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Risk settlement market 2018

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Longevity swaps

Part of the Risk Settlement Market Review 2018

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Navigating the UK longevity swap market

Main players in the longevity reinsurance market

Solvency II requirements for longevity risk

Navigating the UK longevity swap market – looking back and where next?

A notable boost in 2017 thanks to relocation of pricing

Longevity swap activity by UK pension schemes picked up markedly in 2017 – particularly towards the end of the year – with a number of completed transactions ranging from £300m to £3.4bn in size. With longevity risk hedged for a total of £6.4bn of liabilities during the year (based on deals announced), this was an almost threefold increase on 2016.

A strong start to the new year

It has been a positive start to 2018 too. In March, we led the execution of a £2bn longevity swap for a large UK pension scheme (details remain confidential at this time).

Key points

- The longevity swap market is evolving and behaviours are changing
- UK insurers are now able to reinsure longevity risk on all sizes of bulk annuity thanks to Solvency II implications
- Pension schemes and reinsurers are opting for more cost-effective, straightforward options

Looking back at 2017's successes

Reflecting on the activity that contributed to 2017's longevity swap success, take a look at the UK scheme longevity swap transactions announced in 2017 in the table below:

Date	Pension scheme	Size of transaction	Structure	Insurer/Reinsurer
September 2017	British Airways	£1.6bn	Captive (Guernsey)	N/A / Partner Re and Canada Life Re
September 2017	MMC UK Pension Fund	£3.4bn	Captive (Guernsey)	N/A / Prudential Insurance Company of America (PICA)
August 2017	Scottish Hydro-Electric Pension Scheme	£800m	Pass-through	Undisclosed / SCOR
June 2017	Skanska Pension Fund	£300m	Fully- intermediated	Zurich / SCOR
March 2017	Confidential	£300m	Fully-intermediated	Zurich / SCOR

Prediction vs. reality

So, how did this match up to predictions? In our review of 2016, we:

- Raised concerns about a 'dislocation' in longevity insurance pricing, with the longevity risk takers (global reinsurance companies) not reflecting in their pricing the marked slowdown in UK longevity improvements. We felt that these had become too significant to ignore – a key driver in the low level of swap deal activity in 2016.

In early 2017:

- We highlighted positive signs of longevity insurance pricing 'relocating' to a fairer level, which boded well for a greater volume and scale of deals throughout 2017
- We have seen this continue, through several longevity reinsurance broking exercises we led during the course of 2017 – for both pension schemes and insurers. Pricing was significantly better in the second half of 2017 compared to 2016
- Schemes looking to hedge longevity risk can now seek insurance pricing with reassurance that this should fairly reflect the underlying risk, up-to-date information and longevity expectations.

Evolution and segregation

In the same way the bulk annuity market has segregated, with different providers focusing on transactions of different sizes, we are seeing a similar trend in the longevity swap market.

The evolution and segregation in the longevity hedging market has mostly been driven by increasing appetite from UK insurers to reinsure longevity risk on smaller bulk annuity transactions. In particular, due to the implications of the new Solvency II capital regime, UK insurers generally now reinsure longevity risk on all sizes of bulk annuities. This stimulus has consequently encouraged the market to adapt to dealing with 'small' scheme longevity risk, both in terms of process (eg, streamlined to ensure cost efficiency) and pricing (requiring a much greater reliance on postcode modelling in the absence of plentiful scheme experience data). For sub-£750m transactions, a more cost-effective and streamlined approach is required.

All of this has generally enabled a better functioning small scheme longevity market.

Sub–£750m transactions vs. £750m+ transactions

The key differences between the larger end of the market (over £750m transactions) and the smaller end of the market (sub-£750m transactions) are summarised in the table below.

Longevity swap market	Sub-£750m	Over £750m
Active reinsurers	Less than five	10+
Collateralised approach	No	Yes
Pricing	Focus on postcode (as a proxy for health and wealth)	Focus on actual scheme experience *and* postcode
Standard terms	Yes	Often bespoke negotiation
Structural options	Standard approach	Various options – with cost savings available where the pension scheme takes on the reinsurer credit risk (a 'pass-through' approach) and/or sets up its own insurance vehicle taking on the administration of the contract (a 'self-intermediated' approach)
Ongoing management	Less frequent reporting/payments	More frequent reporting/payments Collateral requirements

Canada Life Re
Challenger
Hannover Re
Munich Re
Pacific Life Re
Partner Re
Prudential US
RGA
SCOR
Swiss Life
Swiss Re

The main players in the longevity reinsurance market

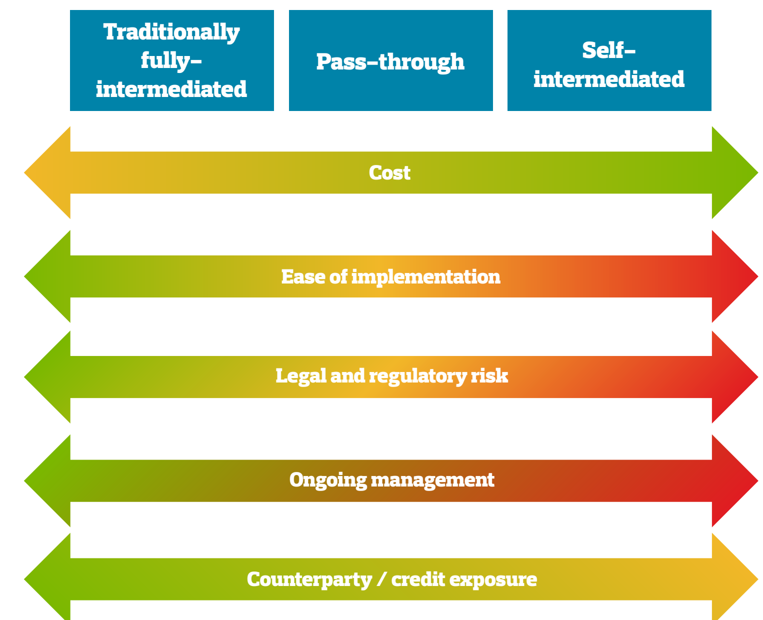
Using a range of swap structures for larger transactions

We have continued to see pension schemes making use of a number of different structural options to access the global reinsurance capacity for longevity risk:

- The British Airways and MMC deals both used a scheme-owned insurance cell based in Guernsey
- The Scottish Hydro-Electric longevity swap is with a UK insurer (Legal & General), on a 'pass-through' basis, under which the scheme takes on reinsurer credit risk
- The £2bn deal we executed earlier in 2018 and the two mid-market Zurich deals in 2017 were on a fully-intermediated basis.

There is no 'one size fits all'

The achievements gleaned from using different structural options demonstrate our view and advice to clients: there is no single solution that fits all schemes. We would recommend considering the different structural options available in line with your requirements.



Navigating mid-market longevity hedging and getting the attention of reinsurers

Both of the ‘small scheme’ longevity transactions that closed in 2017 – for the Skanska Pension Fund and another confidential scheme – covered around £300m of UK DB liabilities. The number of deals might be minimal, but it is encouraging to see that smaller deals are possible as the reinsurance market gradually becomes more interested in this sector of the market.

With lots of £multi-billion pension schemes and UK bulk annuity insurers also competing for reinsurance capacity, it is crucial that smaller schemes (with sub-£750m of liabilities) are well-prepared and armed with an effective go-to-market strategy to ensure they obtain the right level of attention, care and priority from the reinsurers.

Transferring risk

It remains capital-efficient for insurers to transfer longevity risk to reinsurers. This has been evidenced by continued activity from UK insurers to line up reinsurance for both back-book and new bulk annuity transactions. In particular, Rothesay Life, Pension Insurance Corporation and L&G all announced longevity reinsurance treaties in 2017.

Over the course of 2017, we continued to help UK insurers transfer longevity risk and maintained our position as lead adviser on longevity risk transfer for both pension schemes and insurers.

Looking ahead – what is next?

Improvements in pricing mean that greater activity is expected over the coming months. In particular, there is pent-up demand from a number of pension schemes who paused the longevity broking processes when it became clear that reinsurance pricing was lagging behind on the most up-to-date information during the second half of 2016 and the first half of 2017. There also continues to be strong demand from UK insurers to hedge the longevity risk relating to both new bulk annuity business and existing back-book exposures (driven by the implications of the Solvency II capital regime).

All of this means that 2018 could be one of the busiest years to date for the longevity hedging market!

Where next for you? If you would like to discuss any of the themes in this article or understand which option could be most capital-efficient for your scheme, please do not hesitate to get in touch.

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Solvency II

Why insurers and reinsurers are focusing on risk capital optimisation solutions

Since Solvency II went live on 1 January 2016, insurers and reinsurers have been focusing on implementation and analysing the implications for de-risking pricing, as well as their own tolerance for existing risks and their appetite to write new business.

Key points

- Insurers have been reassessing their risk appetite, with some choosing to transfer out their longevity risk
- Initial pricing fears have dispersed, due to higher returns on illiquid assets and improved longevity pricing terms
- The reinsurance market continues to evolve, calling for reassessment of risk appetite and a need for optimisation solutions

Pricing fears disperse

Initial fears that the new standard would have an adverse effect on pricing soon disappeared, primarily due to:

- Insurers and reinsurers seeking out higher returns on illiquid assets as part of their pricing portfolio
- Improved longevity pricing terms, as a result of the heavier population mortality observed in the last five years. Different firms have moved at different paces but our regular price benchmarking indicates that a broad consensus has now formed, with most market participants having moved or intending to move onto the CMI_2016 model (which was released in 2017). Moving from CMI_2016 to the recently released CMI_2017 could typically result in a further reduction of between 0.5%-1.0%, depending on the age profile of the scheme.

Reinsurance market evolves

The nature of the reinsurance market has also continued to evolve. Insurers have been reassessing their risk appetite and need for reinsurance and capital optimisation programmes.

As a result, some market participants have chosen to put their annuity portfolios on the market in order to transfer out their longevity risk – and we expect this consolidation to continue. As a consequence, in-force annuity portfolios have been competing alongside pension schemes for reinsurance risk transfer.

Navigating the right solution for you

We are continuing close observation of the evolving market for deferred annuitant reinsurance and working with clients to develop innovative reinsurance structures that enable the transfer of asset, longevity and optionality risks for these members.

If you would like to explore this as a solution for your scheme, please do not hesitate to get in touch.

Get in touch to find out more here

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