Aon's Risk Settlement Survey 2021

Journey to Settlement

Enter

Executive summary

UK pension schemes are increasingly focused on their ultimate destination — be that self-sufficiency, consolidation or buyout

A key action when agreeing your target is for the trustees and sponsor to jointly establish a detailed strategy for their overall journey, ensuring all steps are completed in a coordinated, efficient and cost-effective way and, crucially, that early actions are taken to avoid the risk of missing beneficial opportunities which will arise en route.

Aon surveyed 120 UK pension schemes about their Journey to Settlement progress and plans, and found that:

- 34% are targeting buyout. This percentage is consistently increasing as funding positions improve and buyout becomes more achievable.
- 77% of schemes are over 80% funded on their endgame target (good news!) but only 26% of schemes expect to reach their endgame in less than five years. In our experience some respondents may have overestimated their expected timescale to reach their endgame target increasing the risk of missed opportunities along the way.
- Only 29% of pension schemes are statistically assessing their longevity risk. Robust analysis is required to understand potentially volatility in journey plans, reducing the risk of derailment and facilitating optimal hedging decisions.
- Member support is now commonplace with around 75% of pension schemes at least somewhat likely to implement support for members' retirement decision making.
- Only 32% of pension schemes currently assess their investment performance relative to their low risk measure or buyout cost. However, we see an accelerating move towards benchmarking against the endgame target as funding positions improve.
- Phased buy-ins will be used as a risk management tool by many pension schemes, with the majority understanding the resulting impact on their investment strategy.
- 40% of pension schemes consider they have reliable data and 54% of pension schemes are considering aligning data cleanse projects resulting in cost efficiencies and improved settlement readiness.

In summary, endgame targets are becoming more achievable, with time horizons reducing, meaning that trustees and sponsors should act now to ensure they are fully prepared to take their next step and avoid the regret risk of missed opportunities by delaying action.

Introduction

Our survey

We surveyed the UK pensions market to explore where schemes are placed along their journey to their endgame and to identify the opportunities that can increase certainty and reduce the cost of reaching the endgame.

This report summarises over 120 responses received from pension scheme trustees and sponsors of schemes of all sizes, alongside insight and views from Aon's Risk Settlement experts.

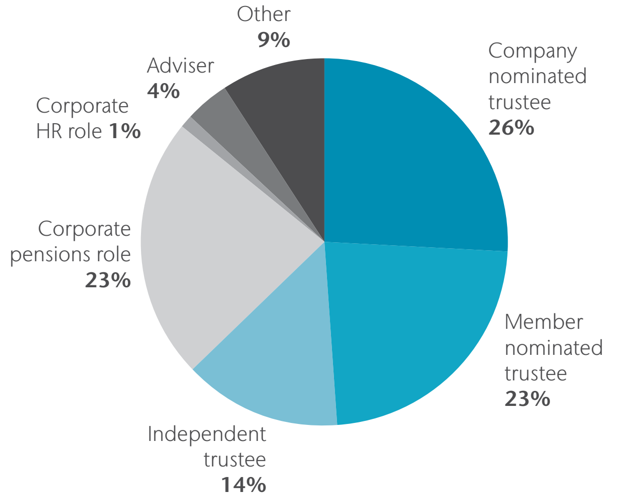
The survey results are split into five sections each covering a key workstream as part of a scheme's journey:

- **Transaction considerations and governance**
- **Member experience**
- **Asset preparation**
- **Data**
- **Benefits**

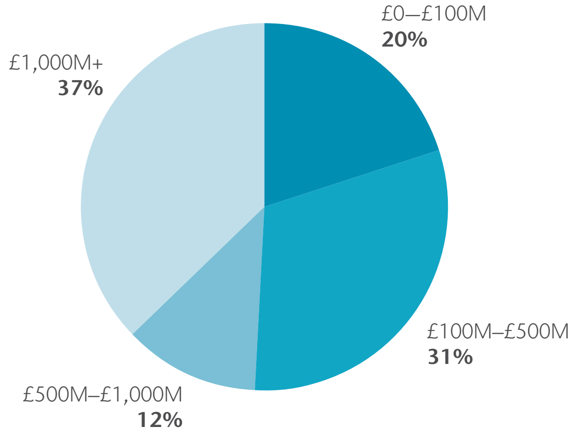
We would be happy to discuss the survey results with you and put them into context for your trustee board or sponsor. We also hope they help you understand the positive actions that you can take to make your journey a success for the trustees, the sponsor and the pension scheme members.

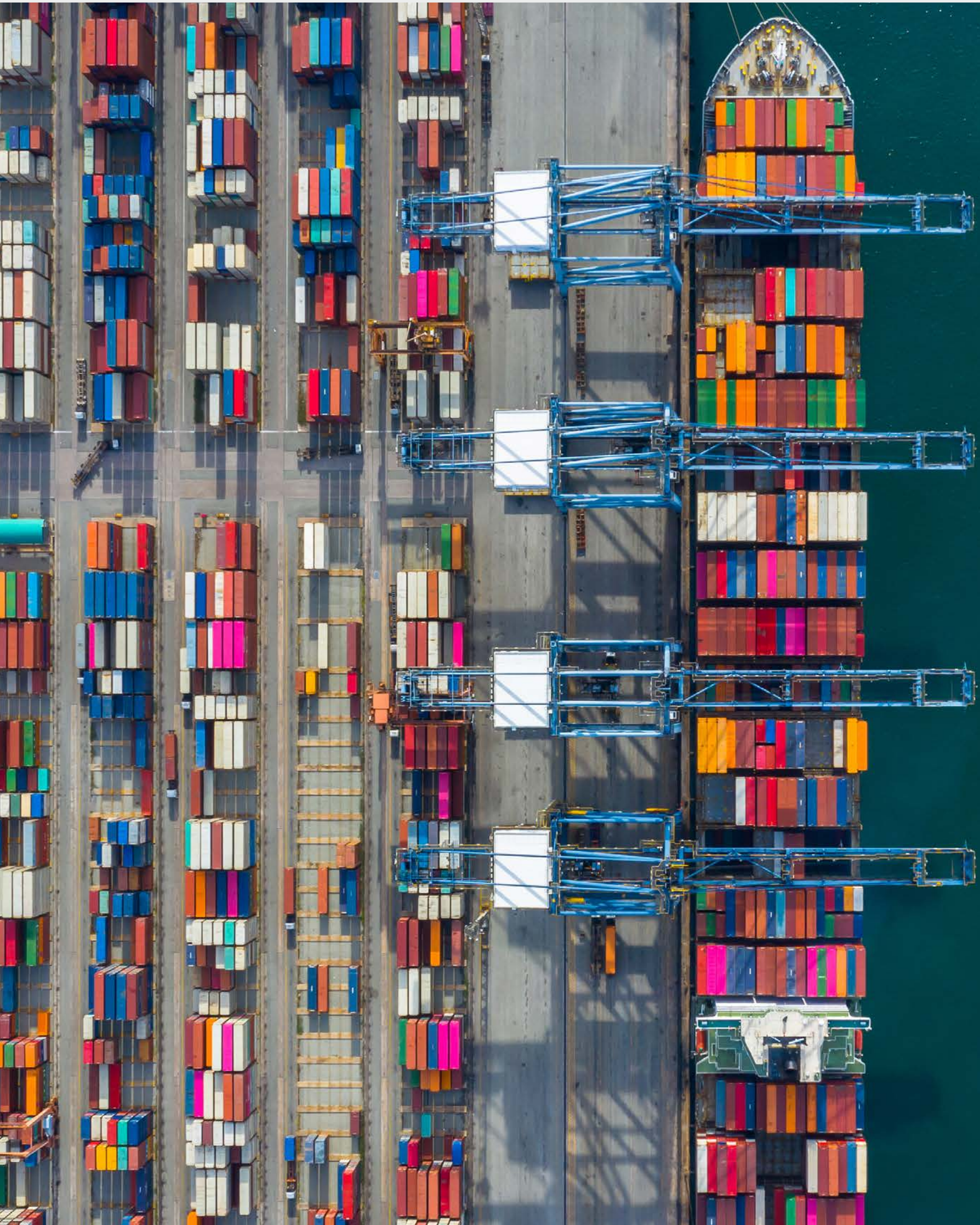
Survey responses

What is your role?



How large are your scheme's current assets?





Transaction considerations and governance

Transaction considerations and governance

Target

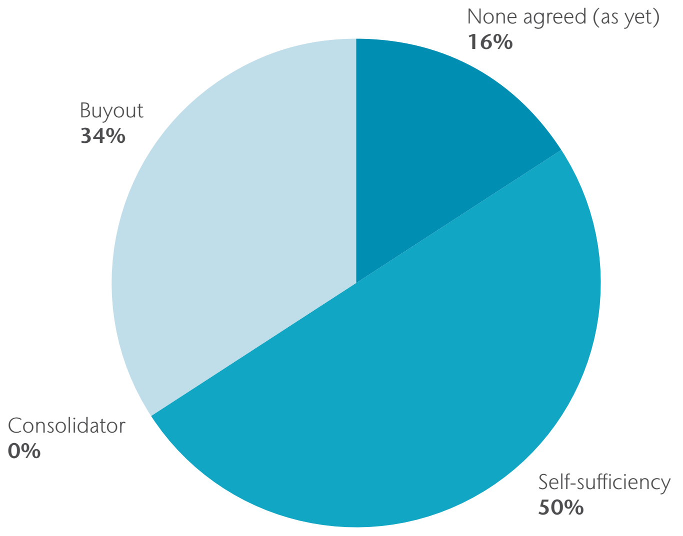
Across the UK pensions arena we have seen funding positions improve, making lower risk targets more achievable. We have observed a consistent trend of gradually strengthening long-term targets, with 34% of schemes now adopting buyout as their ultimate destination.

The most common target, adopted by nearly half of pension schemes, is self-sufficiency. However, on reaching this target, the next question for trustees and sponsors to address will be "what happens next?". If the trustees wish to fully secure members' benefits, or the sponsor wants to extract any surplus, then the scheme will need to be transferred to a settlement vehicle and buyout is the most likely endgame.

Our survey showed respondents are not currently targeting transfer to a commercial consolidator as an outcome. This reflects the embryonic nature of this market and is an area we expect to evolve in the coming years.

Focusing initial decision making on your ultimate destination (and not a stepping stone target) can provide greater efficiency, improve member experience, and reduce the time to reach your target, as well as increasing the certainty of reaching it.

What is your current endgame target for your pension scheme?



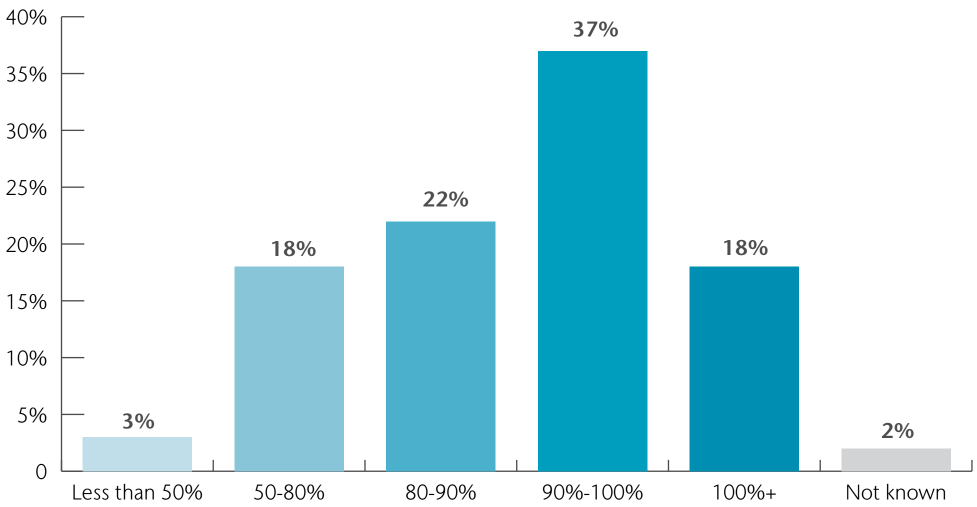
34%
pension schemes are now **targeting buyout**

A key question for the 50% of schemes targeting self- sufficiency is "what happens next", once that target is reached?

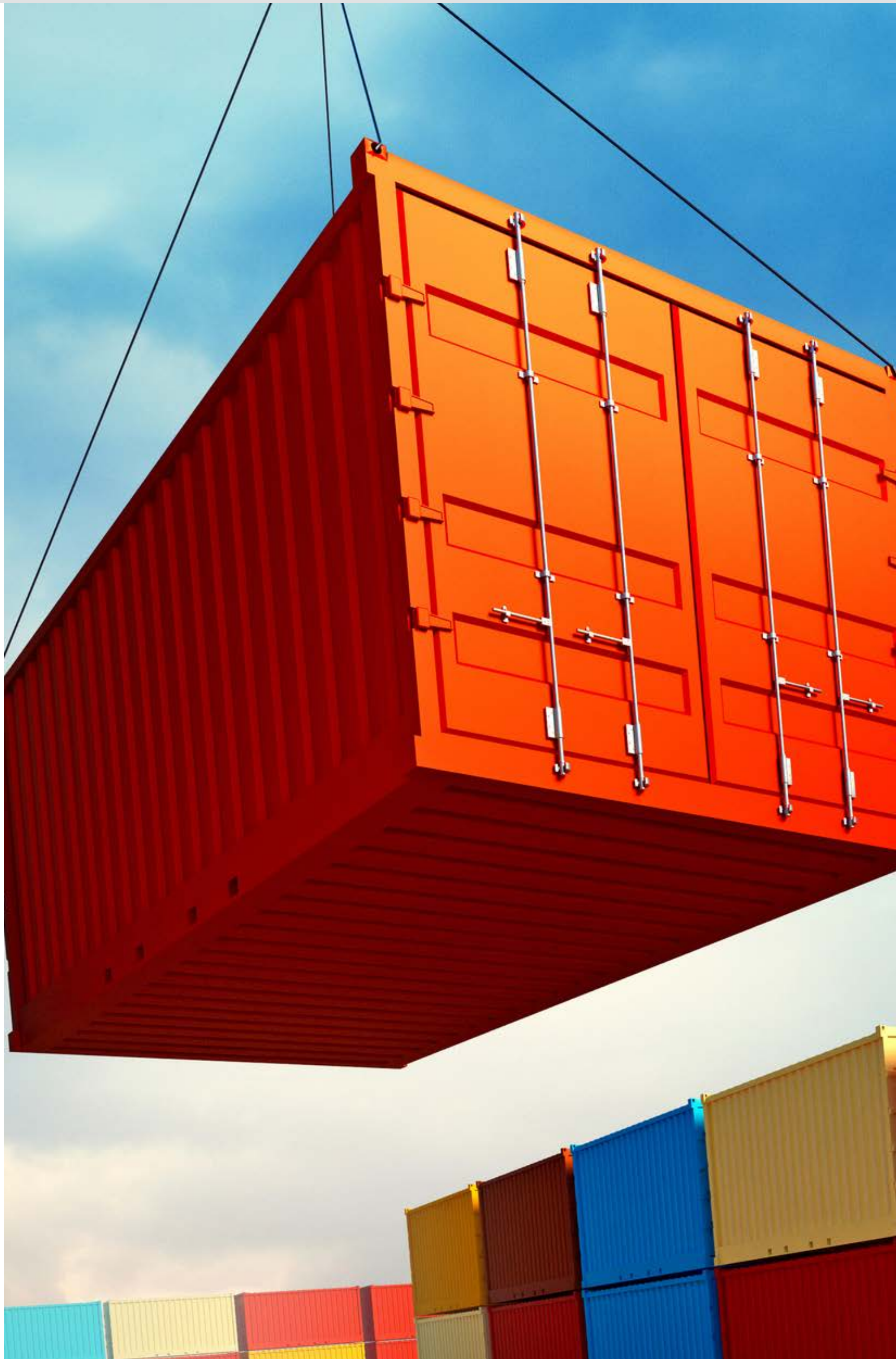
Time horizon

Our survey showed that 18% of respondents are currently over 100% funded on their endgame target (see chart below). Half of these schemes are targeting self-sufficiency, with the other half targeting buyout. It is potentially surprising that those who are already fully buyout funded haven't already seized the opportunity to transact. We expect a proportion of these schemes are part way through their buyout process and others are subject to wider considerations, eg, sponsor restrictions on the timing of recognising the buy-in/buyout accounting impact or a desire to consciously generate surplus, which emphasises the need for collaborative planning to avoid missed opportunities when full funding is reached.

What is your current funding level against your endgame target?



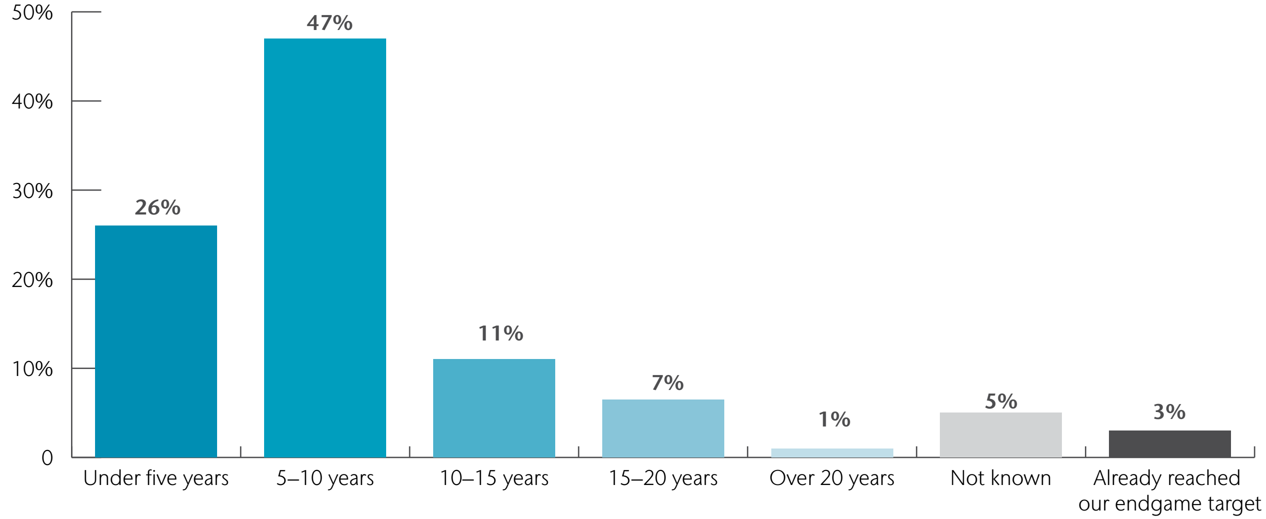
"Understanding your time horizon to full endgame funding is crucial in setting your strategic plan"



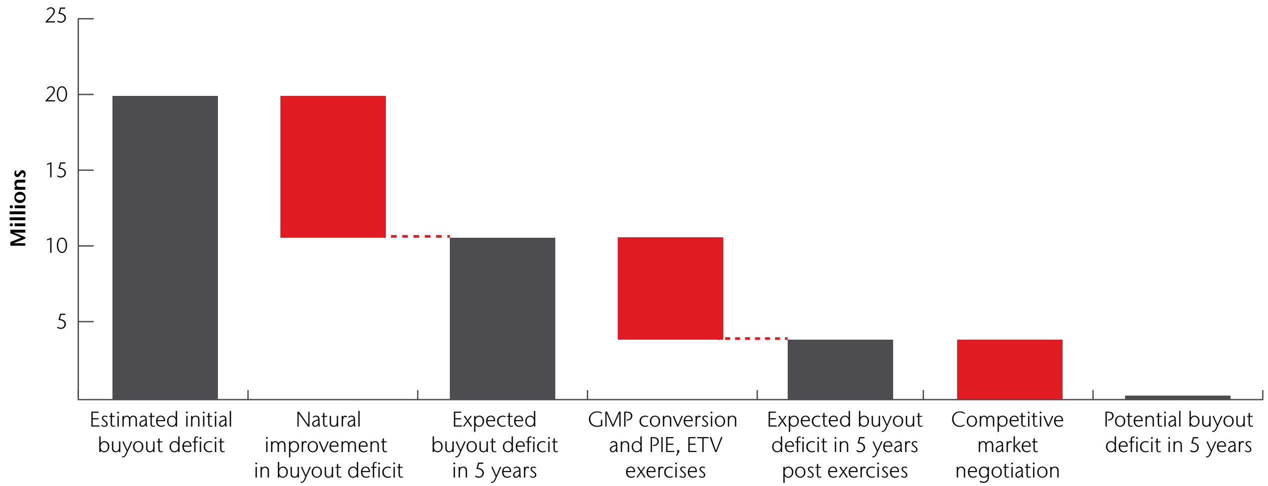
Our survey showed that 77% of schemes are over 80% funded on their end game target (good news!) but 47% of schemes expect to take 5–10 years to reach their endgame. In our experience respondents may have overestimated their expected timescale to reach their endgame target. As illustrated on the example deficit bridge below, for a scheme currently 80% funded on a buyout basis, a combination of investment returns, scheme maturing and member options exercises can lead to full funding being achieved sooner than initially expected.

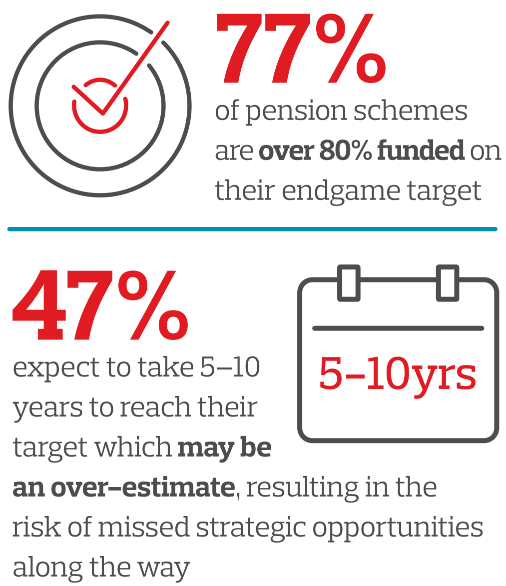
Understanding your window to full endgame funding is crucial in setting your strategic plan.

What is your expected timescale to reach your endgame target?



Deficit bridge example





Longevity risk

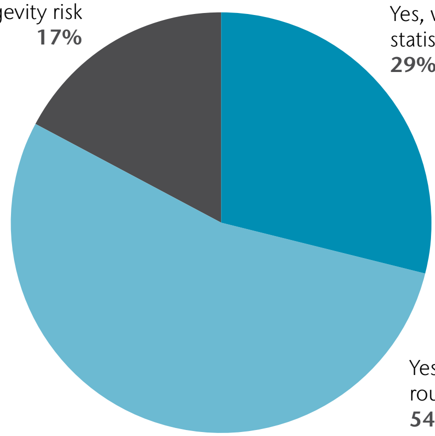
As more and more schemes have removed asset risk over the last few years, longevity risk is becoming an ever-increasing proportion of a scheme's residual risk profile. However, only 29% of respondents have carried out statistical analysis of the current amount of longevity risk in their scheme.

Schemes with only a rough idea of their longevity risk could be underestimating the potential impact of additional longevity improvements on their liabilities, resulting in a risk of their long-term strategy being derailed.

The combination of improved funding positions and asset de-risking is often the trigger to obtain an accurate assessment of longevity risk and to evaluate whether, when and how to hedge longevity risk.

Robust analysis is required to understand potential volatility in journey plans, reduce the risk of derailment and make optimal hedging decisions.

Do you understand the current amount of longevity risk in your scheme?



Only 29% of pension schemes are statistically assessing their longevity risk

Aon expertise

Our market-leading Demographic Horizons team provides specialist demographic tools and modelling capability. We have experience data relating to 19 million person years of exposure and c. 700,000 deaths. To date our model has been used to advise on over 1,000 cases, including the Aon pension scheme client base, longevity transactions and reinsurer/insurer longevity advice. This includes mortality advice for c.£150Bn of reinsurance pricing.

Member experience

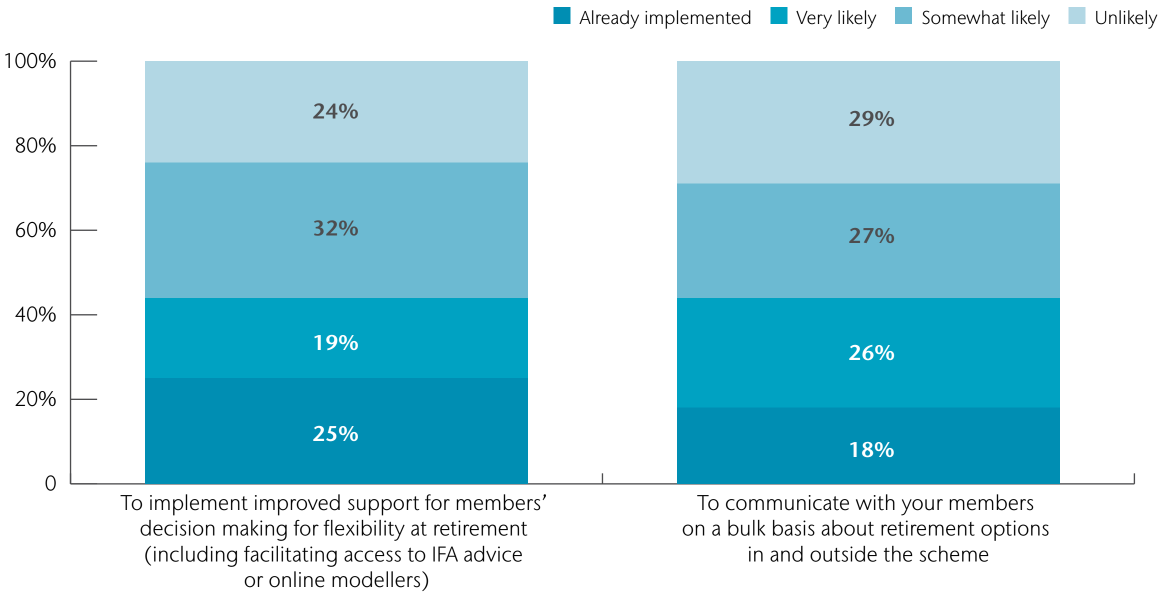
Member experience

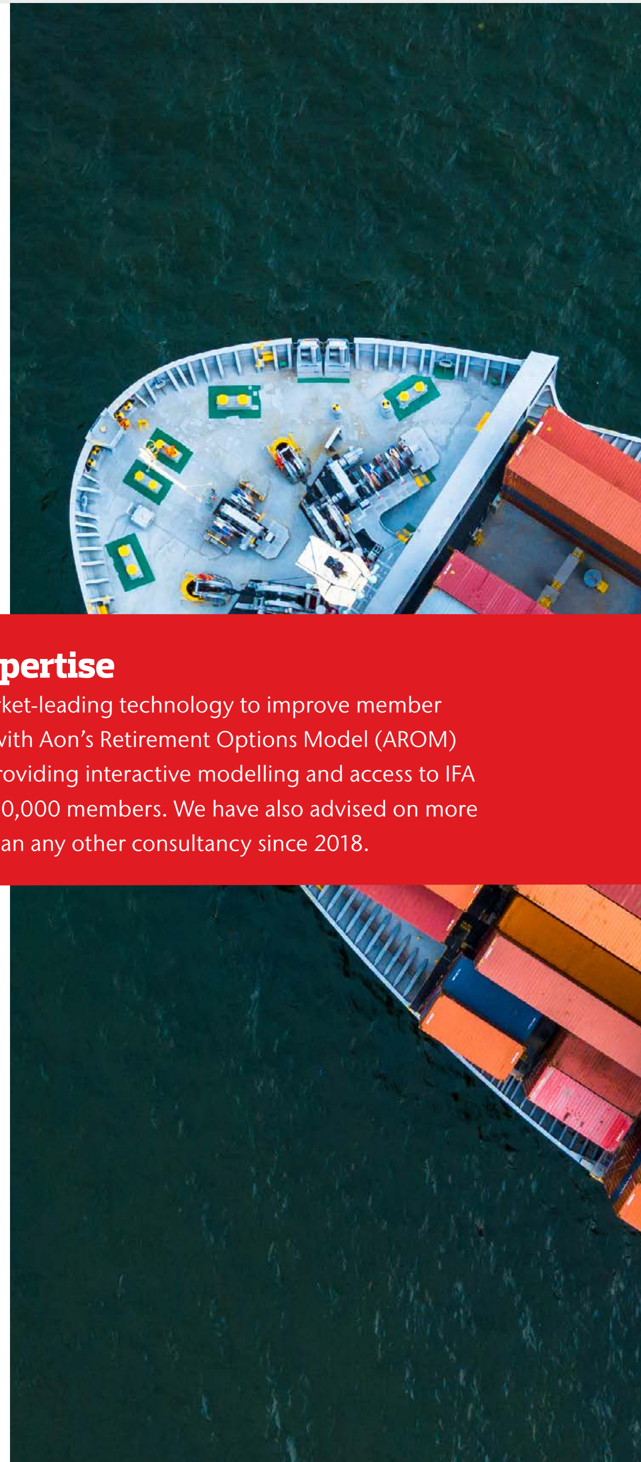
Retirement support

Our survey showed positive news about support for members. Around three-quarters of schemes are at least somewhat likely to implement support for member decision making at retirement and communicate options to their members on a bulk basis. Facilitating transfers out of a scheme is a very economical and efficient method of managing longevity risk and reducing liabilities on an endgame target basis, while also giving members more flexibility and choice.

Member support is now common place with around **75% of pension schemes** at least somewhat likely to implement support for member decision making

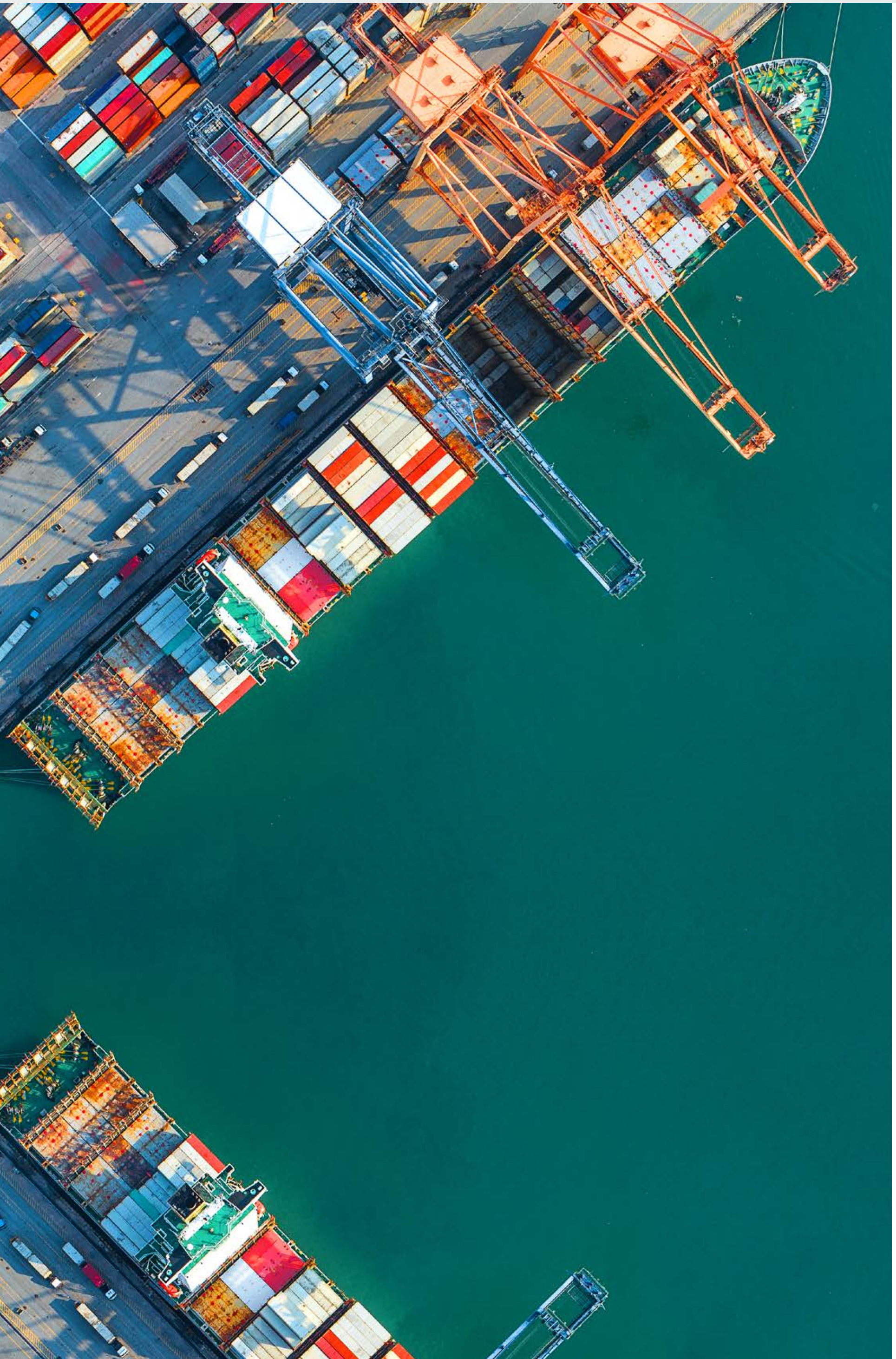
How likely is your scheme to do the following?





Aon expertise

We use market-leading technology to improve member outcomes with Aon's Retirement Options Model (AROM) currently providing interactive modelling and access to IFA advice for 30,000 members. We have also advised on more exercises than any other consultancy since 2018.

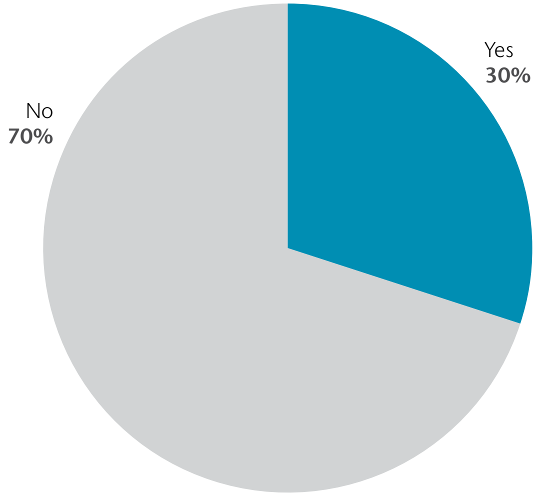


Member option factors

If deferred members' benefits are eventually to be transferred to an insurer, then the terms for exchanging pension for a tax-free cash lump sum at retirement would be set by the insurer. This could lead to a step change in members' benefits based on when they retire (typically an improvement). 30% of schemes considered this scenario at their last factor review which is consistent with the proportion of respondents who are targeting buyout (34%).

Factor reviews are typically only performed every three years, so there could only be limited future opportunities for trustees and sponsors to address any change of terms ahead of members' benefits being transferred. The routes typically considered by pension schemes are either to improve the existing commutation terms to be closer to those provided by an insurer, reducing any step change in buyout and concerns about intergenerational fairness, or to plan to ask the insurer to scale down their terms to be closer to the scheme's existing terms, reducing the cost of insurance and accelerating the settlement journey.

At your most recent factor review, did you take into account your scheme's commutation factors compared against those offered by insurers / consolidators?



Asset preparation

Asset preparation

Performance assessment

The first two questions in the asset preparation section of our survey focussed on how respondents measure the performance of their investments. The most striking finding is that 48% of respondents assess investment performance relative to their Technical Provisions liabilities with only 32% of respondents assessing relative to their low risk measure or buyout cost. As a scheme moves through its journey towards its endgame we would expect its focus to shift towards it's endgame measure – whether that be buyout or a low risk measure of liabilities.

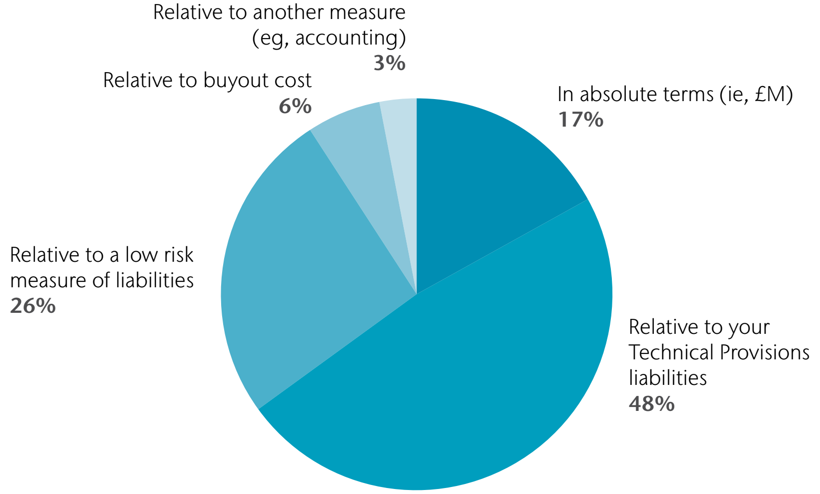
It is reassuring that over half of respondents are considering longevity risk as part of their regular monitoring, although further investigation would be needed to ensure that longevity risk and asset risk are being assessed consistently, particularly given our previous finding that only 29% of respondents are measuring this risk based on statistical analysis. Having a holistic view of a scheme's risk profile allows informed de-risking decisions as a scheme moves towards its endgame.

Only **32%**

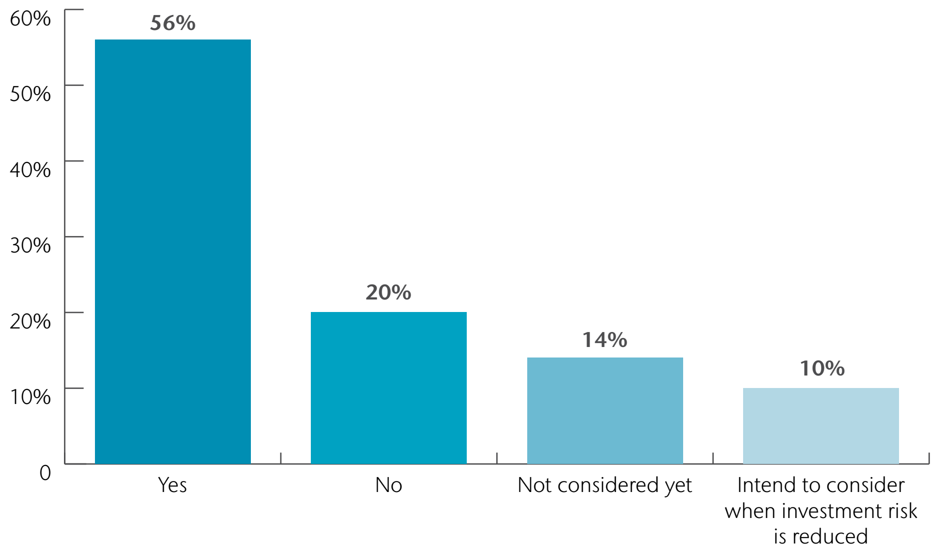
of pension schemes currently assess **investment performance relative to their low risk measure or buyout cost**

We are seeing an accelerating move towards **benchmarking against the endgame** as funding positions improve

How do you assess the performance of your investment strategy?



Do you consider investment risk and longevity risk together as part of regular monitoring?



Phased buy-ins

Phased buy-ins can be a powerful tool in reducing cost and volatility over the a scheme's journey to its endgame. More than half (62%) of respondents are at least somewhat likely to use phased buy-ins on their journey or have already done so – highlighting that they can be applicable for self-sufficiency endgame targets as well as on the journey to buyout. The proportion of respondents who fully understand the impact of a future buy-in correlates well with those who have already implemented a transaction. 86% of respondents have some understanding of the impact of a future buy-in, which shows how insurance transactions are a well established de-risking option.

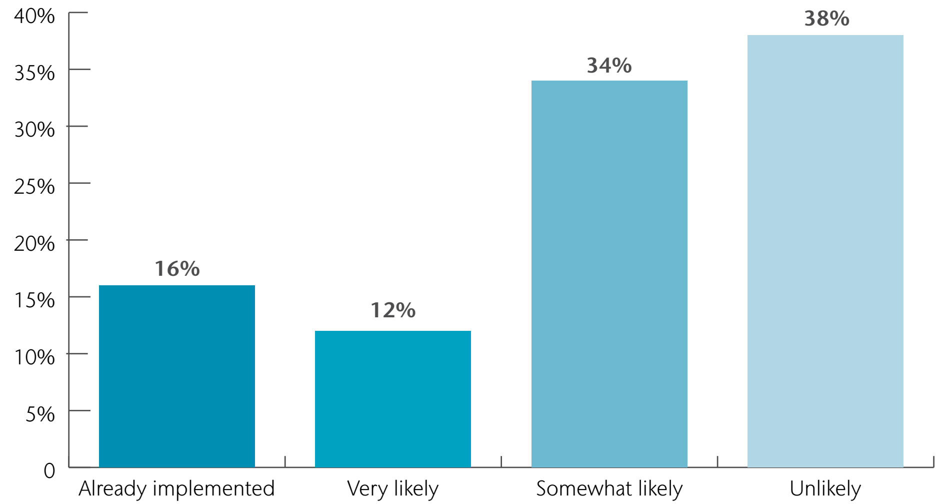
Adopting a policy of phased de-risking allows schemes to lock in improved funding positions and capitalise on favourable insurer pricing when available

Aon expertise

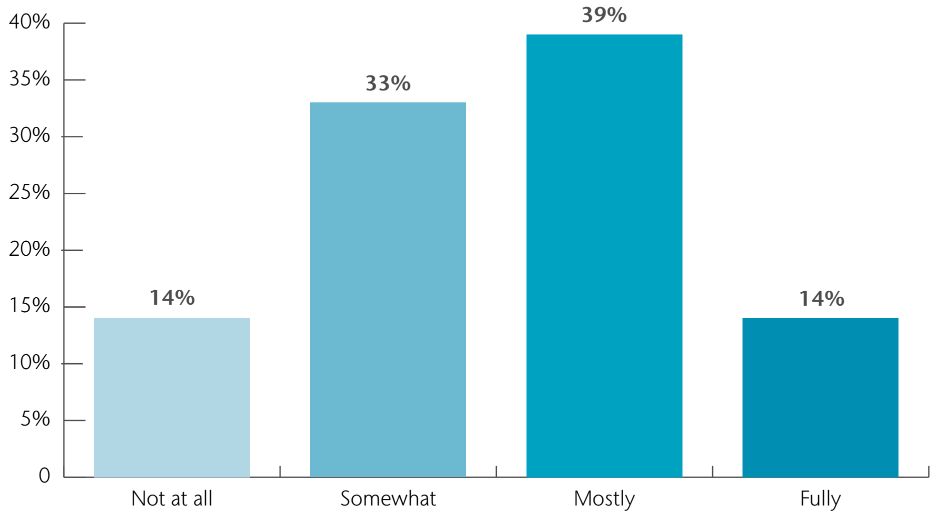
Aon is the leading strategic adviser and deal broker in the risk settlement market. We have been the lead adviser on 200+ bulk annuity deals since 2010. We have brokered 40% of bulk annuities by volume since 2019 including the UK's largest bulk annuity.

62% of pension schemes are at least somewhat likely to use **phased buy-ins** or have already done so

How likely is your scheme to use phased buy-ins on the journey to your endgame?



How well does your scheme understand the impact of a future buy-in on your current investment strategy (eg, return, risk, leverage, liquidity)?



Benefits of a phased buy-in strategy

Hedging longevity risk

Buy-ins hedge longevity risk and implementing a series of buy-ins over time offers a way to hedge that risk in incremental steps.

Better cashflow matching

A buy-in can provide a perfect match for pensioner and dependant cashflows, for example precisely reflecting inflation linkages and caps and floors on different pension increases. The degree of matching far exceeds the matching that can typically be achieved using 'buy and maintain' credit or gilts as part of a cashflow driven investment or traditional LDI strategy.

Better pricing

Implementing a series of buy-ins when affordable can allow schemes to lock in attractive pricing opportunities, which are often short-lived. Securing liabilities in this way when pricing is attractive also reduces the risk of a full buyout being unaffordable due to worse pricing in future (as the scheme does not have to insure all of its liabilities at one time).

Data

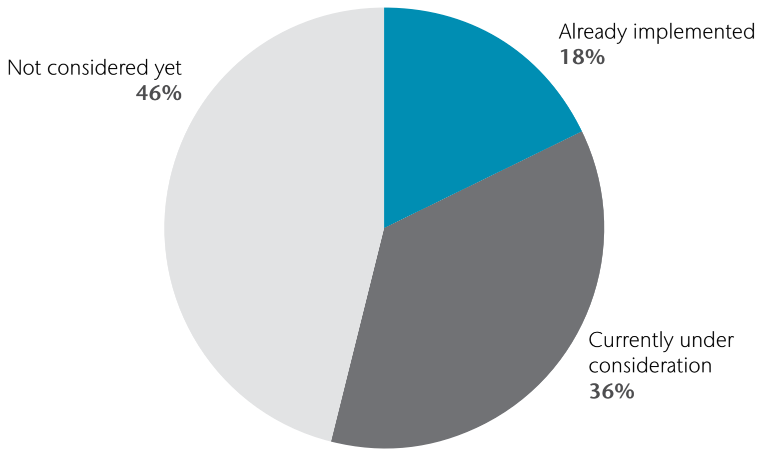
Data

Our survey showed that 40% of respondents believe they have reliable data.

Even if a scheme believes it has reliable data, it is good practice to formally document the data cleaning actions that have been undertaken. We would recommend carrying out a data audit ahead of any potential insurance or consolidation transaction, as clean and reliable data helps increase insurer engagement and enables you to access best pricing.

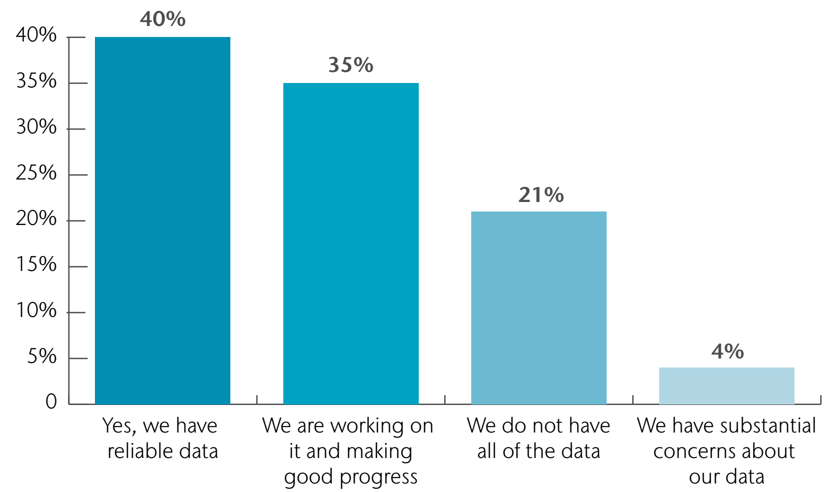
Ensuring this simultaneously covers GMP equalisation, member options and settlement activity can be the most efficient way to clean data for multiple purposes. This appears to be a key area for consideration with 46% of respondents not currently considering combining these projects.

Have you considered conducting a combined data audit covering requirements for GMP equalisation, future member options exercises and future insurance / consolidation transactions?



Are you confident that you have the data that an insurer / consolidator would request to price a transaction?

For example, do you hold current addresses for the vast majority of deferred members and up-to-date marital status information for deferred members and pensioners?



40% of pension schemes consider they have **reliable data**

54% of pension schemes are considering **aligning data cleanse projects** resulting in cost efficiencies and improved settlement readiness

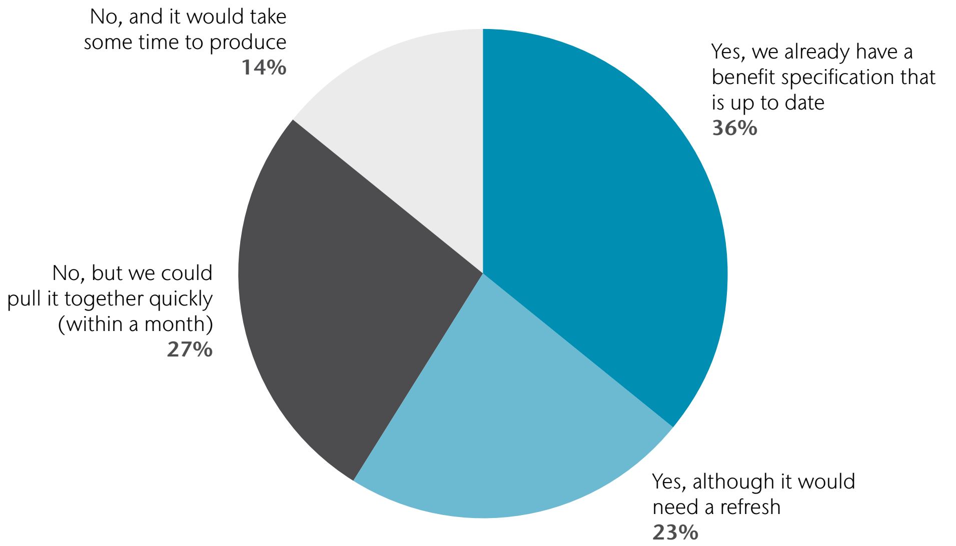
Benefits

Benefits

A full, legally reviewed benefit specification is a key step in understanding the detail of benefits that are being provided to members. Just under two-thirds of schemes have a current benefit specification meaning that benefit uncertainties are unlikely to cause significant deviation in the endgame target. If a settlement transaction is part of the scheme's de-risking journey then we would recommend considering a full benefit documentation exercise and review well ahead of any transaction.

59% of pension schemes have **a benefit specification** although some consider it needs refreshing

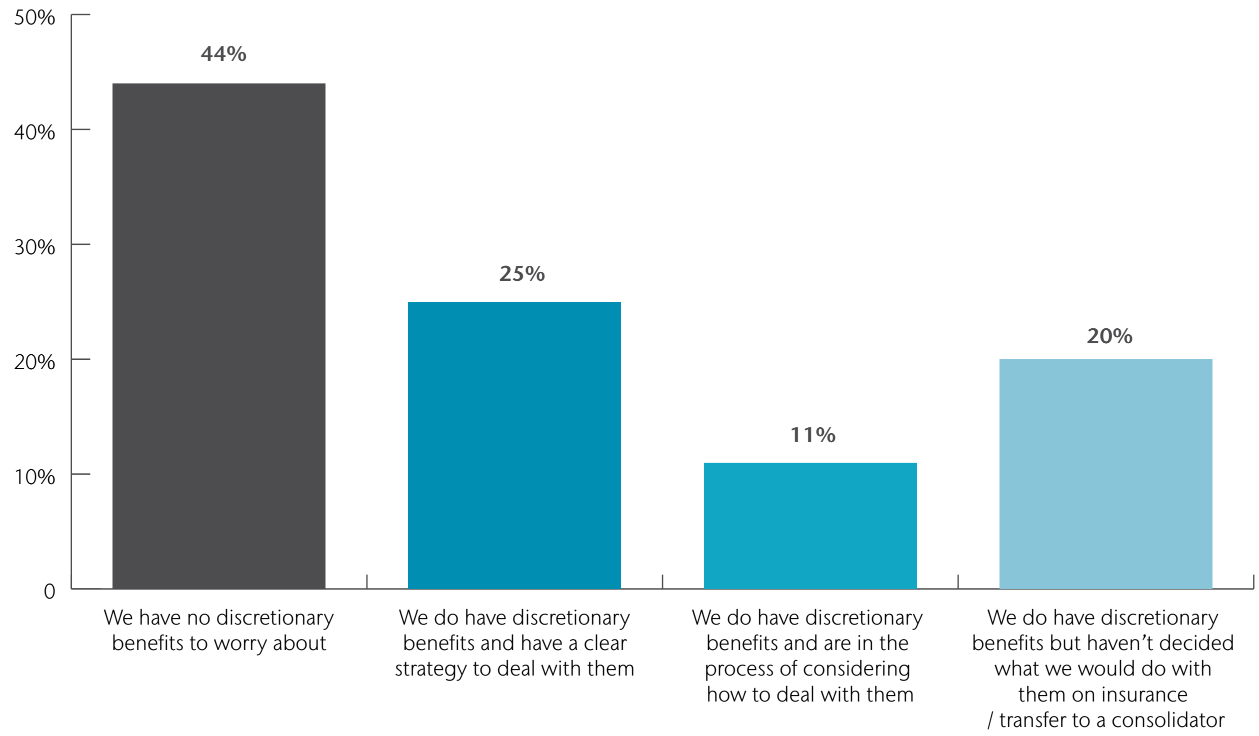
Do you have a comprehensive benefit specification, in sufficient detail that an insurer / consolidator would know exactly what benefits they would need to provide?

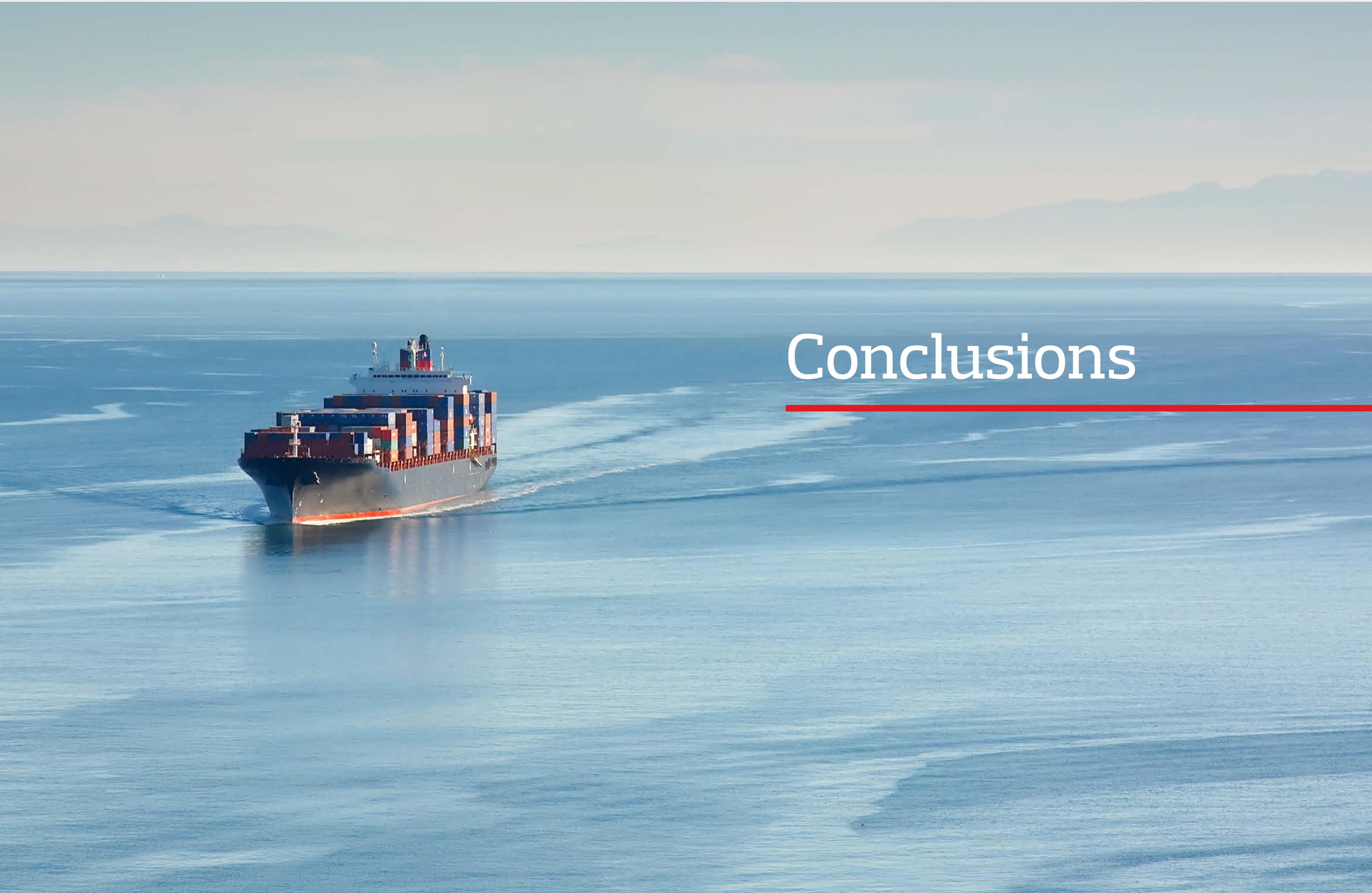


For any settlement transaction, discretionary benefits will need to be codified. Of those schemes with discretionary benefits, around a third do not have a plan on codification. It is important to understand the practical and cost implications of codifying discretionary benefits well ahead of any transaction to ensure you can access best pricing.

Having benefit certainty up front ensures schemes are targeting the right level liabilities – crucial to smoothly reaching your destination

Do you have clarity over the treatment of discretionary benefits for those members that you would want to insure / transfer to a consolidator?





Conclusions

Conclusions

Our survey shows that

Pension scheme funding positions are improving, resulting in a trend of strengthening of endgame targets

Trustees and sponsors are likely to reach their long-term objectives sooner than expected

Preparing a strategic plan up front will deliver a smoother, more efficient and cost-effective journey, avoiding the risk of missed opportunities along the way

Support for at-retirement decision making is widespread but there are untapped opportunities to deliver greater flexibility to members, while simultaneously reducing liabilities

Phased buy-ins will be used as a risk management tool by many pension schemes, with the majority understanding the resulting impact on their investment strategy

Data and benefits are cleansed and well understood by only a third of pension schemes, demonstrating that further work is required by most to become ‘transaction ready’

Aon expertise

Aon’s Journey to Settlement service allows trustees and companies to establish a joined-up strategy and document a formal plan of actions over the coming years. By co-ordinating the multiple workstreams, we target a smooth and stable journey to your endgame, giving improved outcomes to trustees, sponsors and crucially your members.

Contacts

John Baines
Partner
+44 (0)121 262 6944
john.baines@aon.com

Andrew Cooper
Senior Consultant
+44 20 7086 9057
andrew.cooper.2@aon.com

Karen Gainsford
Associate Partner
+44 (0)20 7086 9071
karen.gainsford@aon.com

David Thompson
Associate Partner
+44(0)121 230 6835
david.x.thompson@aon.com

Michael Walker
Associate Partner
+44(0)1372 733 027
michael.walker.3@aon.com

About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

aon.com