UK Risk Settlement Bulletin

Q1 2020

Records broken as 2019 ends

The end of 2019 marks the busiest year for the UK bulk annuity market to date. Earlier in the year, Aon predicted that bulk annuity market volumes would exceed £40Bn for the first time in a single year, and so it proved to be.

Estimated volumes

We had previously reported that almost £18Bn of bulk annuities had been placed in the market between 1 January and 30 June 2019. This record-breaking first half year was followed by an even busier second.

Aon are now aware of at least £40Bn of UK bulk annuity transactions in 2019, with more expected to be disclosed in the coming weeks as insurers prepare their year-end reporting. At present, it is estimated that the total could be approximately £42Bn.

The chart below shows the overall UK bulk annuity market volumes since 2006. It illustrates the rapid growth in the market in recent years.

Transaction sizes

The largest deals grabbed the headlines in 2019 with 10 disclosed deals over £1Bn.

The 5 largest deals of 2019 are shown in the table below, including the largest ever UK bulk annuity for *telent* at £4.7bn. Those highlighted in grey were brokered by Aon.

£bn	Scheme	Insurer	Date
4.7	telent	Rothesay Life	September
4.6	Rolls-Royce	L&G	June
3.8	Allied Domecq	Rothesay Life	September
3.8	Asda	Rothesay Life	September
3.4	British American Tobacco	PIC	June

Chart source: Publicised deals in the market.

But the market wasn't only open to the biggest deals. We experienced competitive pricing for schemes of all sizes across 2019, with a number of transactions below £100M achieving a strong outcome.

2020 outlook

The busy market is expected to continue into 2020, but we understand there will be far fewer multi-billion-pound transactions dominating insurer capacity. There will be excellent opportunities for sub £1Bn deals.

Bulk annuity business written with UK pension schemes

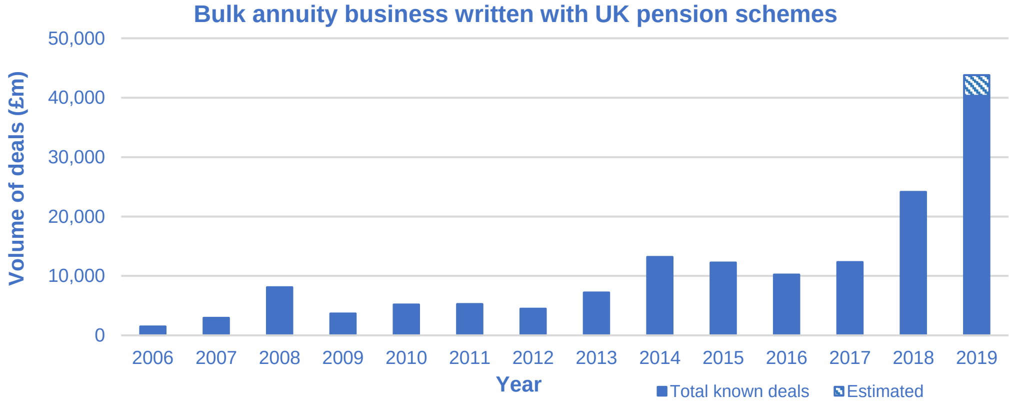


Chart source: Aon's Due Diligence team

'Transaction Ready', Set, Go!

In our Q4 2019 bulletin, we discussed some of the key early stages of risk settlement transactions – feasibility, planning and preparation. We are now looking forward, discussing the typical key stages and decision points that follow once you have decided to go ahead with a transaction.

Market approach

As part of the preparation for a transaction your risk settlement advisor will begin discussions with potential counterparties, to explore the project. This helps assess insurers' scope and willingness to be involved in any auction, ensuring that insurers can plan their man power and resources effectively. It encourages insurer engagement and means you can time quotations exercises with possible pricing opportunities.

Once the timescales for a project have been agreed, your broker will prepare a formal Request for Quotation (RFQ) for insurers. This will include enough information for insurers to accurately price the contract (e.g. membership and mortality experience data, specification of scheme benefits) and a description of the proposed transaction.

Quotations

Traditionally, risk settlement transactions have followed a rigid process with pre-agreed market auctions and timescales. These processes first ascertain whether a transaction is viable, and then determine a shortlist of insurers expected to deliver the best pricing and terms.

But bulk annuity and longevity reinsurance markets are becoming increasingly busy. As pockets of capacity emerge, pricing opportunities may appear quickly. A busy market means insurers are becoming more selective about the deals on which they quote. Schemes that are well prepared, can demonstrate execution certainty, and run a flexible process, are more likely to be in the best position to seize these pricing opportunities.

Due Diligence

When selecting an insurer, the trustees and sponsor should be comfortable that they are choosing a suitable counterparty. There are many attributes to consider (see below), alongside the price and commercial terms available. It is important to consider at what stage of the project due diligence advice will be sought to ensure it forms a key part of the decision-making process, rather than simply being a step in the process.

Considerations when choosing a provider

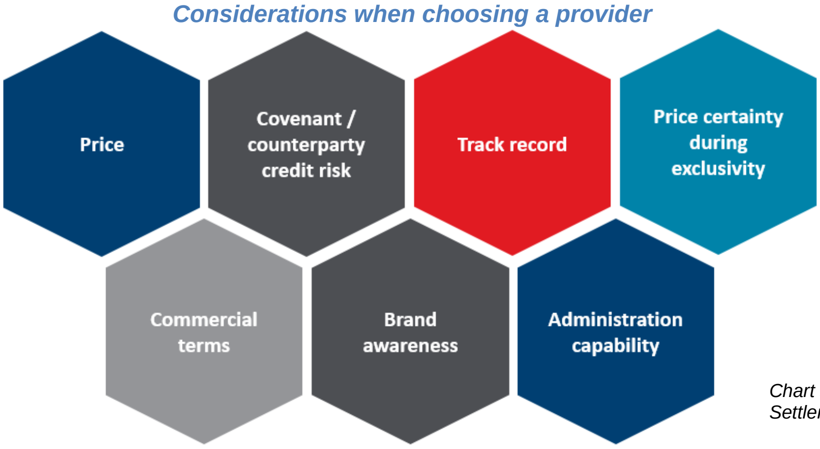


Chart source: Aon's Risk Settlement Group

Exclusivity and execution

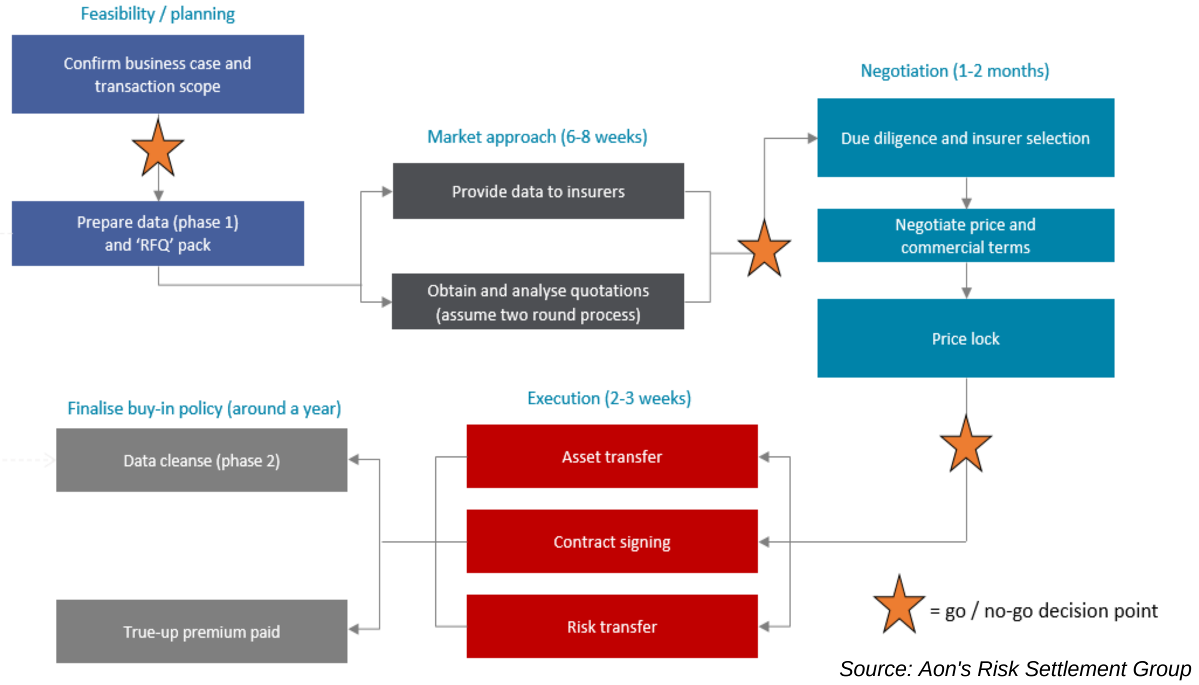
Once an insurer has been selected and the transaction agreed in principle, the Trustee will enter exclusive negotiations with that insurance provider.

This represents a period when both parties apply best endeavours to complete a transaction on the headline terms already agreed.

A scheme's risk settlement adviser, legal advisers and investment advisers all have pivotal roles to play to negotiate and agree detailed terms of the proposed transaction.

This will include the agreement of contractual terms, the transition of assets (to fund any premium) and/or the structure and mechanism for any security arrangement (for example a collateral structure for a longevity swap).

An example project plan for a bulk annuity transaction:



Source: Aon's Risk Settlement Group

Example transaction plan

The diagram above demonstrates an example project plan for a proposed bulk annuity transaction. This steps through the stages described here and provides the typical time periods required to complete each stage. After each step in the process there is a decision required by the stakeholders on whether to proceed with the transaction or not.

Upon finalising the transaction and signing the contract, a cleanse period begins in which any remaining data issues are resolved.

Please contact your risk settlement contact if you would like any further information or would like to discuss any of this article in more detail.

Aon | Risk Settlement Bulletin

For professional clients only

Does size matter?

Over 2019, we saw market volumes dominated by the so-called 'jumbo' transactions. Despite not grabbing the headlines, the so-called smaller transactions of under £100M were still more common in the market.

Maximise your chance of success

In a busy market, insurers only have limited asset and people capacity. This means they are more likely to be selective about which smaller deals they quote on, particularly when there is strong demand for bulk annuities. Schemes need to stand out to ensure insurer engagement and ultimately a positive outcome.

Ultimately, insurers are looking for schemes which are well-prepared, have clean data and clear targets. This creates more transaction certainty and reduces the risk that an insurer will dedicate time and resource to an unsuccessful case.

Aon's Pathway to success

Using Aon's *Pathway* model, schemes can streamline their risk settlement approach and maximise their chance of success. We help prepare schemes and run a process that will result in a high likelihood of execution, for an affordable cost to the scheme.

This includes potentially adopting a simplified quotation process, standardised data and benefit documentation to simplify the broking process. Pre-negotiated contracts, advised by lawyers at Eversheds Sutherland, are used to ensure a quick and efficient execution.

Last year our Pathway approach ensured successful outcomes for schemes as small as £10M. Many trustee boards who thought risk settlement was impossible for their scheme secured deals insuring their members benefits.

Please get in touch with your risk settlement contact if you would like any further information.

Provider	Quote on sub-£100M cases?	Comments
Aviva	✓✓✓	Active in this market; will require data cleanse work up front for some cases
Just	✓✓✓	Keen to provide quotations; would look to standardise process where possible
Legal & General	✓✓✓	Have developed an offering for sub £100M transactions, but will be selective based on available resources
Canada Life	✓✓	Active in this market but won't quote on every case due to available resource
PIC	✓✓	Active in this market but won't quote on every case due to available resource
Scottish Widows	✓✓	Have developed an offering for sub £100M transactions, but will be selective based on available resources

Chart source: Aon's survey of providers

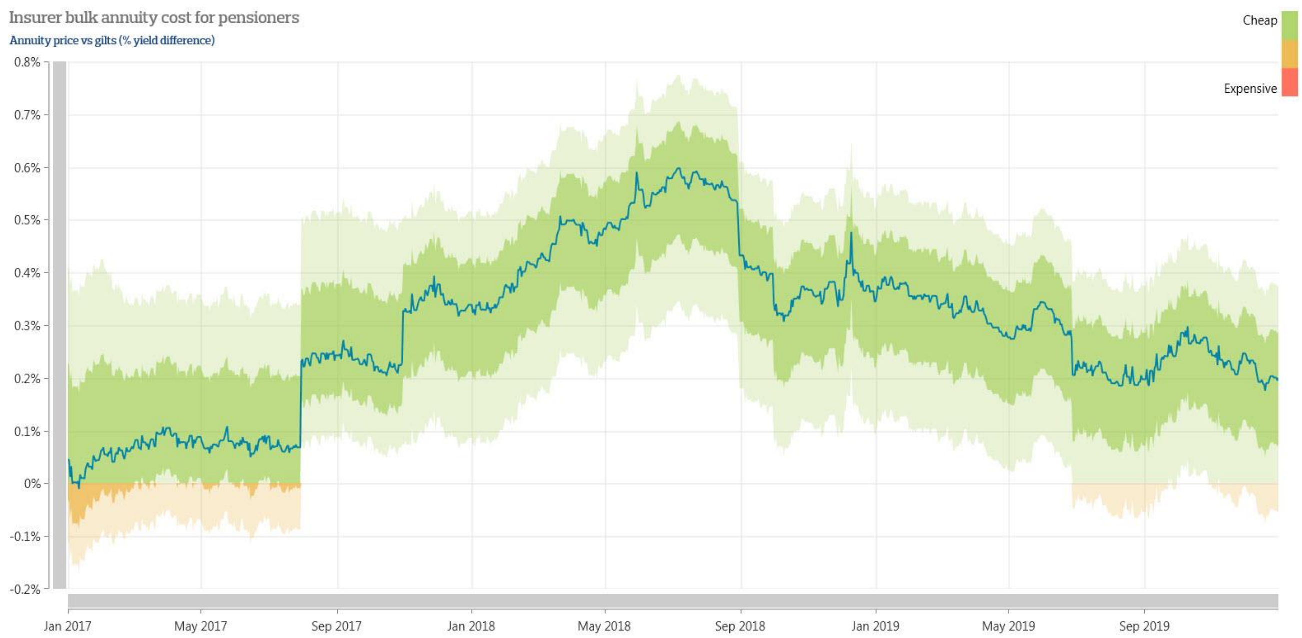
Insurer bulk annuity cost

The chart below indicates the expected range of best pensioner pricing available in the bulk annuity market, for a typical scheme, up to the end of 2019.

On this measure pricing fell away slightly towards the end of 2019, largely driven by a narrowing of credit spreads (a proxy for the additional investment return insurers can achieve above the 'risk free' rate). This makes pricing look worse when measured to gilt-based comparators used by schemes.

Even then, we saw very strong pricing in some cases concluding towards the end of the year, with gilts + 0.50% p.a. levels achieved where auctions were well planned and fiercely contested.

Capacity is expected to grow further in 2020, and markets are forecast to be particularly bumpy at the start of the year. So, we know there will be pricing opportunities for schemes that are ready.



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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