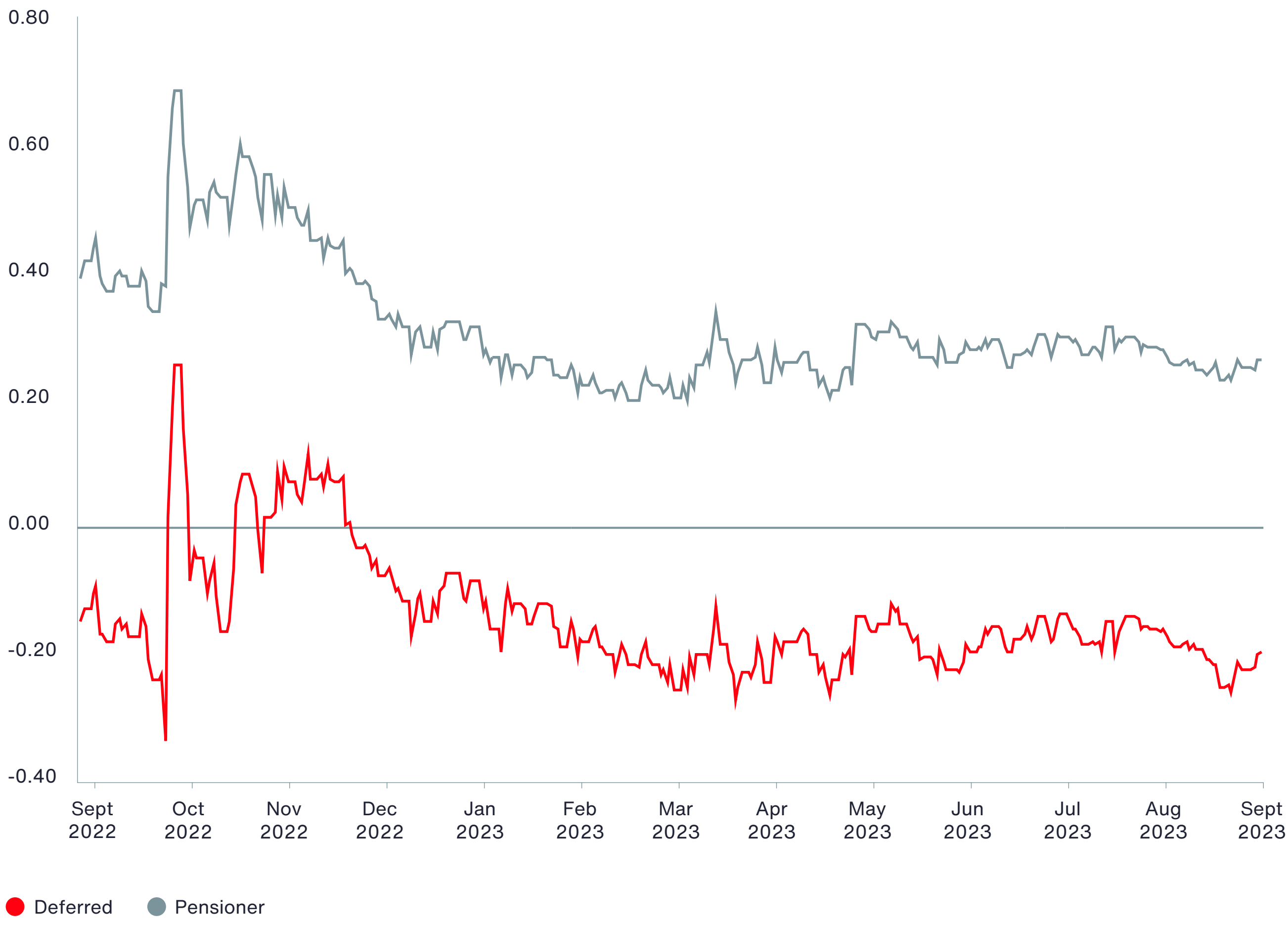
If you would like to hear more about how the recent trends in the bulk annuity market could impact your scheme, then please contact your usual Aon Risk Settlement consultant.

Bulk Annuity Pricing

The level of bulk annuity pricing has remained broadly stable across 2023, despite high levels of demand from schemes that could have led to upward pressure on pricing. This will partly reflect the strong capital and reinsurance availability in the market, and allowance for some subtle easings of reserving requirements being introduced by the Government over 2023-24.

Bulk Annuity Pricing Relative to Gilts

Return relative to gilts % p.a.



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.
- The graph reflects a standardised scheme with a typical profile (deferred average age of 50 with 15-year term to retirement & NRA of 65, pensioner average age of 65), but different answers will be produced for different liability profiles. This may affect both the level of the curve and its variability over time.
- 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, such as what we have seen over the last few months, this uncertainty is likely to increase. Accurate pricing can only be achieved by going to market.

Chart source: Aon's Risk Analyzer

PRA Consultation on Matching Adjustment

In September 2023, the Prudential Regulatory Authority (PRA) released a long-awaited consultation on proposed changes to the insurance regime underpinning regulation of insurers in the UK (known as Solvency II). The proposed changes relate to the Matching Adjustment, which largely drives how insurers invest their assets to match pension liabilities. They are also part of the Government's post-Brexit target to encourage more direct investment into the UK economy.

The proposals set out by the PRA would allow insurers to invest in a wider range of assets than is currently allowed under Matching Adjustment eligibility rules. This would however be combined with further tests and reporting to the PRA to ensure appropriate risk management is undertaken.

We don't expect the proposals to have a material impact on policyholder protection, nor to provoke notable further changes to the level of pricing available in the market. However, the proposals could help support the market in scaling up to meet the high level of demand from schemes. For more information on the changes, please see our note on the PRA consultation.

About

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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