UK Risk Settlement Bulletin

Taking advantage of opportunities in the current market

20 April 2020

At a glance…

- **Bulk annuity pricing** – Pension schemes are successfully completing bulk annuity transactions, despite challenging investment market conditions and operational constraints. Our recent experience demonstrates these challenges are not insurmountable ***(see case study of the recent Co-operative Bank buy-in)***.
- **Trading costs** – Market liquidity fell sharply at the beginning of March and remains well below 'normal' levels. In recent weeks we have seen insurers keen to be paid annuity premiums through a transfer of assets rather than cash, to reduce trading on both sides.
- **Emerging longevity impact of COVID-19** – new data is emerging regularly on the impact of COVID-19 on life expectancy. Our latest views can be found here.

Links to other recent bulletins

Our 19 March bulletin explored the impact of COVID-19 on longevity views and investment markets, as well as the effect on insurers' solvency positions and operations.

Our 26 March bulletin looked at changes in asset liquidity and bulk annuity pricing, as a result of shifting markets.

Co-operative Bank case study

In April 2020 the Co-operative Pension Scheme secured a £400M partial pensioner buy-in with PIC. This deal, for the Co-operative Bank sponsored section of the Scheme, followed two £1Bn transactions for the Co-operative Group sponsored section earlier in the year.

We ran a full market auction for the Bank Section transaction in late 2019, but pricing and capacity did not meet the Scheme's requirements. However, a bespoke price monitoring arrangement was put in place with PIC, based on the Scheme's price target. This process was based on a dataset (the approach used to choose a subset of lives for insurance) and benefit specification already agreed with PIC. As a result, these points did not need to be refined at the contractual stage, meaning a fast execution.

PIC provided regular price updates in early 2020 and when markets shifted in March confirmed that they were able to hit the target.

As noted in the next article, asset trading around this time was particularly difficult, but this was overcome through two important levers.

Firstly, efficient decision-making and governance meant the Trustee was able to confirm a decision to proceed with the deal on the same day the offer was made by PIC, with the transaction then signed within a few days.

Secondly, the premium was paid in-specie, by the transfer of a portfolio of gilts from the Scheme's existing holdings.

Trading costs

While market volatility and price falls have been well covered in the media, less attention has been paid to some of the key challenges markets are experiencing. Notably, market liquidity fell sharply at the beginning of March and remains well below 'normal' levels – directly increasing the costs of any transaction.

The chart below illustrates the cost of trading a Vodafone bond since the beginning of the year - showing how even investment grade debt (BBB) has quickly become very expensive to trade. This increase in transaction costs has compounded the effects of price falls on corporate bonds and other assets.

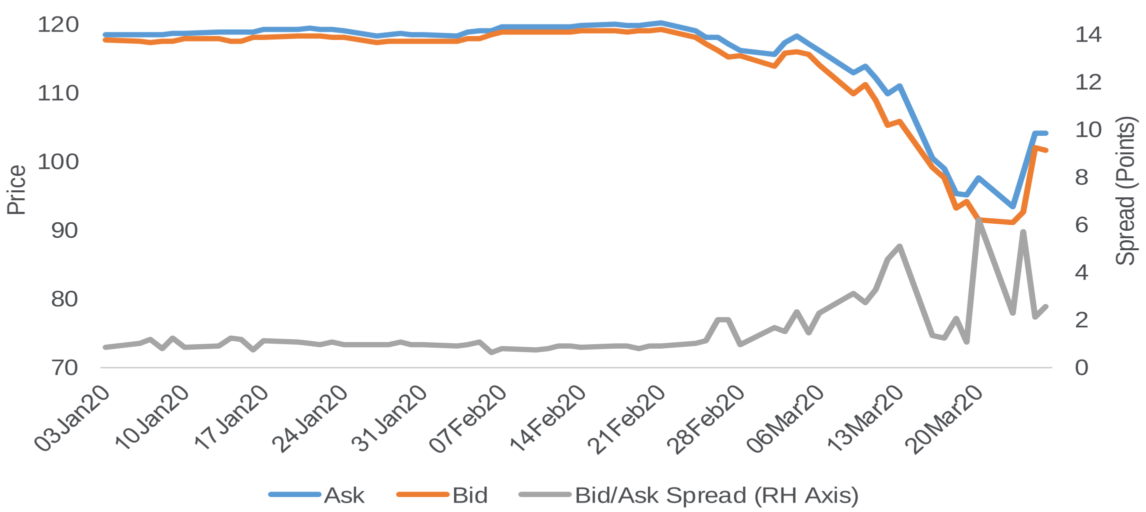
Any increase in asset transaction costs means that careful consideration must be given before undertaking any trading, thus ensuring the costs of paying the premium are reflected in any affordability analysis.

Central Bank stimulus (such as Quantitative Easing) has helped to improve liquidity in recent weeks, however we encourage clients to remain cautious. While costs may be starting to look more palatable (although still high), there is little 'depth' to the market – this means that these costs are only achievable for relatively small disinvestments and extra care is needed when buying or selling.

We have always been willing to suggest clients pause transactions where conditions are not right, and this environment is no exception. During March we saw several settlement deals paused due to higher asset transaction costs (despite annuity pricing being very attractive). In some instances, these were quoted as being 8x higher than normal.

We have however completed transactions which are primarily funded from gilts, showing transactions remain possible and clients can take advantage of the annuity pricing.

Vodafone Bond



Source: Bloomberg

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Compliance code: A104-301020