HYMANS ROBERTSON

Risk transfer report

Your annual overview and analysis of the risk transfer market

November 2018

Welcome to a unique insight into the risk transfer – bulk annuity market

2018 marks a significant new era for the pension scheme risk transfer market, with bulk annuity transaction volumes set to exceed £20 billion, a 50% increase compared to the previous record of £13.2 billion set in 2014.

We entered 2018 with extremely competitive buy-in pricing as a result of strong competition from the insurers. The cost of insuring deferred members via a buy-in or buy-out has also reduced significantly in recent years and so pension schemes are often closer to being able to afford to fully buy-out than they may have realised. This, coupled with improved pension scheme funding levels and lower risk investment strategies, means that this is the first year that demand from pension schemes to complete bulk annuities has outstripped supply from insurance companies.

Indeed, all of the eight insurers active in the bulk annuity market are expected to have had their record year for transaction volumes during 2018, with Legal & General and Pension Insurance Corporation alone completing around £14 billion of buy-ins and buy-outs. Furthermore, whilst 2017 did not see any individual bulk annuity transactions of more than £1 billion, there have been several of more than £1 billion in 2018.

Excellent pricing opportunities remain, but the shift in supply and demand means that pension schemes will need to use a more intelligent approach to broking the bulk annuity market in 2019 and beyond. Before approaching the market, it is now more important than ever for trustees to be well prepared and to have a clear understanding of insurance companies and how they prioritise their efforts. Timing the approach, to factor in the latest activity levels, and not trying to rush through a transaction is also critical.

I am delighted to share with you our third annual report where we track the key changes in the bulk annuity market and look at what these changes could mean for your defined benefit (DB) pension scheme. We also share our insights into the trends for the coming year and beyond, and the implications for DB schemes looking to capture opportunities to transfer risk to insurance companies.

We take a look at five key areas:

1. **Bulk annuity insurers overview** (pages 4-17) – an update on key factors affecting insurance companies.
2. **The trustee perspective** (pages 18-21) – trustee views on the risk transfer market.
3. **Regulatory update** (page 22-27) – what's new and what this means for you.
4. **Longevity risk update** (pages 28-31) – what the latest life expectancy trends mean for risk transfer transactions.
5. **Demand from DB pension schemes** (pages 32-43) – important considerations from the pension scheme perspective.

Additionally, in the appendices, an overview of how transaction volumes have changed since the market took off in 2007 is provided. We also summarise key details on each insurer and how they are positioned in the market.

You'll hopefully find our insights helpful for your journey towards whatever goals you have for your scheme and towards ensuring your members have better, more secure futures.

James Mullins
Partner and Head of Risk Transfer Solutions
James.Mullins@hymans.co.uk

1 Bulk annuity insurers overview

DB bulk annuity size appetite for each insurer

The table and chart below show, for each insurer in the bulk annuity market, recent activity and current appetite for buy-in and buy-out transactions by size and whether or not they provide insurance for deferred members.

Current insurer appetite

	Business written over 12 month period ending 30/06/2018				Appetite by transaction size			
	Number of transactions	Total size	Average size	Deferreds?	‹£50m	£50m - £100m	£100m - £500m	›£500m
Aviva	56	£3,258m	£58m	✓	Target market	Target market	Target market	Target market
Canada Life	3	£268m	£89m	✗	Target market	Target market	Target market	Unlikely to quote
Just[1]	30	£1,421m	£47m	?	Target market	Target market	Target market / More selective	Unlikely to quote
L&G	23	£2,408m	£105m	✓	More selective	More selective	Target market	Target market
Phoenix Life	1	£470m	£470m	✗	Unlikely to quote	More selective	More selective / Target market	Target market
PIC	31	£5,013m	£162m	✓	More selective	Target market	Target market	Target market
Rothesay Life	3	£725m	£242m	✓	Unlikely to quote	Unlikely to quote	More selective / Target market	Target market
Scottish Widows	7	£1,345m	£192m	✓	Unlikely to quote	Target market	Target market	Target market

Key

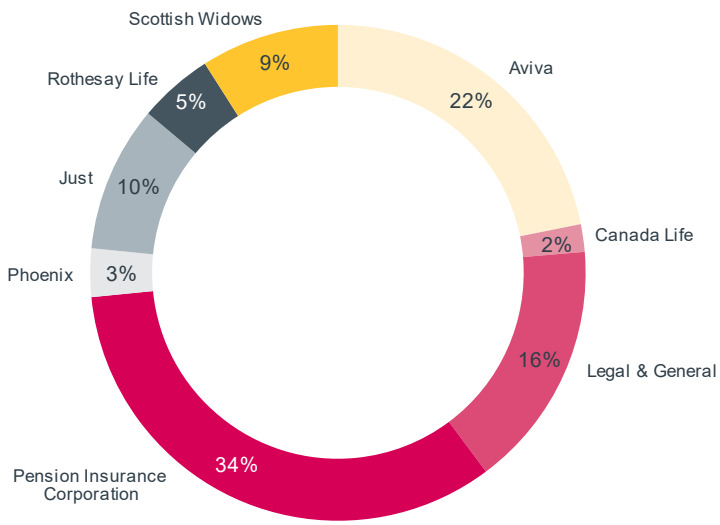
✓ Able to write
? More selective
✗ Unable to write

● Target market ● More selective ● Unlikely to quote

[1]Number of transactions estimated based on the assumption that the average size of transactions completed by Just in H1 2018 was in line with H1 2017.

Kieran Mistry
Risk Transfer Specialist
Kieran.Mistry@hymans.co.uk

Insurer market share over 12 month period ending 30 June 2018



One size doesn't fit all

The appetite from insurers for buy-ins and buy-outs varies significantly depending on the size and profile of the transaction. This means that the insurance market can look very different for each scheme, and schemes have to adapt their approach to suit their circumstances and achieve the best outcome. The best approaches will be very different for a £10m scheme and a £10bn scheme.

There is a place for schemes of all shapes and sizes in this market. The table below gives an indication of how the market may look for different transactions.

Size of buy-in or buy-out	Pensioner only	With non-pensioners
‹£10m	Up to three insurers interested, but sometimes only if they are exclusive.	Up to two insurers interested, but sometimes only if they are exclusive.
£10m-£100m	Three to six insurers are likely to quote. Insurers interested in this size range will also have an eye on larger buy-ins, so schemes will have to position themselves well to attract insurer appetite.	Three to five insurers are likely to quote. These insurers are currently particularly interested in deferred liabilities where they feel they can differentiate themselves. This may provide an edge over slightly larger pensioner-only buy-ins.
£100m-£500m	Potential interest from all insurers means there will often be the most competition in this size range, though some insurers are currently more selective about pensioner only transactions of this size.	Up to six insurers will quote. Contrary to recent years, some insurers will be particularly interested in transactions of this size with a material proportion of deferred liabilities.
›£500m	Transactions in this range are more strategic, with insurers typically sourcing assets and longevity reinsurance specifically for the deal (rather than drawing on a pool of assets and pre-arranged reinsurance treaties). Schemes can consider splitting transactions into tranches to get the best pricing. Up to six insurers will be interested, with only one (Phoenix) unable to insure deferred liabilities at the moment.	

Appetite from insurers for different transactions is constantly evolving. We've seen this over the last year, with Aviva entering into a £925m pensioner buy-in with the M&S pension scheme, signalling an expansion of their appetite to the largest transactions. Also, increasingly competitive pricing for pensioner buy-ins has led some insurers to prioritise transactions with deferred liabilities including full buy-outs, where non-price considerations such as the insurer's administration and transition capabilities are more important to trustees.

This has increased competition for buy-outs of all sizes. There is also the potential for boosted competition from new market entrants looking to benefit from the expected volumes of pension scheme buy-ins and buy-outs over the coming years.

Can the insurance industry accommodate £2.3 trillion of DB pension liability?

According to the most recent Purple Book data published by the Pension Protection Fund (PPF), total estimated buy-out liabilities across all DB schemes stands at £2.3 trillion, with total assets falling somewhat short at £1.5 trillion. Currently, assets (and of course liabilities) have been moving from pension schemes to insurance companies at a rate of around £10 to £15 billion per year, or around 1% of DB assets at the upper end. We have spoken a lot in this report about how active the market is and how busy insurers are, but what we are seeing at present is more of a trickle than a flood. What if the waters were to rise? After all, if that 1% were to increase to a modest 3%, that would mean triple the volume of business. Would we just see supply increase to meet demand, whether that be from existing insurers or new entrants, or would prices rise?

What drives insurer capacity?

There are four main considerations when it comes to capacity of the bulk annuity market:

- Availability of capital
- Longevity reinsurance capacity
- Human resource
- Assets to back the liabilities

We will consider each of these in turn. In previous research we have looked at longer term demand for insurance from pension schemes, but for now we will over-simplify and try to answer the titular question – **can the insurance industry accommodate £2.3 trillion of DB pension liability?**

We will score each of the four as to how positive the outlook is in both the short and long term, with green being the most positive and red the least.

1. Availability of capital

Insurers have to hold regulatory capital in respect of liabilities. The minimum amount of capital insurers are required to hold under the Solvency II regime can be split into:

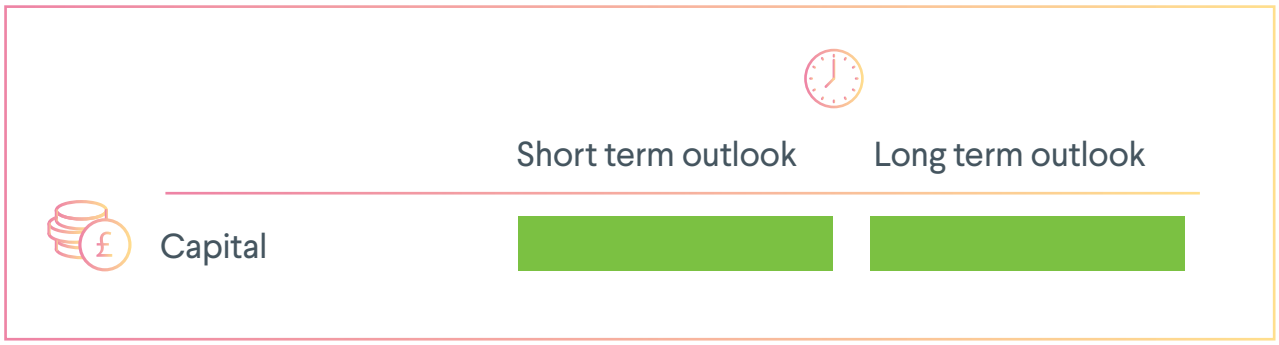
- assets to back the best estimate liabilities;
- a 'risk margin' to cover the cost to another insurer of taking on the business; and
- sufficient capital to cover a 1 in 200 year stress event.

Insurers will also hold a buffer of voluntary capital in excess of this regulatory minimum amount of capital. Crudely, we might assume that an insurer chooses to hold total capital of 15% in excess of the best estimate liabilities. What might not be readily apparent is that insurers don't actually put up all of this capital themselves, as some of it is paid for by trustees through the buy-in or buy-out premium. If we assume that half of the capital is supplied by pension schemes, then the insurance industry might need around £170 billion of capital over the coming years in order to insure the majority of the £2.3 trillion of DB liabilities.

Assuming that insurers are willing to reinvest excess capital already allocated to annuity business, we estimate that there is around £1-2 billion of capital being released each year that can already be deployed.

It is impossible to measure how much global capital there is that is seeking insurance above and beyond this amount, though we take comfort from the fact that sovereign wealth funds across the globe have assets in excess of £5 trillion. These funds typically have very long term time horizons, so it would not seem unreasonable that £170 billion (around 3%) may find a home to back annuities if expected returns are sufficiently attractive. In addition, insurers could of course tap into public equity markets.

Capital outlook:

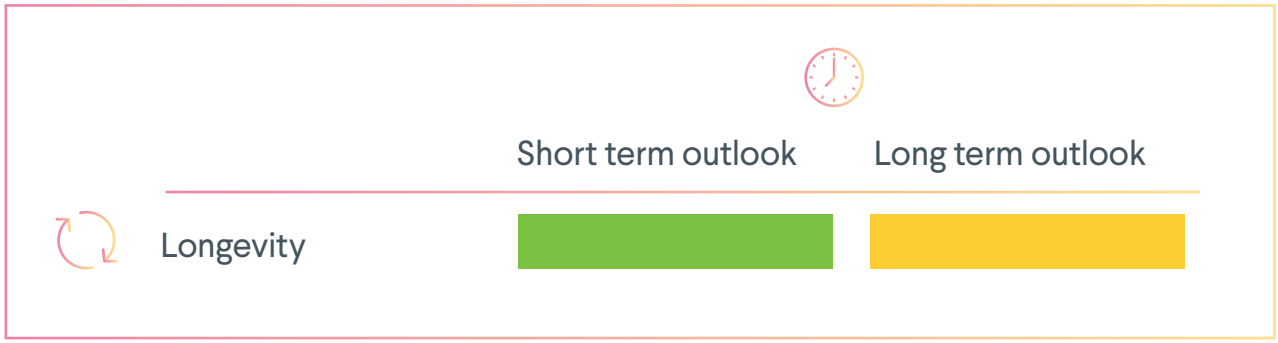


2. Longevity reinsurance capacity

The current insurance regulatory regime does not reward insurers for retaining longevity risk, so for the most part they look to pass this risk to reinsurance companies. While there are a number of reinsurance companies who are actively seeking longevity risk, we believe that there is also a lot of untapped capacity. In theory, there ought to be appetite somewhere in the global insurance market for enough longevity risk in order to provide balance for the opposing risk, namely mortality risk (from life insurance). On this basis, we estimate that there is potential global capacity to support the full £2.3 trillion of liability. The only caveat here is that around 70% of reinsurers have a preference for non-UK longevity exposure, though there is currently limited appetite for longevity de-risking outside the UK. A large proportion of reinsurers' mortality risk exposure (against which longevity provides a natural hedge) is based in North America, so building up a concentrated exposure to the UK is by no means optimal.

We do see scope for the capital markets to serve as an additional source of longevity hedging capacity, which ought to be able to help plug any deficit should North American pension plans or insurers suddenly develop an appetite for longevity de-risking. In this scenario we would also expect further acceleration of the development of longevity hedge indices to support more readily tradeable instruments to help draw in capital and deliver capacity. However, these innovations remain untested as yet.

Longevity outlook:

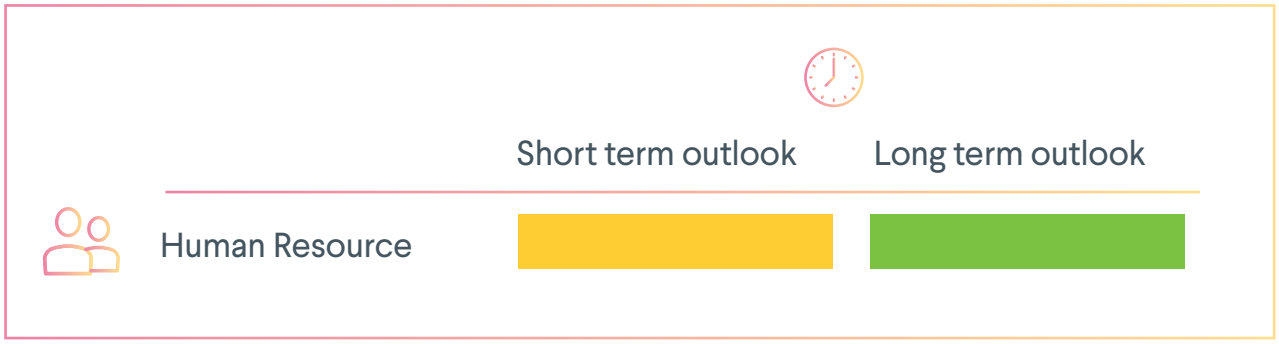


3. Human resource

Technology has moved forward in leaps and bounds, but securing a bulk annuity is still quite a people-intensive process. Requesting a buy-out quotation from an insurer is like asking a new scheme actuary to do a full scheme valuation with some capital modelling thrown in as well, all in around 6 weeks. Insurers need people to: interact with schemes and their advisers, interpret benefit specifications, convert data to their formats, project cashflows, source and model assets to match the liability cashflows, run the asset and liability cashflows through capital models, present figures at internal sign-off meetings, draft and negotiate contracts, handle the premium transfer, invest the assets, transfer the member data, set up pension payroll... the list goes on. The same considerations will be there for reinsurers as well, and as we have seen they are integral to the smooth operation of the market.

Both insurers and reinsurers are struggling to keep up with current levels of demand from pension schemes, and as we have said, what we are seeing today is a trickle rather than flow. While we expect that part of the answer here will be technological advances, in the meantime there is a clumsy fix – hire more people – but this has a lag time for both recruitment and training. So while there is no long term problem here, it will be a bumpy ride.

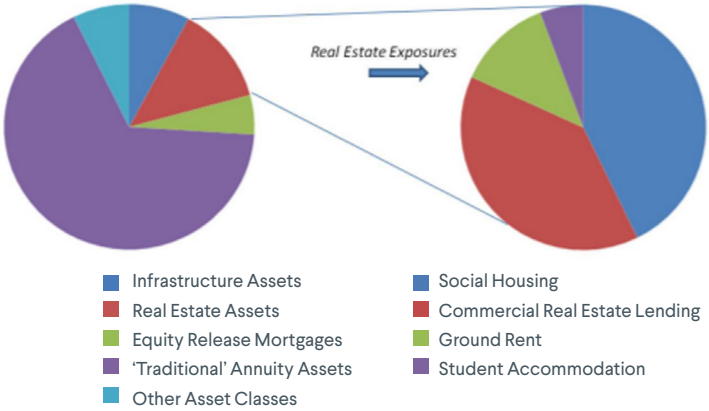
Human resource outlook:



4. Assets to back the liabilities

Wind the clock back far enough, and insurers used to back annuity liabilities with gilts. Then they began to use corporate bonds as well, in order to pick up additional spread. Today insurers are investing heavily in less liquid assets such as infrastructure, direct commercial lending, social housing, and equity release. The below chart shows a breakdown published by the Prudential Regulation Authority (PRA) of insurer 'matching adjustment portfolios', which are the portfolios they use to back annuities, and we can see that around a third of all assets are allocated to less liquid investments.

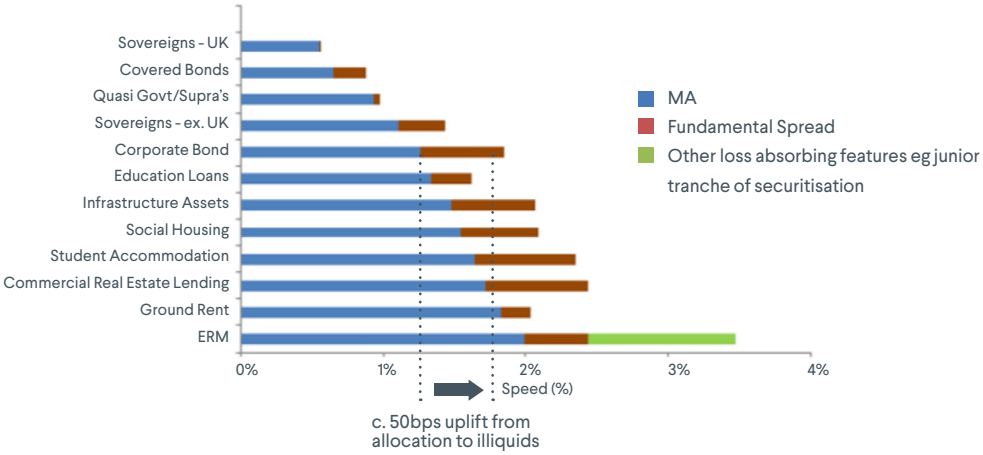
Asset allocation in matching adjustment portfolios



Source: Bank of England: 31 December 2016

However, what this chart hides is that the allocation to these asset classes is much, much higher for new business. An insurer could be allocating as much as 80% of their portfolio to these asset classes when pricing new business, and the current attractive pricing that pension schemes have benefited from is largely thanks to this high allocation. This is evident from the below chart, also published by the PRA, that shows in blue the amount of spread that insurers are able to take into account when valuing their liabilities (and therefore pricing) for different asset classes. As we show, the net uplift from illiquid investments is around 50 basis points, which could translate to a 5% price decrease for an average pensioner buy-in.

Average matching adjustment by asset class



Source: Bank of England: 31 December 2016

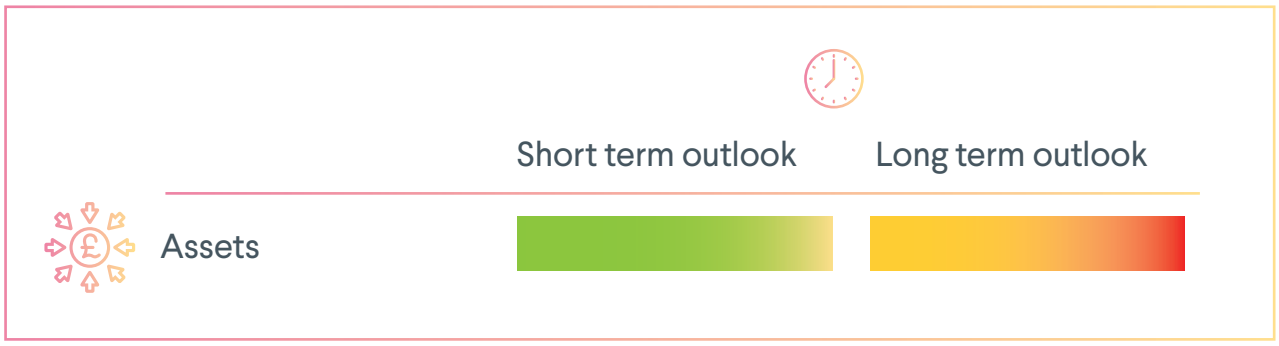
But this is not an unlimited pool of assets and there is reason to be cautious about the future outlook. For example, the spread on Equity Release Mortgages (ERM) is likely to drop as a result of the recent PRA consultation in this area (more on ERMs can be found on page 24). Ground rents are a limited pool of assets as they no longer exist on new builds, and many other areas will only grow as fast as the UK economy. Insurers may have to look further afield, and some are already investing in other geographies, in particular the US, though let's not forget that there are around $2 trillion of North American pension liabilities, some of which are also looking to de-risk through insurance. And while insurers can invest overseas, they will need to incur the cost of hedging long term income streams back to sterling, which will reduce the net spread on these opportunities.

As more and more pension schemes look to de-risk, competition among insurers for business is likely to drive down yields on less liquid assets. We have already seen some insurers grapple with a limited supply of illiquid investments this year, with some finding that their pipeline of new business from pension schemes is bigger than their pipeline of investment opportunities. This is likely to be accentuated in the short term by the potential outcome of the PRA consultation on ERM as some insurers may struggle to find alternative illiquid assets in sufficient volume.

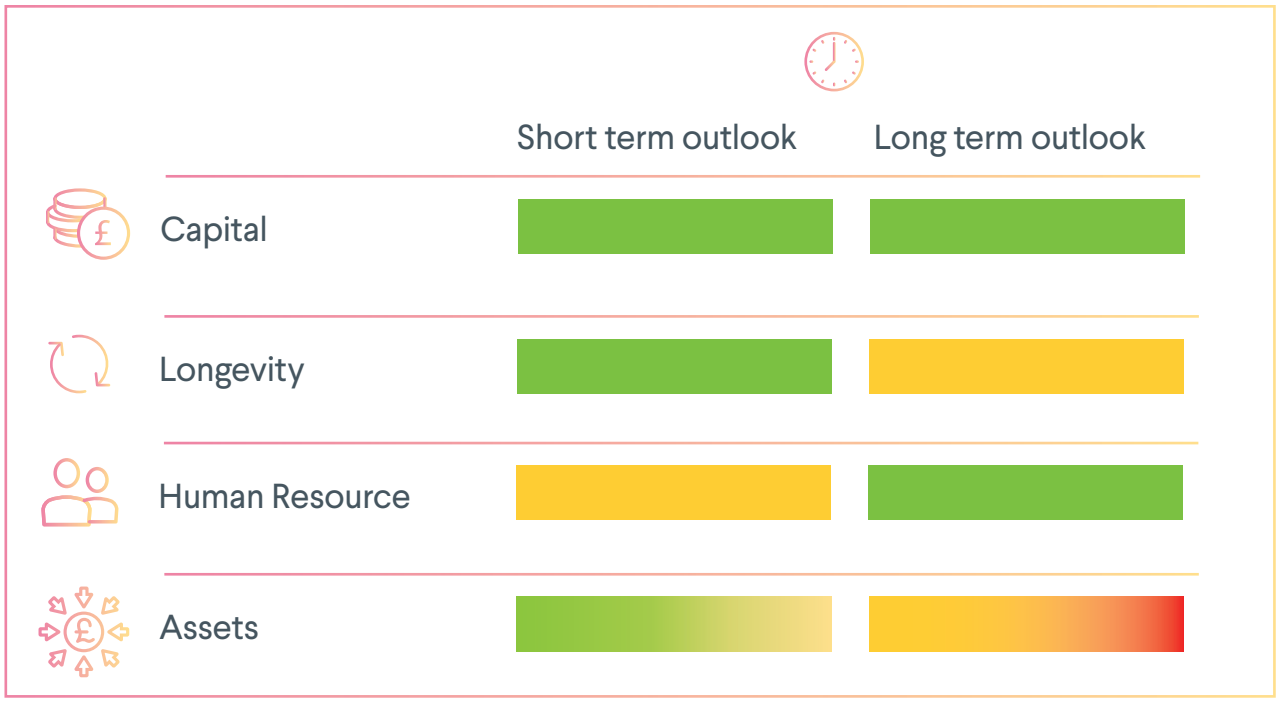
So if anything will constrain capacity at current pricing, it will be assets. What does this mean in practice? As demand increases, insurers will gradually allocate lower proportions of illiquid investments to new business, which will push prices up for pension schemes. However, at a certain point, higher pricing will mean that insuring benefits is not attractive to pension schemes, who will simply walk away.

Wherever this balance lies, there will be a limited amount of capacity at this price point, as it will still be somewhat reliant on illiquid investments. So we may see an equilibrium where there is simply a limited amount of capacity at a tradeable price. Where this price point lies, and how much capacity there will be at this level remains to be seen.

Asset outlook:



What will the future hold?



While there may be something of a lag in short term capacity, in particular as a result of limited human resource, there is a longer term capacity issue that is tied to the availability of illiquid assets to back the liabilities. In this future world, there is likely to be a limited supply of insurance at a price point that is higher than today, but remains attractive to pension schemes.

As this evolution plays out, schemes will increasingly be required to form a view on tactical and strategic buy-in decision making. When approaching the market to enter into a buy-in, trustees will increasingly be required to consider not only their walk away price today, but also the outlook for pricing in the future. At the point where a material number of large schemes decide to defer a transaction until price targets are met, we expect the industry to quickly evolve to a point where "the queue" has well and truly formed. This will undoubtedly create market dynamics that will need careful management by both schemes and insurers.

This lends credibility to a message that you may be tiring of but is ultimately true! Namely, that the buy-in market could do well to adopt the motto of the Scouting movement: 'be prepared'.

If schemes are going to have to form an orderly queue for insurance in the future, insurers will undoubtedly favour those who have already done the necessary groundwork and who can show a clear intent to transact. In order to cut out as many of those precious man hours as possible, those well prepared schemes in the queue will be best placed for opportunities along the way.

Back book transactions: why should pension schemes care about them?

What is a 'back book'?

2018 has already seen around £17 billion of 'back book' transactions, and we expect to see more before the year is out. What do we mean by 'back book'? This is industry jargon for an insurer's existing business, in this case annuity business. 'Front book', for what it's worth, refers to new business. Insurers will often have different teams dealing with these different 'books', so one team will deal with bringing in business and another will then manage and optimise that business as it runs off.

2018: a history to date

The two transactions that have seen annuity business move from one company to another in 2018 have been in completely different forms. Firstly, Prudential has reinsured around £12 billion of its annuity portfolio with Rothesay Life, which will then transfer to Rothesay Life through a Part VII process (see page 15 for an explanation of Part VII). Secondly, Phoenix has purchased the insurance arm of Standard Life Aberdeen, which includes around £5bn of annuity liabilities.

Economics of a deal

Let's focus on the Prudential deal. For the purchaser, Rothesay Life, this is economically very similar to insuring a buy-in that then moves to buy-out. At the outset, Prudential will transfer sufficient assets from its annuity portfolio to cover the premium that Rothesay Life deems necessary to cover the liabilities they are inheriting. This is like the premium payment for a buy-in. During the reinsurance phase, Rothesay Life will make monthly payments to Prudential equal to the total payments due under the reinsured annuity policies. After the Part VII transfer has been completed, the individual annuitants will be policyholders of Rothesay Life, who will then take over the administration and relationship with the annuitants. This step is akin to a buy-in moving to buy-out.

Here we'll take a look at a number of nuances that do make this different to a typical buy-in, but there is one nuance that is worth understanding in a little more depth. As a reminder, here is a review of insurer capital requirements. Insurers have to hold capital in respect of liabilities, over and above the assets held to back the best estimate of the liabilities. When Solvency II was implemented on 1 January 2016 these capital requirements became more onerous for annuity business, but business written before this date was grandfathered and the Solvency II capital requirements would be phased in gradually over a period of 16 years. The catch here is that the grandfathering follows the business, so if Insurer A purchases a book of annuities from Insurer B and Insurer B wrote the business prior to the introduction of Solvency II, Insurer A gets to treat that business as if it were written pre Solvency II and therefore holds less capital. Most back book transactions are in respect of pre Solvency II business, so, as a rather sweeping generalisation, **an insurer will favour a back book transaction over a buy-in or buy-out** as they can hold less capital. Of course, this is all relative to the price paid and we would expect competitive pressures in the bidding processes to drive down the price for a pre Solvency II back book to reflect this dynamic.

We have already covered the changing dynamics of the pension risk transfer market, as insurers start to become more selective about where they will quote. Having now explored the economics of a back book transaction, we can see that not only are pension schemes having to tussle with other pension schemes to vie for the attention of the insurers, but potentially also with other insurers.

Chasing the same assets

If, as will often be the case, the insurer acquiring the business intends to optimise value by transitioning to a different investment portfolio, the insurer could then seek a significant amount of illiquid investments that might otherwise be used to back buy-ins. Increased competition for these assets could push up the prices of the assets or reduce their availability, either of which would have a detrimental impact on buy-in pricing.

Not all bad news

As we've already noted, 2018 has seen around £17 billion of back book transactions so far, and yet we've seen some of the most attractive buy-in pricing to date. So it would seem that capacity has not yet been pushed to its limits. In fact, back book transactions can create some interesting market dynamics, not all of them bad for pension schemes. For example, if Prudential had chosen to split their £12 billion transaction across three or four insurers, that could have meant that those insurers were less hungry for pension scheme business this year. But as it was, Prudential transacted with just one insurer, and no doubt some other bidders became even hungrier for pension scheme business when they lost out. This may have contributed to the particularly attractive levels of buy-in pricing this year.

Part VII transfers: what are they and what is their relevance to pension schemes?

What is a Part VII transfer?

A 'Part VII transfer' refers to the transfer of contracts from one legal entity to another as governed by Part VII (Control of Business Transfers) of the Financial Services and Markets Act 2000 (FSMA 2000). For the purposes of a pension scheme, it is the only way that an insurer could move a buy-in policy to another legal entity. The most common use of these transfers is for internal business restructuring, i.e. moving from one legal entity to another within the same Group, but they can also be used by insurers to move business to a third party insurer. For example, the transfer of £12 billion of annuity business from Prudential to Rothesay Life this year will require a Part VII transfer to complete the transaction.

How do they work?

Part VII transfers are highly regulated processes, as required by FSMA 2000. They ultimately require approval from the High Court, but there are a number of other protections for policyholders (including trustees), such as:

- Insurers must appoint an independent expert to assess the impact on policyholders;
- the independent expert must be approved by the PRA, having consulted the Financial Conduct Authority (FCA);
- the PRA and FCA are entitled to be heard as part of the court proceedings, and will usually submit a written report to the court on the proposed transfer;
- the insurers must notify all policyholders of the proposed transfer; and
- policyholders are entitled to be heard by the court if they feel that they would be adversely affected.

The court then acts in the interest of policyholders in order to determine whether to approve a transfer or not. It also has extensive powers to amend the terms of the transfer.

What should trustees do if they are notified of a proposed transfer?

If trustees are notified of a proposed Part VII transfer, they will receive an information pack that they will need to digest. This will typically include a summary of the proposed transfer, a summary of the independent expert's report, and Q&A giving further details and issues for note by policyholders. The main considerations for the trustees will be whether the transfer changes the security of the policy, and whether it changes the operation of the policy in any way. Trustees should also reflect on whether they have any additional contractual rights in respect of the proposed transfer.

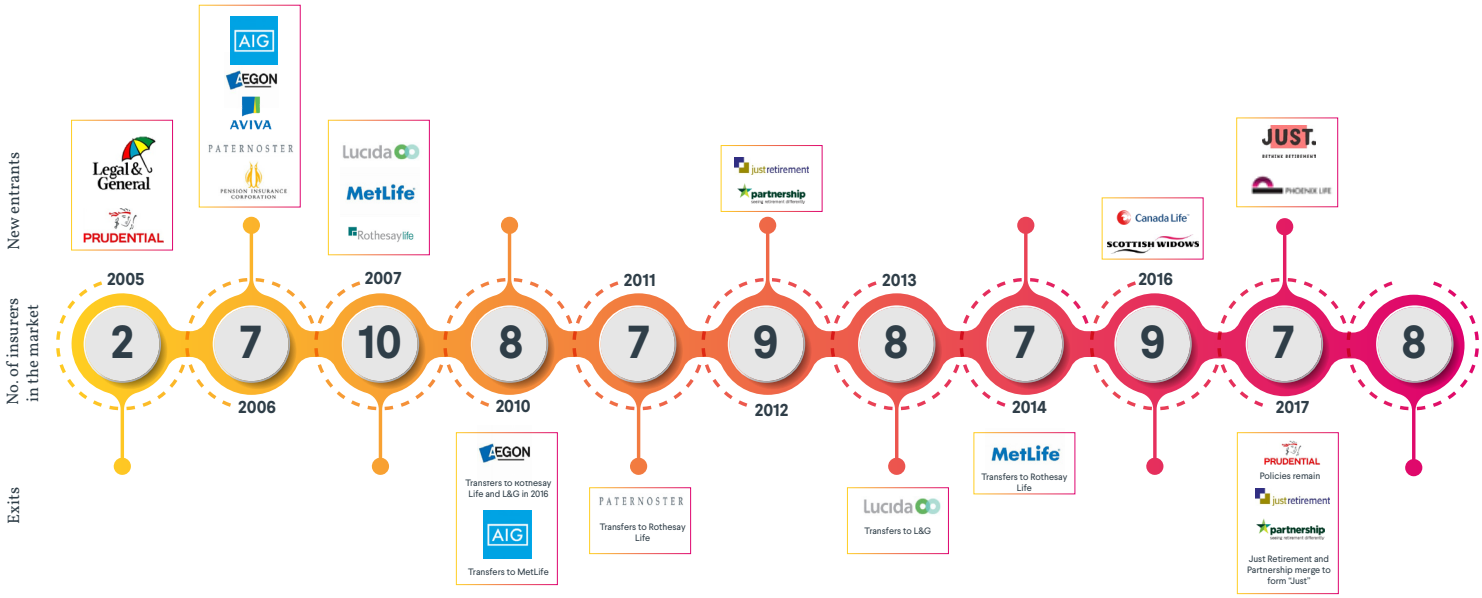
For most schemes, the principal decisions will be whether or not to make representations to the court, and whether and how to communicate the change to the scheme members.

Trustees will generally perform due diligence on their chosen insurer at the point of buy-in or buy-out, in particular looking at the financial strength of the insurance company. The ability of the insurer to pass this business by Part VII transfer to another insurer means that trustees must also be comfortable with the insurance regime as a whole. For example, trustees should consider the capital requirements that apply to all insurers, the strength and effectiveness of the regulatory bodies, and the protections that we have discussed above that are inherent in business transfers.

Michael Abramson
Partner & Risk Transfer Specialist
Michael.Abramson@hymans.co.uk

Potential new entrants

Historic entrants and exits from the bulk annuity market



There continues to be a number of parties analysing a potential entry into this market. The market forecasts significant growth – potentially a four-fold increase in demand over the next 15 years – and this compares very favourably to other business lines. With-profits funds are generally in run-off, protection business is fairly stable, and retail annuity business has been muted since the introduction of pensions freedoms. The main growth areas in insurance are unit linked investment funds, driven by growth in defined contribution funds and drawdown flexibilities, and bulk annuities.

Insurers looking to enter the bulk annuity market will need to overcome the following challenges:

Asset sourcing capabilities

To win new business at the price point demanded by pension schemes, a new insurer to this market will need to develop the ability to source long dated illiquid assets

Brand

Those insurers without a recognisable name or brand will need to establish themselves amongst trustees and pension scheme members. Some may be looking to differentiate themselves, rather than compete with other insurers on price alone.

Longevity expertise

New insurers will need to source relevant data and expertise to enable them to price the longevity risk they are taking on and arrange longevity reinsurance, which is critical given the current insurance regulatory regime does not reward insurers for retaining longevity risk.

Capital and risk appetite

Existing insurers looking to start writing bulk annuities may have capital they are looking to deploy to new business lines, or may need to raise the capital needed to write new business. They will need to understand the risk and profit profile of bulk annuity business and ensure it fits with their stakeholder requirements and philosophy.

There are sufficient rewards from navigating these challenges and new entrants will undoubtedly emerge over the next few years. Given the queue that is starting to form of pension schemes looking to buy-in / buy-out, these new entrants are vitally important for the future of the market, as they will provide:

- a pipeline for additional capital that will be needed to meet pension scheme demand (the c. £170bn needed, as mentioned on page 7);
- a source of competition to maintain competitive pricing for pension schemes; and
- most importantly, a driver of innovation – be that through evolving investment and risk management strategies or though efficiency transformation of how insurers take on new business.

Richard Wellard
Partner & Risk Transfer Specialist
Richard.Wellard@hymans.co.uk

2 The trustee perspective

Independent trustee survey

We surveyed a wide range of independent trustees (ITs) to seek their views on the risk transfer market. We received responses from all of the UK's leading independent trustee companies as well as a selection of other prominent ITs. The results are shown below.

Two thirds of the pension schemes for which the independent trustees surveyed are responsible are expected to buy-out, with 2030 being the average date by which trustees expect this to have occurred.

Buy-in pricing has been very attractive in 2018 and the majority of independent trustees, who gave a view, believe pricing in 2019 will be more expensive than 2018. However, many feel such projects should continue to be undertaken because it is the right time and the right fit strategically for their schemes.

Interestingly, even though consolidation vehicles have only recently come to prominence, they are starting to be considered as a viable long term target.

Survey results

The market in 2018 and 2019

100%
believe there will be a higher value of transactions in 2019 compared to 2018

45%
believe there will be less competitive pricing in 2019 than in 2018

64%
have pressed ahead in 2018 with a buy-in/buy-out where risk transfer opportunities were being considered rather than tactically delaying until 2019

Number of buy-ins before fully insuring

64%
of their schemes will undertake 1 or 2 buy-ins before fully insuring

18%
are expecting to do 2 or 3 buy-ins

As a trustee, what is the most important consideration when deciding whether or not to complete a buy-in?

"Price being aligned with the right timing for the scheme"

"Whether it's the most cost effective use of capital"

" Affordability and making it part of a sensible journey plan"

"The security that buy-in provides to the entirety of the membership"

Likely long term strategy

65%
of their schemes will buy-out

23%
will run on indefinitely

6%
will enter a consolidation vehicle

Remainder said their schemes will likely enter the PPF or merge with other schemes

2030
is, on average, the year that most ITs expect their schemes to have fully secured their benefits and wound up

How do independent trustees play a pivotal role?

Risk transfer decisions are some of the biggest that trustee boards will make in the lifetime of a pension scheme. They impact on member security, member experience and involve investing large sums of money in an insurance policy that can't subsequently be sold as well as requiring management of many stakeholders.

So, what's the role of an independent trustee and what value can they bring when discussing and assessing such projects?

Lay trustees regularly need to balance their trustee duties with other commitments and often don't have a deep pensions background. Independent trustees' experience and involvement in the pensions market means they can bring significant value, and play a pivotal role on trustee boards.

3 key areas where ITs can add value include:

1 Strategic alignment; doing it for the right reasons

We've long been advocates of ensuring risk transfer transactions fit the scheme's funding journey. They must make strategic sense. There are many angles to consider: capital efficiency, impact on company contributions (and company accounting), investment returns, risk profile and data accuracy are just a few. But overall, it must provide meaningful steps towards the scheme's long term objective, increasing benefit security and improving outcomes for members.

Whilst attractive market pricing is a tempting lure to engage in risk transfer, these are significant projects so it's key to undertake them when it's the right time for the scheme, making sure it's the most efficient use of the stakeholders' time and money.

Our survey, and experience in working with ITs, shows they share the same view.

2 Bringing stakeholders together

Good stakeholder engagement and collaboration are key ingredients to ensuring a successful risk transfer project. Making sure this happens naturally sits with the adviser. However, due to their unique position, ITs are brilliantly positioned to help support this engagement and collaboration. Through their access to different forums, they can bring the key stakeholders (from other trustees to the sponsor) with them, resulting in wide-spread support for a risk transfer transaction. With their experience and stakeholder management skills, they are well placed in understanding the different needs, objectives and concerns. Supported by proactive advisers, ITs create the collaborative approach needed to ensure a successful project.

3 Challenging the status quo

With their experience, ITs are perfectly placed to help drive these projects towards better outcomes, constructively challenging stakeholders (including advisers) to ensure the best solution for the scheme. And as more innovative risk transfer solutions are now available, their ability to challenge the status quo will continue to be important.

Case Studies

Section B of the Menzies Pension Fund

The Menzies Pension Fund was sectionalised to align with the strategy for the John Menzies group, separating its Aviation and Distribution divisions. Following this exercise, the Trustees sought opportunities to lock down the risk associated with the Scheme.

The Scheme section sponsored by the Distribution division had insufficient assets to immediately buy-out all benefits in full. A bespoke structure was agreed, whereby the Scheme will meet the shortfall to the cost of buy-out through a number of future fixed instalments. This allowed the Scheme to lock into the particularly attractive pricing seen in the first half of 2018, removing risk and securing a buy-out much earlier than the Trustees and sponsor thought was possible, and for less than the Scheme's technical provisions.

The structure of the buy-out gives certainty over contribution requirements from the sponsor, an important factor when John Menzies plc entered into a conditional agreement to sell Menzies Distribution Limited to Endless LLP, announced on 26 July 2018.

"For the Menzies Pension Fund, we had an underfunded section with committed contributions that we expected would get us to a good funding position in a few years' time. All parties were motivated to proactively lock down risk whenever possible.

We identified an opportunity to structure a transaction that would allow us to use the contributions already committed by the sponsor to take advantage of the attractive pricing in the market at the time and immediately remove the risks that could have blown us off course. Thereby securing our members' benefits in full – much earlier than we had originally believed was possible.

As an independent trustee, I was able to draw on experiences from other buy-in and buy-out transactions to guide the wider trustee board through the process, and work collaboratively with our advisers to deliver an innovative project with evolving parameters that met the objectives of all parties – the sponsor, the trustees, and most importantly, members.

Clive Gilchrist, BESTrustees"

Morgan Sindall

"Schemes of all sizes can benefit from buy-ins and buy-out, as Morgan Sindall's scheme did earlier this year. Recognising we were close to being able to fully insure the scheme, we set up a process with multiple insurers to provide regular pricing, planning to disclose a price target at each update to show insurers that we were serious about transacting. This generated sufficient competition to enable us to beat that price target early on and fully insure the scheme's liabilities with Aviva without any additional contribution from the sponsor. Key to a smooth and efficient process was aligning stakeholders through a joint working group, comprising of company and trustee representatives, meaning we could enter into the policy very quickly once the price was right.

Chris Martin, Independent Trustee Services"

Alan Garbarino
Risk Transfer Specialist
Alan.Garbarino@hymans.co.uk

3 Regulatory update

Insurance company regulation remains a hot topic for the management of bulk annuity writers. Regulation can significantly impact the pricing that insurers are able to offer to pension schemes, as well as being a key driver of the security of benefits once schemes have transacted.

A major overhaul of insurance regulation occurred at the start of 2016 when the "Solvency II" regulatory regime came into effect across the European Union (EU). The 18 months that followed involved a lot of "bedding in" – with insurers adapting their business models to take account of the new regime. But there remain lingering concerns in the industry about certain aspects of the rules and how they have been implemented.

Treasury Committee vs PRA: Round 2

In October 2017, the Treasury Committee (a parliamentary select committee) published its report on the implementation of Solvency II in the UK. This was uncomfortable reading for the PRA, which regulates UK insurance companies. MPs sided with the industry on virtually every issue discussed, with implied criticism of the PRA throughout.

Given the strong growth that the bulk annuity market has exhibited, it came as no surprise that a considerable proportion of the report was devoted to this market. MPs concluded that the PRA should look to improve certain aspects of the regulations so as to enhance value for insurers' customers (which we note would include pension schemes which have transferred risk to the insurance environment).

Particular recommendations for the PRA included:

- Removing unreasonable barriers to insurers investing in long-term assets.
- Improving the calibration of the so-called "Risk Margin".

The Risk Margin is an additional component of the Solvency II liabilities, designed to enhance policyholder security, which is particularly significant for annuity business. It has been criticised by the industry for being larger than is necessary to secure an adequate level of policyholder protection, and for being overly sensitive to changes in interest rates.

The argument being advanced by MPs is that, if insurers were able to invest in a wider range of long-term assets, then this should lead to improved investment returns, part of which may be passed on to pension schemes in the form of lower bulk annuity prices. And if the Risk Margin was smaller, then insurers would need to put up less of their own capital each time they write business – meaning that they would charge lower prices and still obtain their required return on the capital invested.

In response to the Treasury Committee's report, the PRA published fresh guidance relating, in particular, to the assets insurers use for backing annuity business – this was consulted on in October 2017 and finalised in July 2018. However, no action has yet been taken on the Risk Margin, with the PRA stating that "in the context of the ongoing uncertainty about our future relationship with the EU ... we do not yet see a durable way to implement a change...".

For now, there is a temporary hiatus in relation to major regulatory changes until Brexit is resolved.

Our view

The Treasury Committee's report made sweeping recommendations, seemingly without acknowledging the effects of EU law. While the UK remains a member of the EU, its ability to act unilaterally is pretty limited, and some of the things asked of the PRA are simply not within its gift.

With this in mind, the new guidance on the assets used to back annuity business represents a few "easy wins" for the industry – rather than fundamental reform – and isn't expected to materially impact pricing.

It's pretty clear from numerous statements over the past couple of years that the PRA is not a big fan of the Risk Margin. But the path to reform is unclear and interlinked with Brexit. It may still be some time until we see any regulatory changes that have the potential to improve pricing – if, indeed, these come at all.

Equity release mortgages (ERMs)

One area that has hit the headlines recently is the use by insurers of equity release mortgages to back annuity business. The PRA opened a consultation on a new set of requirements on 2 July 2018, and, quite coincidentally, the issue hit the popular press on 7 July when BBC Radio 4 aired a documentary entitled "The Equity Release Trap".

Equity release is a product where the customer is advanced a loan, secured on their home. The loan typically rolls up with interest at a set rate and is usually repayable when the customer dies or moves into long-term care. The product normally contains a so-called "no negative equity guarantee", which means that the amount repayable cannot exceed the value of the customer's home on death or entry into care.

The PRA is proposing requirements which, if adopted, could force some bulk annuity insurers to strengthen their reserving for no negative equity guarantees. This could potentially tie up more of an insurer's capital, meaning that equity release mortgages may look less attractive as an asset class once the cost of this capital has been taken into account.

Over the past few years, the returns available to insurers investing in equity release mortgages have looked attractive relative to other asset classes – and these have, to some extent, been reflected in bulk annuity pricing. But this could potentially change if the PRA's proposals are adopted.

There may also be implications for insurers with large equity release portfolios already on their books. Having to reserve more for the business already written may lead to a weakening of some insurers' solvency position. A firm's appetite for new bulk annuity business may be driven in part by its solvency position – with better capitalised firms more willing to accept the risks involved with taking on new business – and this may have a knock-on effect on pricing.

Our view

While the Treasury Committee's report points towards a potential relaxation of some parts of the insurance regulatory regime, the latest developments in relation to ERMs points to a strengthening in other areas.

This could be a sign of a shift in attitude: with less regulatory attention on the letter of the law and a greater focus on the main risks being run by insurers.

While ERMs make up a relatively small proportion of the assets on insurers' books, the volumes being sold have increased significantly in the last few years – meaning that equity release may be much more significant when it comes to backing new bulk annuity business. All else being equal, this has the potential to increase prices.

Brexit – where are we and what could be the impact on the bulk annuity market?

It has become something of a cliché for consultants to say that there is "great uncertainty" when it comes to Brexit. However this remains as true as it was in the immediate aftermath of the referendum result two years ago.

The potential impacts of Brexit on insurers in the bulk annuity market can be divided into four main groups:

1. Potential changes to regulation once the UK is no longer bound by EU law;
2. potential for volatility in the financial markets;
3. effects of a general economic downturn; and
4. ability of insurers to service contracts written to policyholders in other EU countries.

1. Potential changes to regulation once the UK is no longer bound by EU law were suggested above. However, the ability of the UK to make changes will be very dependent on what agreement is reached about the future relationship between the UK and EU – be that "hard" or "soft". The UK will also need to consider whether it wishes to have a regime which is considered to be "equivalent" to the EU's regime, and whether any changes it makes to the rules will impact upon that.

2. Political uncertainty has the potential to lead to volatility in the financial markets. Since annuity pricing tends to be strongly correlated with long term interest rates, any fall in long term rates may increase pricing in absolute terms. This may not affect affordability for pension schemes that are heavily invested in fixed-income assets or have otherwise hedged their exposure to interest rates.

   It is also worth considering the impact of market volatility on the insurers themselves. When long term interest rates fell sharply over the first half of 2016, many insurers saw their solvency positions being squeezed. Solvency positions of bulk annuity writers may also be impacted by credit spreads and – depending on what other lines of business the insurer writes – by volatility in equity or property markets.

   A firm's appetite for new bulk annuity business may be driven in part by its solvency position – with better capitalised firms more willing to accept the risks involved with taking on new business. This means that market volatility may have knock-on implications for pricing.

3. While it is largely possible for insurers to hedge their exposure to the financial markets, it may be hard for them to escape the effects should there be a general economic downturn. If customers have less money to save, or can no longer afford the protection provided by insurance products, then insurers may see a fall in new business volumes across a range of products. This may increase their focus on the bulk annuity market and thereby increase competition – although this relies on there being no reduction in the demand from pension schemes, who may themselves be affected by Brexit.

4. The final point in relation to Brexit concerns those insurance contracts that have been sold to customers in other EU countries using Freedom of Services or Freedom of Establishment. Once the UK leaves the EU then, depending on the nature of the agreement between the UK and the EU, UK insurers may lose their authorisation to carry on insurance business in EU countries. This could potentially make it illegal to pay benefits to residents of EU countries – even if those customers have policies that were sold while the UK was part of the EU.

   Some insurers are therefore considering setting up new subsidiaries in other EU countries, with a view to transferring the affected policies to the new subsidiary which, by virtue of its location, will retain the right to service the contract.

   This is mostly an administrative headache for the insurers, and is unlikely to cause major disruption to the market. However, there may be implications for schemes with members overseas.

In general, we expect that buy-in policies will be little affected, since the policyholders are the trustees who will usually be UK residents. However, if a buy-in policy is subsequently converted to a buy-out then each pension scheme member will have their own individual insurance contract. This means that members who reside in other EU countries may end up having to be insured by an EU subsidiary rather than by the legal entity which provided the buy-in contract. Trustees may want to pay particular attention to overseas members when entering into a buy-in contract or when converting to buy-out.

Our view

The market volatility that we saw in the aftermath of the 2016 referendum was something of a baptism of fire for life insurers, coming as it did less than six months after the Solvency II regulatory regime came into force. The plus side is that insurers should be able to draw on this recent experience when devising their plans to weather any future volatility that might result from the current political uncertainty.

When considering the longer term implications for the market, the impact on insurers is only part of the picture, and the implications for pension schemes will be just as important in determining whether the market continues to grow.

IFRS 17 – what, when, and possible impact?

Last year, the International Accounting Standards Board (IASB) published a new accounting standard for insurance contracts. Its aim is to replace the patchwork of different local standards for insurance contracts with a single framework that applies across all countries that adopt International Financial Reporting Standards (IFRS).

The new standard is termed IFRS 17: Insurance Contracts and it comes into effect at the end of 2021. The European Commission is currently deciding whether or not to "endorse" the standard, which would make adoption compulsory for all listed insurers in the EU. Past practice suggests that the Commission does generally endorse new standards from the IASB, although there remains the potential for some amendments to be made.

At present, we expect that all of the insurers currently operating in the bulk annuity market will adopt IFRS 17. One of the attractions of the bulk annuity market for insurers – relative to other insurance markets that they might operate in – has been the ability to recognise part of the profit expected to arise on an annuity contract in the IFRS accounts at the point at which the contract is sold. In contrast, some other types of insurance contract may lead to the insurer recognising a loss when the contract is sold, with profits being recognised later in the term.

A key feature of IFRS 17 is that insurers will not be able to recognise any new business profits at the point of inception. Instead, the profit will be deferred and spread over the lifetime of the contract.

While this treatment is no different for bulk annuities than for any other insurance contract, the nature of how this business has been accounted for historically may mean that the adoption of IFRS 17 leads to the market being relatively less attractive for insurers despite there being no change to the underlying economics. This could potentially affect how competitive the market is.

At this stage, such speculation is little more than conjecture. Insurers are currently waiting on the outcome of the EU endorsement process. It is by no means certain that a change in accounting will lead to a change in business strategy - insurers may simply look to explain their accounting results to the market. For example, insurers may add supplementary reporting to their accounts, with a focus on the profits expected to arise from new business written.

Our view

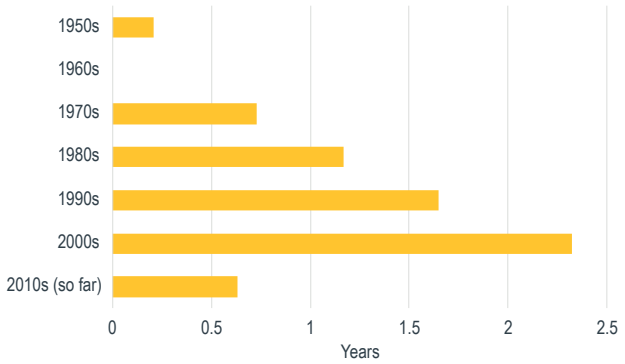
There is much industry criticism of IFRS 17, some of which is undoubtedly merited given its flaws. While the standard is positive news for insurers operating internationally, bringing greater consistency to their overseas business, this will be little consolation to bulk annuity providers operating in the UK where restrictions on the recognition of new business profits have the potential to reduce competition in the market. That said, this is arguably a less real risk if insurers and their investors assign less weight to the IFRS 17 owing to these flaws.

Andrew Scott
Life Consultant
Andrew.Scott@hymans.co.uk

4 Longevity risk update

The continued slowdown in longevity improvements in England & Wales has been well reported. After a prolonged period of falling deaths (despite a rising average age), over the 2010s we have seen increases in the number of deaths reported in several years, and the decade is likely to be the first 'lost decade' (where life expectancy does not materially increase) since the 1960s. The chart below illustrates how life expectancy for men at age 65 has increased over recent decades, covering the period up to 2016.

Increase in male life expectancy at 65



Source: HMD data for the United Kingdom. Chart shows increase in period life expectancy at age 65 for men over each decade. For 2010s we show the increase from 2010 to 2016 (the latest year available).

It may be tempting to conclude that the period of strong improvements in life expectancy is at an end. However, there are dangers in extrapolating short term trends into the future. Risk transfer pricing (like trustee funding) has generally been gradually revising downwards the assumed level of improvements over the short and medium term. There have been limited changes to the level of year-on-year improvements anticipated in the longer term.

Why have improvements slowed down?

Speaking to experts from several disciplines, we have identified a number of possible explanatory factors for recent population experience, including:

- **End of an era:** Recent improvements in life expectancy have been dominated by huge declines in cardio-vascular mortality. Have the benefits of smoking cessation, cholesterol monitoring, statins and stents largely run their course? If so, we may be in a transition period before any future waves of improvements arrive.

- **Cash-strapped Britain:** An ageing population has increased demand per capita for social and geriatric care services. Concurrently, supply has been squeezed as austerity has limited both health and local authority care budgets. Key services for the health of our oldest – such as district nursing – have felt this most acutely.

  However, there is potential for future changes to government policy, through an easing of austerity policies, or a renewed focus on health care (perhaps driven by an increasing elderly voting population), which could reduce or reverse any impact on life expectancies in the future. For example, the Autumn budget confirmed the five-year NHS Settlement previously announced in June, which will see spending on the NHS in England rise by £20.5bn per year in real terms by 2023/4 alongside additional funding for social care.

- **Winter induced frailty:** Since 2011 we have seen multiple harsh winters and flu seasons. Winter deaths have run at high levels, but excess mortality has actually continued year round. This should be no surprise though. Both flu and harsh winters (falls, respiratory conditions, etc...) lead to periods of frailty amongst older people. In many cases this can lead to hospitalisation and/or muscle wastage. This frailty can be a trigger, which tips individuals into a cycle of declining frailty, ultimately leading many months later to a premature death. But the trigger event of the winter/flu is unlikely to appear on the death certificate (and certainly not in the primary entries which determine the headline 'cause of death' statistics). This is likely to have always been a feature of winter mortality; but this decade may have been different in that (i) we have had several of these events in quick succession which are liable to have blurred into an apparent continuum of heavy mortality, and (ii) the effects will have been amplified by the supply/demand pressures within the health and social care system.

  With increasing concerns around climate change, it is possible that we could see 'extreme' weather events more often in future. Alternatively, this prolonged period of heavy winters and flu could result in an improvement in the average health of those who have survived (as the frailest have already succumbed), which may mean that the population is more able to survive future stresses.

The reality is likely to be a complex combination of the above (and other) factors.

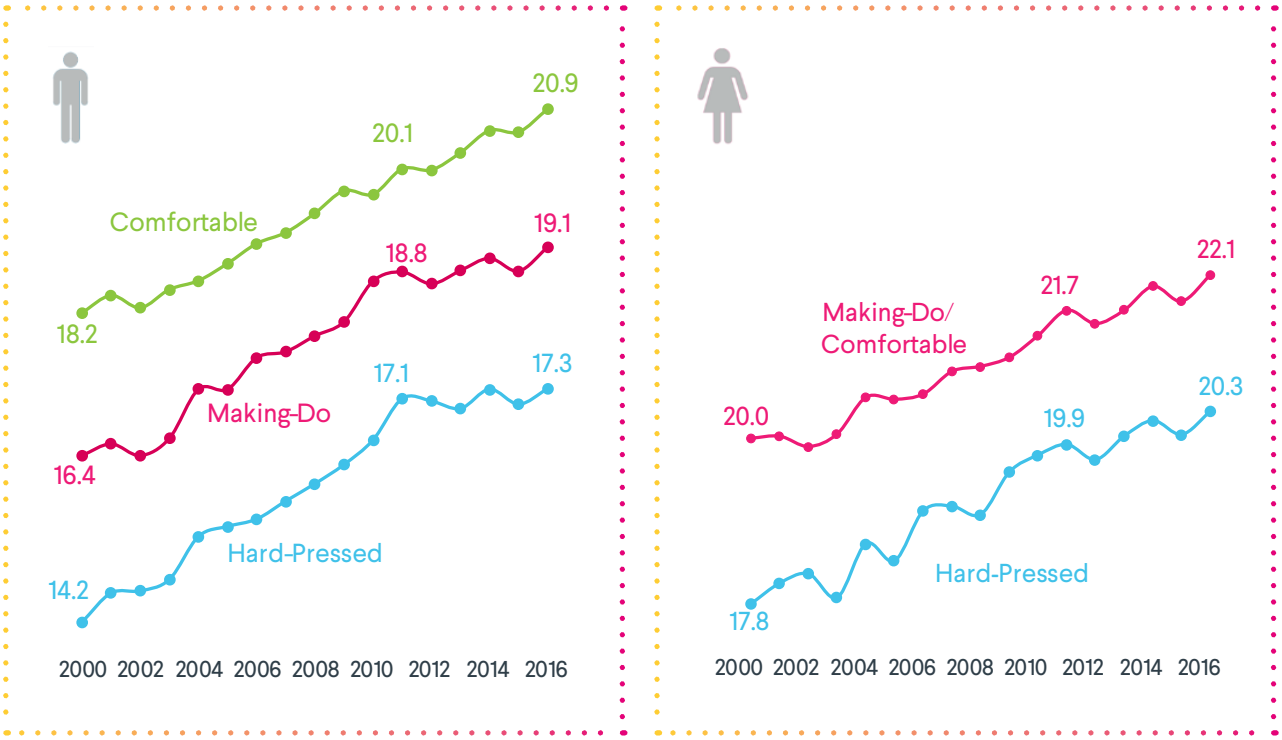
Is everyone equal?

Members of pension schemes do not all contribute equally to their scheme's liabilities. The more affluent pensioners will dominate the liabilities (due to both typically having higher pension amounts and also higher life expectancy). Insurers and reinsurers therefore pay close attention to any differences in trends by socio-economic background when setting pricing.

Whilst the slowdown at population level is universally acknowledged, there is more debate on the picture by socio-economic background. Analysing trends by simply grouping locales with similar deprivation levels suggests this recent slowdown has impacted all socio-economic groups to a similar extent. This is seen both in the population data analysed by the CMI and within the Club Vita dataset of defined benefit pension schemes. However, deprivation is a broad measure, and within any locale there will be pockets of more or less affluent people. Ultimately, personal circumstances are much more relevant to individual longevity outcomes.

Bringing in affluence – something specific to an individual – in Club Vita's data shows a different picture. The 'Comfortable' men – broadly those with a DB pension in excess of £7,500 pa – have seen remarkably stable levels of improvement in longevity over the last 15 years, as shown in the chart overleaf. They continue to have improvements of around 2% p.a. despite the slowdown seen elsewhere.

Period life expectancy at age 65



Source: Club Vita analysis of trends in DB pension schemes, split by socio-economic group (Vita Segment).
https://www.clubvita.co.uk/collaborative-research/trends
For more details see the report 'Longevity Trends: One size fits all'.

Returning to the potential causes of the population slowdown, we can consider reasons for the most affluent pensioners being less impacted by each cause:

- **End of an era:** More affluent socio-economic groups are likely to have been earlier adopters of the likes of cancer screening programmes. They may also be the first 'cardio-vascular healthy' cohort to reach the ages where they are seeing benefits of reductions in vascular dementia.

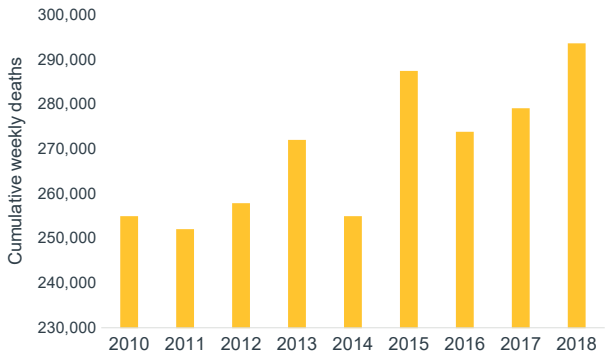
- **Cash-strapped Britain:** More affluent individuals are better placed to arrange for alternative privately funded services, enabling greater resilience to the pressures of austerity and reductions in public sector spending.

- **Winter induced frailty:** More affluent individuals are likely to be able to cope better with heavy winters; for example they are less likely to struggle to meet heating bills.

What does this mean for risk transfer pricing?

In the short term, we are likely to see continued downward pressure on improvement assumptions, with most insurers surveyed expecting a further weakening of their improvement assumptions for financial disclosures for the 2018 year end. To put this into context, we would require a mortality improvement in 2018 of 4-5% for the next edition of the core CMI model (due early 2019) to have the same life expectancies as seen in the latest version. However, such an improvement is looking extremely unlikely; the impact of events including the 'Beast from the East', the 'Aussie Flu', and the recent 'Summer Heat' have made 2018 a particularly heavy mortality year so far. The chart below illustrates the total cumulative deaths over the first 26 weeks of the year, relative to the same period in previous years.

Cumulative deaths over first 26 weeks



Source: ONS data on weekly deaths in England & Wales. Cumulative total of weekly deaths over weeks 1 to 26 inclusive.

Conor O'Reilly
Risk & Modelling Consultant
Conor.O'Reilly@hymans.co.uk

Similarly, ongoing frailty in the elderly population and continued squeezes on health and social care budgets could easily create a hangover into 2019's mortality rates. It's likely that the next couple of versions of the CMI model (at least) will continue to show lower initial rates of improvement, and so projected life expectancies.

Many bulk annuity writers are under pressure from shareholders and analysts to reflect this emerging experience in reserving, and so release capital for dividends. Pricing views are varied – with at least some in the market happy to give at least partial credit for a period of continued low improvements. All else being equal, it is likely that risk transfer pricing will continue to creep down over the next couple of years. However, pricing could also change relatively quickly. The real question, therefore, is whether the factors driving recent years are likely to continue into the medium term. As noted, material injections of money into health and social care in response to public pressure and/or a few benign winters/flu seasons could lead to a rapid return to higher improvements and the hardening of risk transfer pricing.

Even if it is hard to see this kind of change happening, socio-economic differences in improvements continue to be important. Whilst the more affluent socio-economic groups who dominate liabilities remain resilient to the national slowdown (as seen by Club Vita), many insurers may be reticent to follow national trends.

This creates a dilemma for trustees – should they close out some of their longevity risk now, or hang on in the hope for a 'better deal' if prices continue to creep down? Either way, a careful review of existing funding assumptions against recent evidence will be necessary to appreciate if risk transfer represents 'good value'.

5 Demand from DB pension schemes

Addressing growing market volumes

Buy-in transaction processes need to recognise growing demand. The image below illustrates the work we have done at each stage of the process to address the challenges of growing market volumes.

	Stage objectives	How we have addressed challenges of a growing market
Stage 1 Feasibility	Buy-in strategy agreed with all stakeholders	Buy-in and longevity swap pricing feeds to inform strategy and achievable pricing
Stage 2 Market testing and shortlisting	Data loaded onto insurers' systems for accurate quotations Assessment of whether price below target Identify most competitive insurers	Clear and complete data packages, shared via dedicated data portal Standardised price monitoring process if target price not met
Stage 3 Negotiation and insurer selection	Best and final quotations received from shortlisted insurers Selection of insurer for exclusivity	Refined broking process, shaped by the market Alignment of trustee and insurer approval process
Stage 4 Implementation	Buy-in contract in place and risk transferred to insurer	Insurer contractual terms under continual review by Hymans Robertson to facilitate swift agreement
Stage 5 Post transaction operation	Procedures in place for minimal BAU operation of contract	Standardised bedding in processes and reporting Formal project closure reporting and trustee sign-off

So you've done a buy-in – now what?

Should you monitor your insurer transaction?

Buy-ins provide pension schemes with income to meet pension payments, but are very illiquid in the sense that they cannot be sold and are generally not designed to be surrendered over the life of the contract. Trustees should therefore ensure that they are satisfied with the strength and capabilities of the insurer before signing the contract. As circumstances change and as responsibility for paying benefits can be transferred between insurers in the future, schemes should also understand the protections set out in the regulatory regime.

Some contracts do provide the trustee with rights to surrender the policy in certain circumstances. In these cases it is worth trustees not only monitoring whether these rights have been triggered, but also considering in advance how they would approach the decision should it arise. Depending on the refund payable to the scheme and the wider circumstances of the scheme, surrender may not always be the best option.

The vast majority of buy-in contracts do not have surrender options. Monitoring is focussed on keeping up to date with the insurer's business, in so far as it may impact the buy-in contract, and monitoring the operation of the contract (data and payments being exchanged correctly and on time).

For some trustees, this may be by collating publically available information (such as the summarised information set out in appendix 2). Others may wish to meet with their insurer as they do their other investment managers, either on a regular basis or in response to any specific considerations. Trustees can also monitor more subjective measures, such as whether new business volumes are significantly lower or higher than usual, whether terms have been updated for GDPR and so on.

Journey planning, trigger monitoring

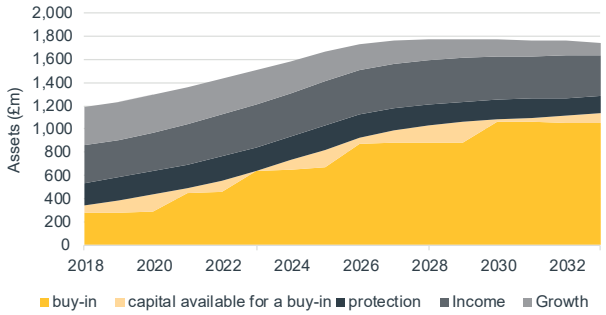
Most schemes that are targeting buy-out are likely to do so by conducting a series of buy-ins. The size of each buy-in is typically restricted by either the availability of matching assets or the size of the pensioner population. Subsequent buy-ins are then contingent on either further asset de-risking into matching assets or the maturing of liabilities.

Having clarity over when and at what price the next buy-in would be appropriate enables trustees to proactively manage their de-risking strategy and set clear timescales for any work required before the next transaction.

Richard Wellard
Partner & Risk Transfer Specialist
Richard.Wellard@hymans.co.uk

By having clearly defined objectives and monitoring progress against these, the trustees will be able to fully engage with the insurers at the appropriate time and demonstrate a clear commitment to transact to insurers to help achieve the highest level of engagement and best possible terms.

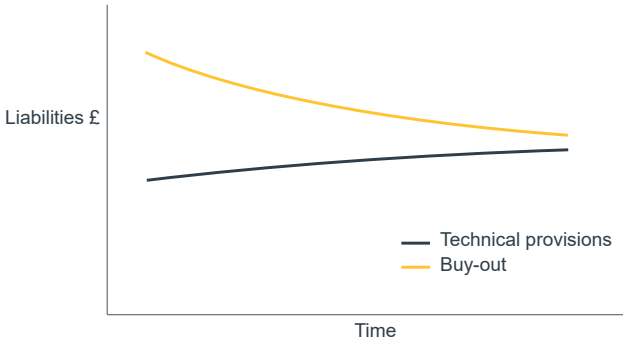
Illustration of clear phased buy-in strategy



Managing your risk on the way to buy-out with a little patience

To date, the vast majority of liabilities transferred from pension schemes to the insurance market have been in respect of pensioners as the insurance premium is more attractive relative to the implicit funding reserve compared to non-pensioner members. Therefore, over time funding reserves and buy-out costs will converge as non-pensioner members retire.

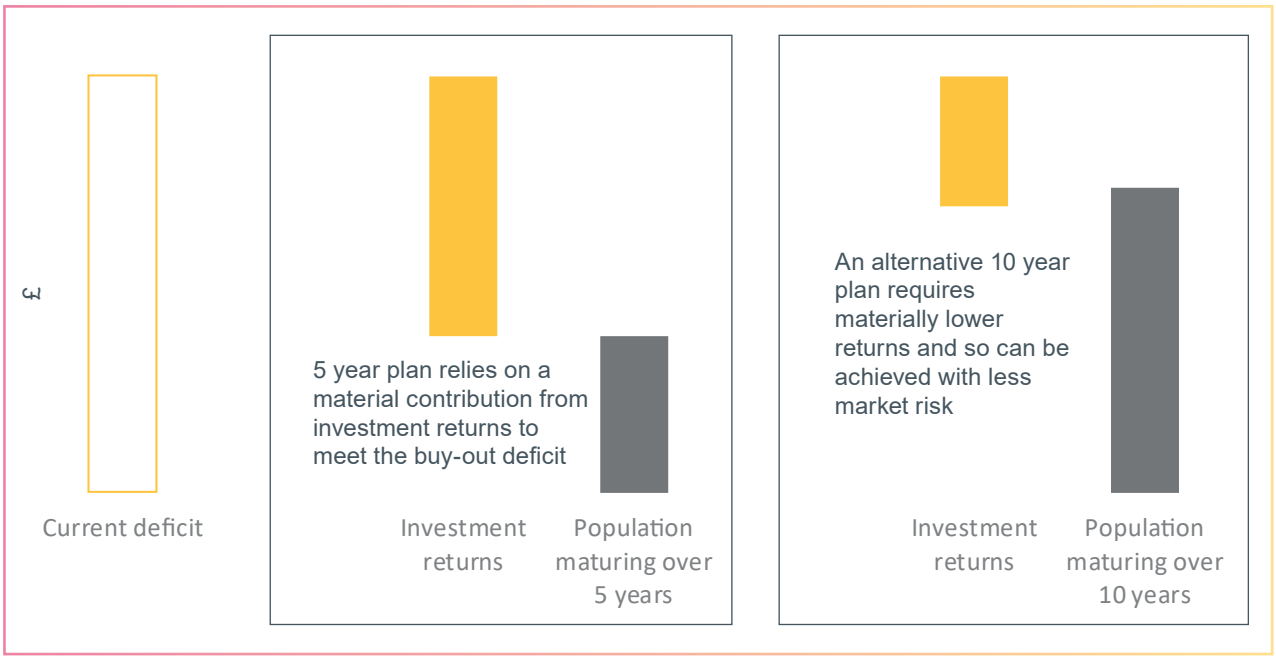
Convergence of funding measures over time



Time alone will address a significant part of current buy-out deficits facing trustees and UK plc. The balance between time, sponsor contributions and investment risk will continue to be a matter of debate with either party likely to have different views. However, it is clear that for most schemes, market risks will tend to dominate liability risks such as changing views on future demographic experience. For a given scheme, trustees will therefore have a choice. They can either take additional investment risk to bridge the gap sooner, or be patient and let the position naturally improve. For many, there may be merit in being patient to achieve aims in a risk controlled way as part of an integrated risk management strategy.

This is illustrated within the following chart which considers the drivers of improvements in the funding level over different timescales.

Illustration of the drivers of expected improvements in buy-out deficits over different timescales



The trustees could seek to achieve significant additional returns to target buy-out over a short period. Alternatively, extending the horizon and allowing the scheme to further mature would mean that the assets would need to generate around half as much additional return over a period twice as long.

This isn't just spreading a return requirement over a longer time period but a material reduction in the need for returns. A lower risk investment strategy would also give more investment freedom, freeing up capital to support larger buy-ins when pricing opportunities become available in the market and increasing the certainty of reaching the target.

Iain Pearce
Risk Transfer Specialist
Iain.Pearce@hymans.co.uk

Consolidators – the death knell for buy-outs?

On 19 March 2018, the Government published a highly anticipated White Paper, 'Protecting Defined Benefit Pension Schemes'. Within the Paper, the Government signalled support for new so-called 'commercial consolidators'.

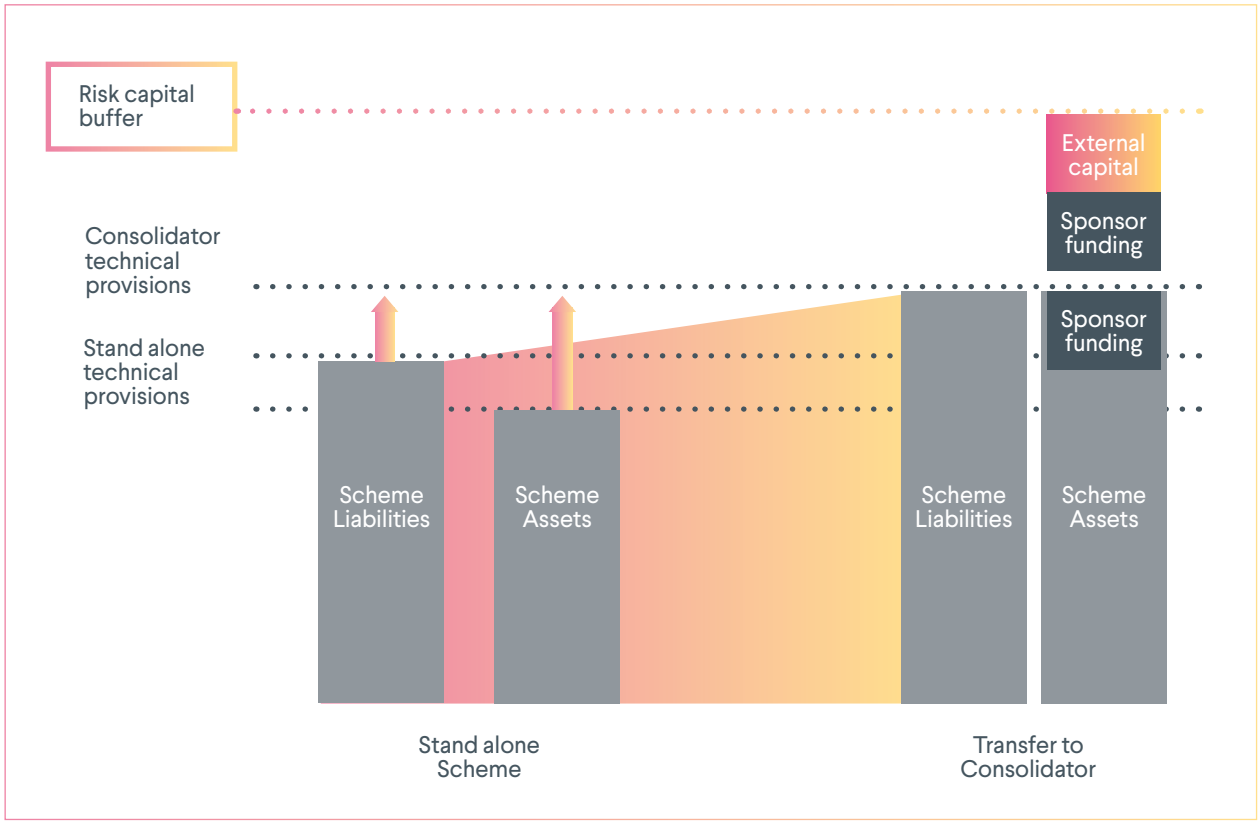
These vehicles offer an alternative to buy-ins and buy-outs for complete risk transfer. In this section we:

- explore how consolidators work and the current consolidators in the market;
- set out our thoughts on the suitability of consolidators versus traditional insurance; and
- consider the impact that consolidators may have on the bulk annuity market.

What are they?

Commercial consolidators are vehicles into which sponsoring employers can transfer their defined benefit pension scheme liabilities (and off-load their risks). The consolidators accept assets and liabilities from employers into a master trust scheme supported by a capital reserve. After the transfer, the sponsor no longer supports the pension scheme liabilities, as with a buy-out.

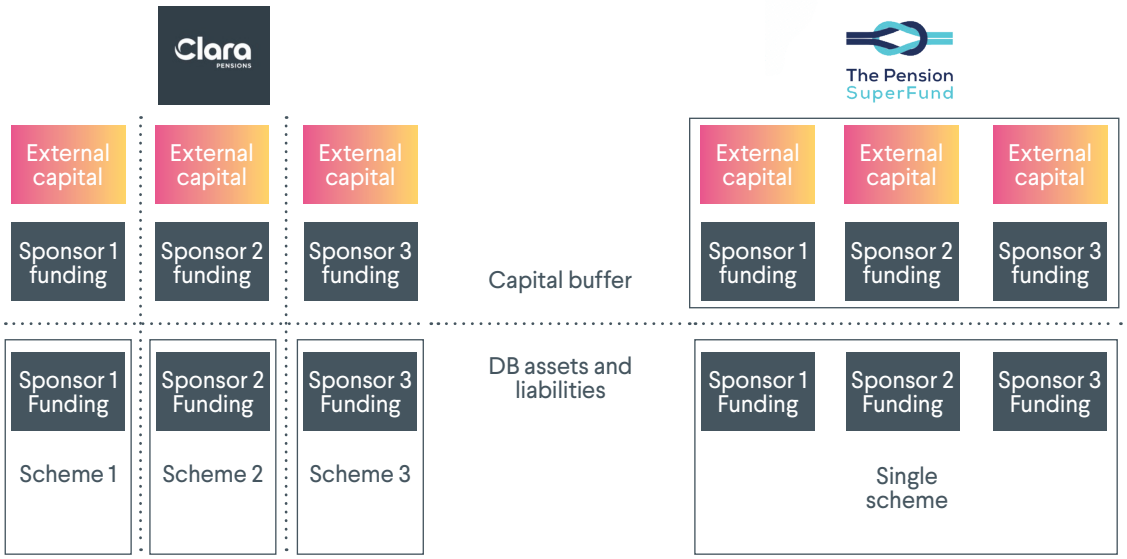
The consolidators require schemes to be very well funded before being accepted, which will often mean a top-up is required from the sponsor to facilitate the transfer. This cost will be lower than the cost of buying out the scheme in full with an insurer, meaning consolidators represent an opportunity for schemes and sponsors to enhance security for members despite not being able to afford to fully insure.



Commercial consolidators are currently new and untested, although the first transactions of this kind are expected by early 2019. While the Government acknowledged in the White Paper a desire to develop a framework for the authorisation, supervision and governance of new commercial consolidation vehicles, a transfer to a consolidator is possible under existing regulations. We expect that any transferring schemes will be looked at closely by the Pensions Regulator, which will likely provide full clearance for the first cases.

Current consolidators in the market

There are currently two main consolidators in the market – Clara-Pensions (Clara) and the Pension SuperFund (the PSF). While there are similarities between the two, there are also significant differences, and these are explored below and overleaf.



	Clara-Pensions (Clara)	The Pension SuperFund (PSF)
Target market	Up to £500m	£200m - £10bn
Full settlement of liabilities for sponsors	Yes	Yes
Ultimate objective	Buy-out liabilities in full with insurers	Long term run off
Structure	Fully sectionalised – each scheme represents a new section	Pooled assets and liabilities
Member benefits	Mirror originating scheme benefits. Schemes will have to be closed to future accrual before being able to transfer	
Investment strategy	Targeting around 0.5% p.a. outperformance above liabilities	Similar to the PPF which targets around 1.8% p.a. outperformance above liabilities
Governance	Trustee board will consist of three independent trustees, with no representatives from Clara. Recently announced the following three additions to its trustee board: • Alan Pickering (BESTrustees); • Michael Chatterton (Law Debenture); and • Frank Oldham (Independent Trustee Services)	Trustee board will comprise: • 2 member nominated trustees • 2 PSF representatives • 2 independent trustees: - Richard Wohanka (Chair) - Antony Miller (2020 Trustees)
Funding reserves (assets plus capital)	Assets plus capital supporting each section intended to be equal to the cost of buy-out on day one	Assets plus capital equal to 115% of PSF technical provisions
Top up required for entry	Top up to around 90% of buy-out, though this depends on the mix of pensioner and non-pensioner members	Top up to 105% of PSF technical provisions
PPF protection	Both expected to be backed by the PPF	
Terms on which capital can be drawn	The capital backing each section is only released once section is fully insured	Capital providers will draw a share of any outperformance when assets plus capital exceeds 115% of PSF technical provisions
Availability of additional capital	Neither vehicle is expected to have a requirement for additional capital to be injected if the initial capital outlay proves to be insufficient	
Upside potential	Any outperformance used to buy-out benefits earlier	Any additional surplus above 115% of PSF technical provisions is shared between capital backers and members. The funds allocated to members can be paid out as benefit improvements or retained as an additional buffer against future adverse experience

Comparison with buy-out

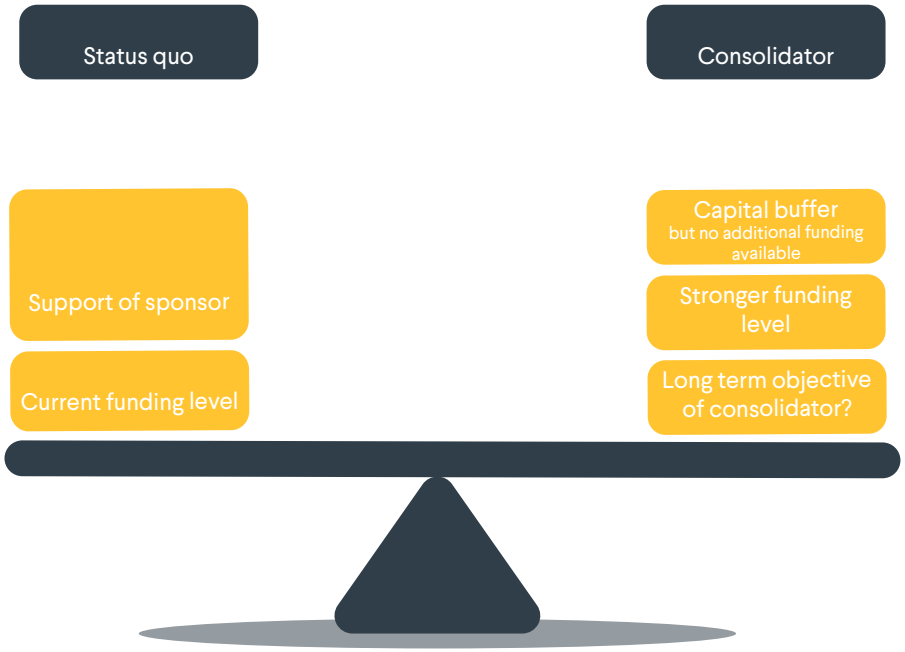
Consolidators represent an opportunity for sponsors to fully extinguish their liability to a defined benefit scheme for less than the cost of buy-out. But there's no such thing as a free lunch, and a cheaper solution will mean compromising in some areas, so how do these consolidators stack up against traditional insurance? The table below compares consolidators against buy-out.

Criteria	Buy-out	Consolidator
Cost	Higher cost reflecting stringent reserving requirements	Expected to be 10%-15% lower than insurance depending on the mix of pensioner and non-pensioner members
Reserves	High reserving requirements under Solvency II, with reserves designed to protect against 1 in 200 year events	Assets plus capital will be better than typical pension scheme funding but significantly lower than the reserves an insurer would hold
Additional layers of security	Capital requirements enforced by law; PRA oversight and intervention; protections afforded by the Financial Services Compensation Scheme	PPF, current funding regulations, potential additional future legislation and regulation, TPR and intervention
Risk management	Tightly managed and monitored by the PRA and subject to Solvency II. Asset-liability matching requirements and careful management of longevity risks	Governance from experienced professional independent trustees and advisers. Similar to a well-run large pension scheme
Benefit structure	Typically matches benefit due under original scheme's governing documentation	
Member options	Typically paid out based on insurer reserves, and generally more generous than original scheme	Likely to be similar to original scheme
Upside	None	PSF may pay out a share of outperformance above certain threshold. Clara does not provide upside to members other than being able to fully insure earlier than expected
Project risk	Low. Well-trodden path. Can be executed with minimal transaction risk if led by an experienced adviser	Currently high. Consolidators are new to the market, and they are yet to take on their first schemes. However, the first transactions are expected soon and so project risk is likely to reduce over time
Disclosure requirements	Significant disclosure requirements under Solvency II	Little, if any, disclosure requirements. Although, they will likely voluntarily disclose in order to give comfort to trustees of incoming schemes
Ability to transfer liabilities taken on	Part VII, a process governed by High Court (see p15)	Bulk transfer rules for pension schemes

Due to significantly higher reserves, enhanced risk management and adherence to a stringent insurance regulatory regime, buy-out will remain the 'gold standard' for settling members' benefits.

Who is this right for?

Ultimately, the decision regarding whether to transfer liabilities to a consolidator will lie with scheme trustees. Trustees will need to be satisfied that the transfer is in members' best interests. This will mean weighing up whether members are better off in the current situation with current funding and the sponsor covenant, or with the consolidator in a better funded scheme with contingent capital but no additional sponsor covenant.



So the key question is: what is the sponsor covenant worth? If it is less valuable than the enhanced funding offered by the consolidator, a transfer to the consolidator may be the way to go. Covenant advisers are clearly going to play a significant role in helping pension schemes answer this question, together with firms capable of modelling likely future member outcomes, within and out of the consolidators.

Schemes will also need to be sufficiently well funded on transfer to the consolidator. Bringing all this together, consolidators appear most appropriate for schemes which:

- Don't expect to be able to afford to buy-out for the foreseeable future.
- Have weaker sponsors, with significant risk that the sponsor will not be able to support the scheme through to buy-out in the longer term.
- Are reasonably well funded with a sponsor with short term cash available to top up the scheme to the funding level required by a consolidator.

Impact on the bulk annuity market

To put volumes into context, there are around £2.3 trillion of buy-out liabilities in the UK defined benefit pension universe, and volumes of buy-ins and buy-outs over the past few years have been around £12bn a year (around 0.5% of UK liabilities).

In the short term, we expect volumes transferring to consolidators to be modest, as the industry gets comfortable with the structure of consolidators and the security that these can offer their members.

Once the first few transfers have completed, it's not unreasonable to expect some (relative) snowballing as schemes with weaker sponsors and minimal hope of reaching buy-out become open to moving to a consolidator.

However, as we explored earlier, consolidators do not provide the same security as buy-out. Therefore, any scheme that expects to reach buy-out will likely keep this as their ultimate goal, meaning the volume of schemes looking to secure their members' benefits with buy-ins and buy-outs is unlikely to be materially impacted by consolidation.

It's also worth reiterating that the objective of Clara, in particular, is to eventually buy-out the liabilities they take on. Therefore, success for Clara will mean sweeping up liabilities for schemes with weaker sponsors and insuring them over time, which would actually buoy buy-out volumes.

While we do expect meaningful volumes of transfers to consolidators, it is unlikely that commercial consolidators will materially impact bulk annuity volumes for the foreseeable future.

Future expectations

With a good number of sponsors struggling to support their schemes, and a number of recent high profile collapses of well-known companies supporting underfunded pension schemes, it appears there is a good market for commercial consolidators to provide enhanced member security for some schemes and reduce the ongoing burden on sponsors. However, buy-out will remain the gold standard outcome, and we still expect most members to ultimately have their benefits secured with annuity policies.

It will be interesting to see how this market develops, particularly over the next year. We expect to see new consolidators being set up over time, and perhaps some changes to the current consolidators as they align their offering to the Pensions Regulator's expectations and any developing regulation. Indeed, we've already seen a big shake up at the Pension SuperFund, with Alan Rubenstein stepping down as CEO in September 2018.

Both Clara and the PSF are in advanced discussions with a number of schemes considering transfer, and we expect to see the first transactions by the start of 2019. While the eventual success of this new proposition is unknown, clearly the addition of a new end game solution will be a welcome one for the DB pensions industry.

Kieran Mistry
Risk Transfer Specialist
Kieran.Mistry@hymans.co.uk

You have been told that your scheme is expensive to insure – what are your options?

"Expensive" in this context is less about absolute cost and more about value. The premium required to insure some benefits can look expensive when compared to the premium required to insure other benefits. This tends to be the case when the scheme has benefits with some of the following characteristics:

- **CPI linked pension increases**
  Insurers need to hedge their inflation risk exposures or hold additional reserves. Due to lack of supply, the cost of hedging consumer price index (CPI) linked inflation is high relative to hedging retail price index (RPI) linked inflation. Insurers either need to incur higher hedging costs, or hedge using RPI instruments and hold additional reserves for the CPI/RPI "wedge" risk. Both of these approaches result in higher costs to the insurer which need to come through in the insurance premium. Buy-in pricing for CPI linked benefits has improved significantly over the last couple of years, but still looks expensive when compared to typical views on the expected long-term difference between RPI and CPI.

- **Tight caps and floors on inflation linked pension increases**
  The cost of hedging inflation with caps and floors can be high and insurers therefore tend to dynamically manage their inflation risks (similarly to pension scheme LDI mandates). Caps and floors on pension increases mean that an insurer's exposure to inflation risk changes in size and nature as the current level of inflation changes. When pension increases are floored and capped in a narrow band, the costs and risks associated with managing inflation exposure increase and these come through in a higher buy-in premium.

- **Complex pension increases or underpins**
  Pensions that have complex increases (for example, annual increases that are the higher of two different measures), or have complex underpins present two issues. Firstly, it may well not be possible for an insurer to hedge the actual benefit increase and so the insurer will either over-hedge or find as close a proxy as possible and hold capital against the mismatch. Secondly, the cost of administering the benefits is greater.

As a result, insuring benefits with these complexities can be uneconomical. In these circumstances, trustees and sponsors have the following options:

1. **Insure better value benefits and retain basis risk**
   When securing a buy-in, trustees do not need to insure the same benefits as the scheme pays to members. The scheme may be able to identify a close, but not exact, match to the payments to members that is better value to insure. With the scheme then accepting the mismatch ("basis risk") in order to obtain better value insurance.

   This is the most straightforward way to avoid insuring expensive benefits and there are a number of examples where schemes have followed this route (for example, the Land Securities buy-in in 2017 excluded cover for the inflation floor on pension increases). The key downside to this approach is that, while the trustee can retain basis risk, at the point of issuing individual insurance policies to members these must match the actual benefits due. This means that the buy-in will need to be adjusted at the point of buy-out and the terms for this conversion are uncertain at the time of entering into the buy-in. Therefore, whether this is an appropriate approach will depend on the saving in the buy-in price from retaining the basis risk and the expected timeframe to buy-out over which the scheme can enjoy the benefits of that saving.

2 **Provide members with the option to change their benefits**

A pension increase exchange ("PIE") exercise can be designed to give members the option of changing the elements of the benefit structure that are expensive to insure for a benefit structure that can be insured on better value terms. This can be a "win-win" by using the savings from insuring less expensive benefits to uplift the benefits of those members who opt to change their benefits.

The key drawback of this approach is that member take up of the option is uncertain and a low take up will mean that the scheme still has material liabilities that are expensive to insure.

3 **Convert benefits without member consent**

Most scheme rules allow trustees and sponsors to modify members' benefits. Such changes to accrued benefits can only be made without members' consent if they meet the requirements of section 67 of the Pensions Act 1995. A key part of these requirements is that, at the time of the change, the value of each member's benefits is not reduced – the benefits after the change must be at least "actuarially equivalent" to the benefits before the change.

For some schemes with particularly complex pension increases, it is possible to change these for simpler pension increases that have equivalent or even better actuarial value, but cost less to insure. These situations are not common, but are well worth exploring given the potential to both enhance members' benefits and reduce buy-out costs for the sponsor.

Richard Wellard
Partner & Risk Transfer Specialist
Richard.Wellard@hymans.co.uk

Appendix 1: Risk transfer market data

Buy-outs and buy-ins – transactions during twelve month period ending 30 June 2018

The total value of buy-out and buy-in transactions struck in the last year was around £14.9 billion.

Buy-out and buy-in transactions	Number of transactions completed			Value of transactions completed		
	H2 2017	H1 2018	Total	H2 2017	H1 2018	Total
Aviva	23	33	56	£1,719m	£1,539m	£3,258m
Canada Life	3	0	3	£268m	£m	£268m
Legal & General	16	7	23	£1,901m	£507m	£2,408m
Pension Insurance Corporation	16	15	31	£1,756m	£3,257m	£5,013m
Phoenix	0	1	1	£m	£470m	£470m
Just	15	estimated as 15	30	£703m	£718m	£1,421m
Rothesay Life	2	1	3	£555m	£170m	£725m
Scottish Widows	3	4	7	£240m	£1,105m	£1,345m
Total	78	76	154	£7,142m	£7,766m	£14,908m

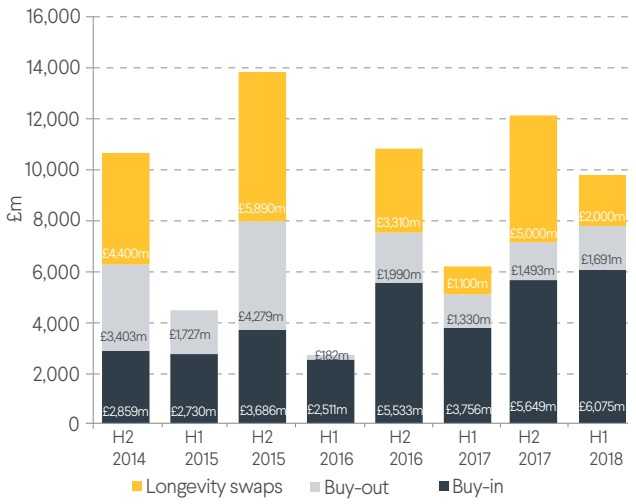
Longevity swaps – transactions during twelve month period ending 30 June 2018

There were three longevity swaps in the last year covering £7.0 billion of liabilities. Forty three transactions, covering liabilities worth over £67 billion, have been completed since 30 June 2009.

Organisation	Date	No. of pension schemes	Provider	Approximate Value
Babcock	Q3 2009	3	Credit Suisse	£1.2 bn
RSA Insurance	Q3 2009	2	Rothesay Life	£1.9 bn
Berkshire	Q4 2009	1	Swiss Re	£1 bn
BMW	Q1 2010	1	Abbey Life	£3 bn
Pall	Q1 2011	1	JP Morgan	£0.1 bn
ITV	Q3 2011	1	Credit Suisse	£1.7 bn
Rolls Royce	Q4 2011	1	Deutsche Bank	£3 bn
British Airways	Q4 2011	1	Rothesay Life	£1.3 bn
Pilkington	Q4 2011	1	Legal & General	£1 bn
Azko Nobel	Q2 2012	1	Swiss Re	£1.4 bn
LV=	Q4 2012	1	Swiss Re	£0.8 bn
BAE Systems	Q1 2013	1	Legal & General	£3.2 bn
Bentley	Q2 2013	1	Abbey Life	£0.4bn
Carillion	Q4 2013	5	Deutsche Bank	£1bn
AstraZeneca	Q4 2013	1	Deutsche Bank	£2.5bn
BAE Systems	Q4 2013	2	Legal & General	£1.7bn
Aviva	Q1 2014	1	Own insurer conduit- Munich Re, Scor Se and Swiss Re	£5bn
BT	Q2 2014	1	Own insurer conduit - PICA	£16bn
PGL	Q3 2014	1	Own insurer conduit - Phoenix Life	£0.9bn
MNOPF	Q4 2014	1	Own insurer conduit - Pac Life Re	£1.5bn
ScottishPower	Q4 2014	1	Abbey Life	£2bn
AXA UK	Q3 2015	1	Own insurer conduit - RGA	£2.8bn
Heineken	Q3 2015	1	Aviva	£2.4bn
RAC (2003) Pension Scheme	Q4 2015	1	Own insurer conduit - Scor Se	£0.6bn
Unnamed	Q4 2015	1	Zurich	£0.09bn
Pirelli Tyres Limited	Q3 2016	2	Zurich	£0.6bn
Manweb Group	Q3 2016	1	Abbey Life	£1bn
Unnamed	Q4 2016	1	Zurich	£0.05bn
Unnamed	Q4 2016	1	Legal & General	£0.9bn
Skanska	Q1 2017	1	Zurich	£0.3bn
SSE	Q2 2017	1	Legal & General	£0.8bn
Marsh & McLennan Companies	Q3 2017	1	Own insurer conduit - Canada Life Re and PICA	£3.4bn
BA	Q3 2017	1	Own insurer conduit - Canada Life Re and Partner Re	£1.6bn
National Grid	Q2 2018	1	Zurich	£2bn
Total to date		43		£67.1bn

Risk transfer transactions (including longevity swaps)

Total pension scheme risk transfer transactions over the last year covered liabilities of around £21.9 billion. Since 30 June 2009 the longevity swap market has now seen deals covering over £67bn of liabilities.

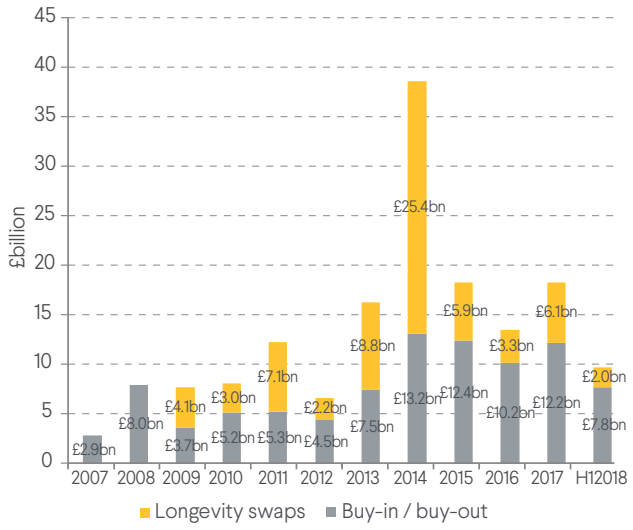


Average buy-in and buy-out transaction size

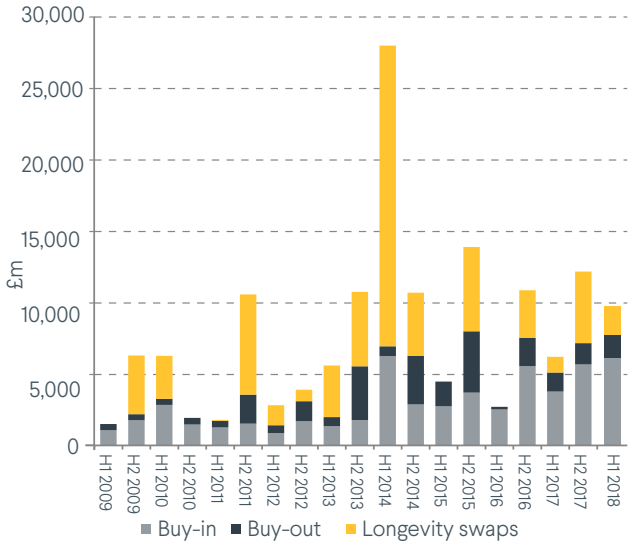
The overall average buy-in/buy-out transaction size for the last year was £97m, which has decreased compared with the average of £150m over the year to 30 June 2017. The average transaction size during the last year varied significantly between the different insurers.

Insurers	Average transaction value
Aviva	£58m
Canada Life	£89m
Legal & General	£105m
Pension Insurance Corporation	£162m
Phoenix	£470m
Just	estimated as £47m
Rothesay Life	£242m
Scottish Widows	£192m
Totals	£97m

Volume of risk transfer transactions since 2007 up to H1 2018



Half-yearly risk transfers since 2009



Appendix 2

Insurer summary insights

Insurer summary insights

Aviva

November 2018

2009 to end of H1 2018

Transactions completed	Value of transactions	Annual variation in transaction volume	Average transaction size
>420	> £8.7bn	£0.5bn	£21m

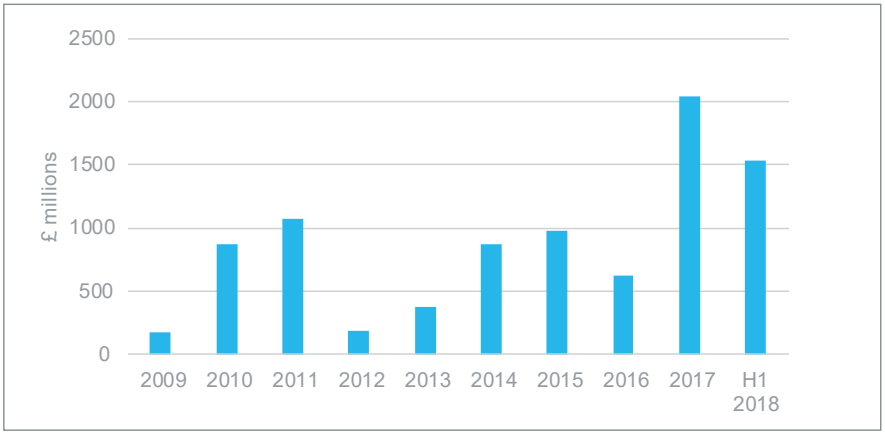
Twelve month period ending 30 June 2018

Market share	Number of transactions	Average transaction size
22%	56	£58m

Noteworthy recent transactions

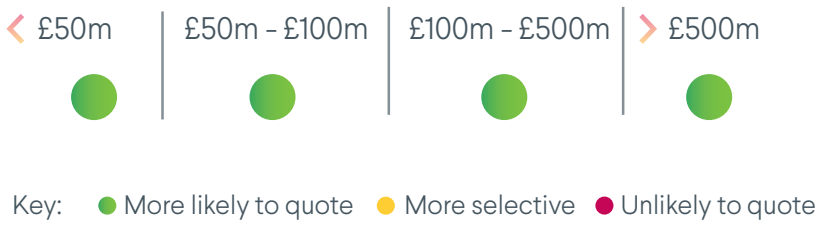
Aviva completed a £925m buy-in with the M&S Pension scheme, their largest transaction to date.

Aviva – volume of pension scheme buy-in and buy-out transactions



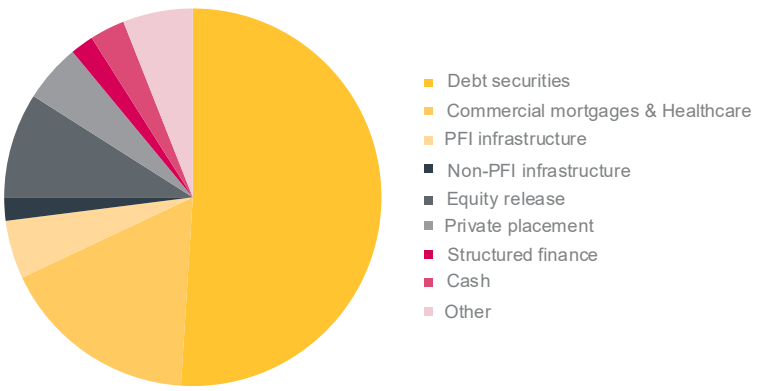
Appetite by transaction size

Aviva



Source: Hymans Robertson research

Annuity asset strategy



Source: BPA and Private Debt Seminar – 22 January 2018

Financial strength – Aviva Annuity

S&P Financial Strength Rating

A+

(July 2018) Note: parent company rating – Aviva Life & Pensions.

Moody's Insurance Financial Strength Rating

Aa3

(October 2017)
Note: parent company rating – Aviva Life & Pensions.

AKG

"A" (superior)

(as at January 2018) Ratings are by AKG Financial Analytics Ltd and are reproduced with permission.

Recent developments

Following Tom Ground's appointment as Managing Director of Aviva's Defined Benefit Solution's team in Autumn 2017, Aviva have shown a renewed strategic focus on bulk annuity transactions, and have been very active in all areas of the market.

Insurer summary insights

Canada Life

November 2018

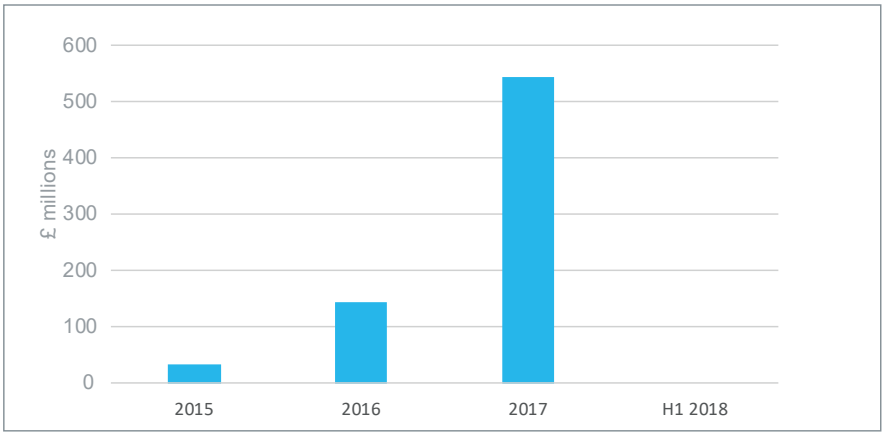
Since 2015 to end of H1 2018

Transactions completed	Value of transactions	Annual variations in transaction volume	Average transaction size
12	**£720m**	**£0.3bn**	**£60m**

Twelve month period ending 30 June 2018

Market share	Number of transactions	Average transaction size
2%	**3**	**£89m**

Canada Life: volume of pension scheme buy-in and buy-out transactions



Noteworthy recent transactions

Canada Life completed a £351m pensioner buy-in with the AA UK Pension Scheme in September 2018.

Canada Life completed a £271m buy-in with Hays Recruitment in August 2018.

Appetite by transaction size
Canada Life

< £50m	£50m - £100m	£100m - £500m	> £500m
●	●	●	●

Key: ● More likely to quote ● More selective ● Unlikely to quote

Source: Hymans Robertson research

Financial strength – Canada Life Limited

S&P Financial Strength Rating

AA
(November 2017)
Note: parent company rating – The Canada Life Assurance Company.

Moody's Insurance Financial Strength Rating

Aa3
(April 2018)
Note: parent company rating – The Canada Life Assurance Company.

AKG

B+ (very strong)
(as at May 2018) Ratings are by AKG Financial Analytics Ltd and are reproduced with permission.

Recent developments

Canada Life continue to write a relatively small number of transactions, though of increasing size and have completed material volumes in the second half of 2018.

Insurer summary insights

Just

November 2018

Since 2009 to end of H1 2018

Transactions completed	Value of transactions	Annual variations in transaction volume	Average transaction size
› 150	› £4.6bn	£0.3bn	£31m

Twelve month period ending 30 June 2018

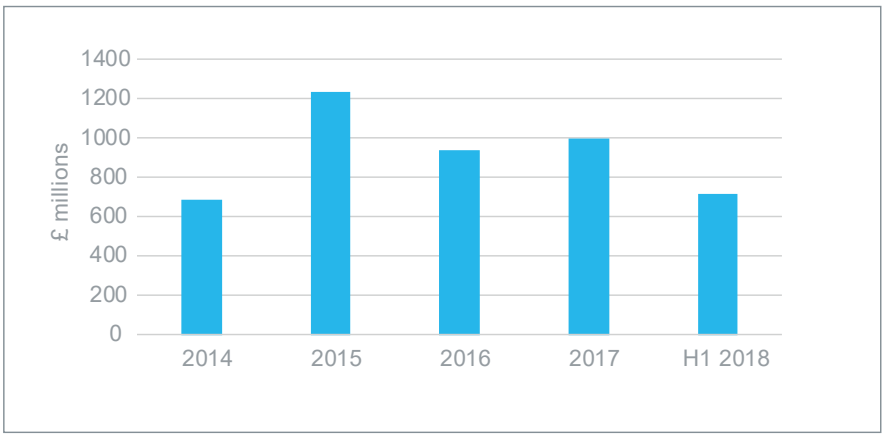
Market share	Number of transactions	Average transaction size
10%	30	£47m

Above figures based on the assumption that the average size of transactions completed by Just in H1 2018 was in line with H1 2017.

Noteworthy recent transactions

Aliaxis scheme completed an £85m buy-in with Just Group in June 2018.

Just – volume of pension scheme buy-in and buy-out transactions



Appetite by transaction size

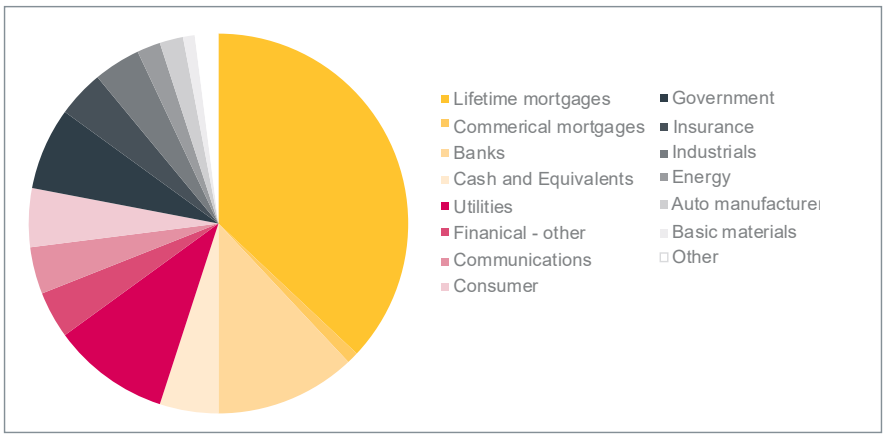
Just

< £50m	£50m - £100m	£100m - £500m	> £500m
●	●	● ●	●

Key: ● More likely to quote ● More selective ● Unlikely to quote

Source: Hymans Robertson research

Annuity asset strategy



Source: 2017 Annual Results Presentation

Financial strength

Just Retirement

AKG

"B+" (very strong)

(March 2018)

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Partnership

AKG

"B+" (very strong)

(March 2018)

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Recent developments

Just wrote £0.7bn in the first half of the year. In August, Just announced they acquired a majority shareholding in Corinthian Pension Consulting, aiming to help trustees of defined benefit schemes run bulk member option exercises. Just have noted that the outcome of the PRA's consultation on equity release mortgages (see p. 24) could have a material impact on their capital position. They are actively considering a number of capital management options that could be deployed once the consultation process is complete, and have deferred any shareholder dividend declaration until there is greater clarity.

Insurer summary insights

Legal & General

November 2018

Since 2009 to end of H1 2018

Transactions completed	Value of transactions	Annual variation in transaction volume	Average transaction size
›630	**› £20.7bn**	**£1.4bn**	**£33m**

Twelve month period ending 30 June 2018

Market share	Number of transactions	Average transaction size
16%	**23**	**£105m**

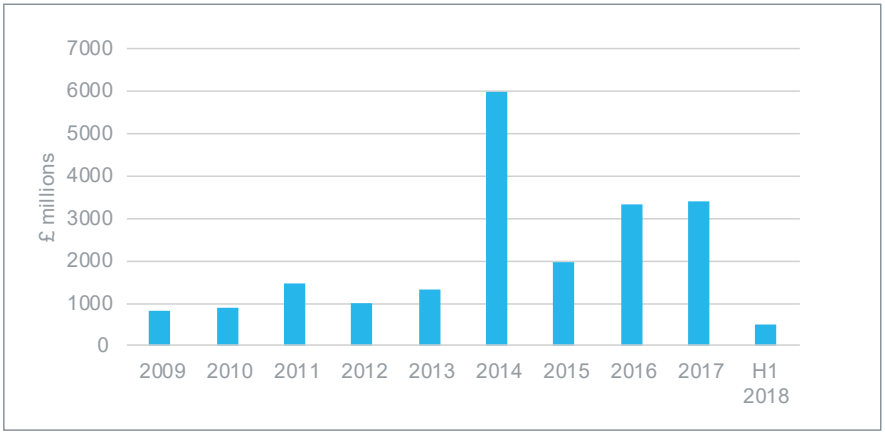
Noteworthy recent transactions

Legal & General completed a record £4.4bn pensioner buy-in with the British Airways sponsored Airways Pension Scheme in September 2018.

They also completed a £285m buy-in with an as yet unnamed Fortune 500 Company in September 2018.

The Nortel Scheme secured benefits in excess of the PPF in a £2.4bn buy-out with Legal & General, announced in October 2018. This deal covers the benefits of more than 15,500 pensioners and 7,200 deferred members.

L&G – volume of pension scheme buy-in and buy-out transactions



Appetite by transaction size

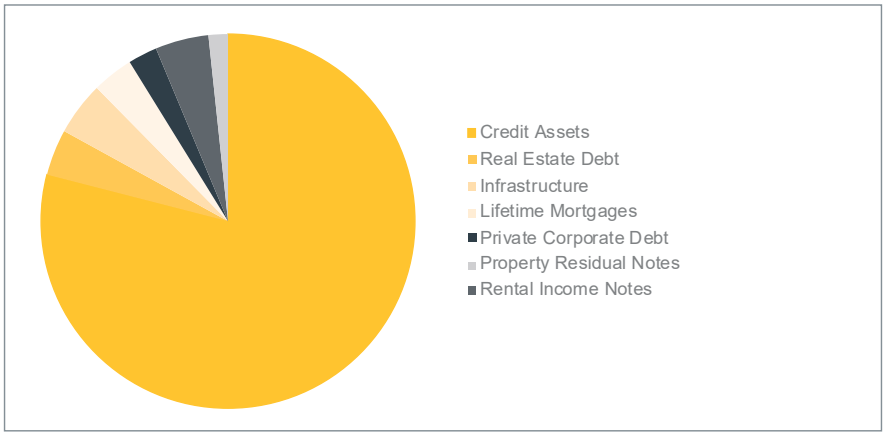
Legal & General

< £50m	£50m - £100m	£100m - £500m	> £500m
●	●	●	●

Key: ● More likely to quote ● More selective ● Unlikely to quote

Source: Hymans Robertson research

Annuity portfolio



Source: 2017 Annual Results Presentation

Financial strength – Legal & General Assurance Society

S&P Financial Strength Rating

AA-

(July 2018)

Moody's Insurance Financial Strength Rating

Aa3

(June 2017)

AKG

"B+" (very strong)

(April 2018)

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Recent developments

After writing £0.5bn in the first half of 2018, L&G announced that they were in exclusive talks with pension schemes looking to transact on a further £7bn of liabilities, which was shortly followed by the publication of their record £4.4bn pensioner buy-in with the Airways Pension Scheme and £2.4bn buy-out of the Nortel Networks UK Pension Plan.

Insurer summary insights

Pension Insurance Corporation

November 2018

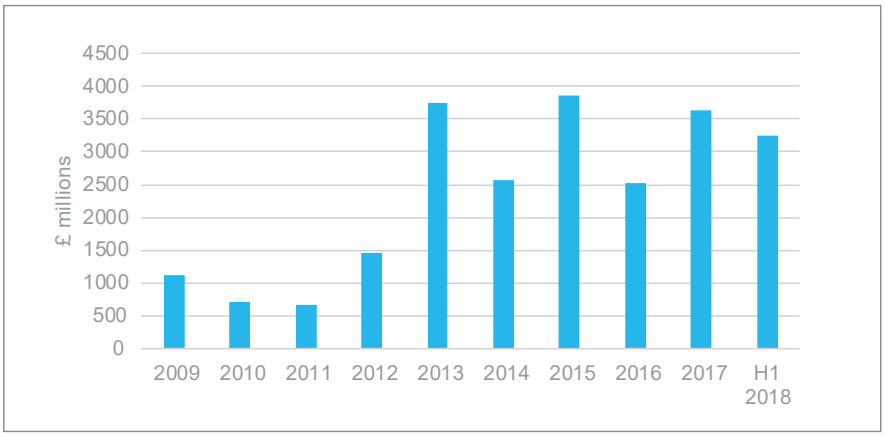
Since 2009 to end of H1 2018

Transactions completed	Value of transactions	Annual variation in transaction volume	Average transaction size
>170	> £23.5bn	£1.1bn	£138m

Twelve month period ending 30 June 2018

Market share	Number of transactions	Average transaction size
34%	31	£162m

PIC – volume of pension scheme buy-in and buy-out transactions



Noteworthy recent transactions

Approximately 9000 members of the two former BHS pension schemes who didn't transfer to the PPF or receive a cash lump sum have had their benefits secured via an £800m buy-out with PIC, in August 2018.

PIC completed a £75m buy-out of the Menzies Pension Fund, in August 2018. This was a bespoke deal involving premium payments in instalments.

In July 2018, PIC entered into a £1.3bn pensioner buy-in with the Siemens Benefits Scheme.

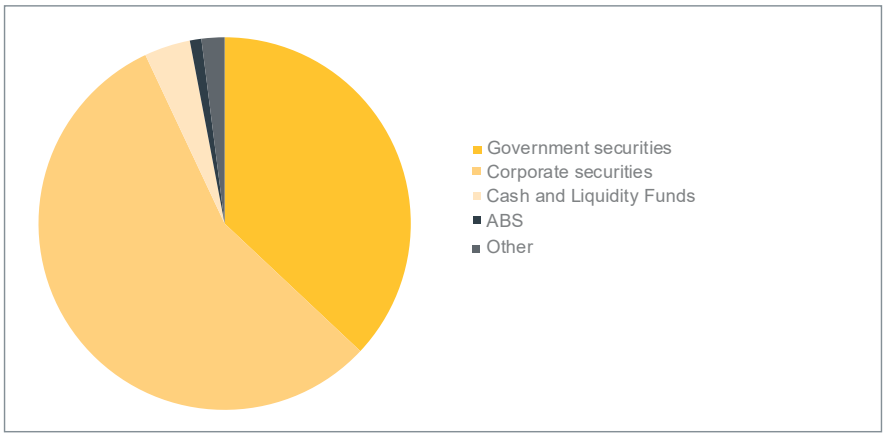
Appetite by transaction size
Pension Insurance Corporation

< £50m	£50m - £100m	£100m - £500m	> £500m
●	●	●	●

Key: ● More likely to quote ● More selective ● Unlikely to quote

Source: Hymans Robertson research

Annuity asset strategy



Source: Annual Report and Accounts for 2017

Financial strength

AKG

"B" (strong)

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Recent developments

PIC have had a change in their financial backers, with Abu Dhabi Investment Authority buying a 21.4% stake from private equity group JC Flowers (in June 2018), one of the founding investors in PIC when they started up back in 2006. Considering transactions completed to date and those in exclusivity, we expect to see PIC write in excess of £6bn of bulk annuity business over the entirety of 2018.

Insurer summary insights

Phoenix Life

November 2018

Recent transactions

Longevity swap converted to buy-in

£1.2bn

converted longevity swap with own Phoenix Group Life Pension Scheme

Buy-in

£470m

Marks & Spencer's buy-in in Q2 2018

Appetite by transaction size

Phoenix

< £50m	£50m - £100m	£100m - £500m	> £500m
●	●	● ●	●

Key: ● More likely to quote ● More selective ● Unlikely to quote

Source: Hymans Robertson research

Financial strength

AKG

"B" (strong)

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Recent developments

After writing their internal buy-in with Phoenix Group's own pension scheme, Phoenix Life has now written its first external pension deal – a £470m pensioner buy-in with the Marks & Spencer Pension Scheme.

Insurer summary insights

Rothesay Life

November 2018

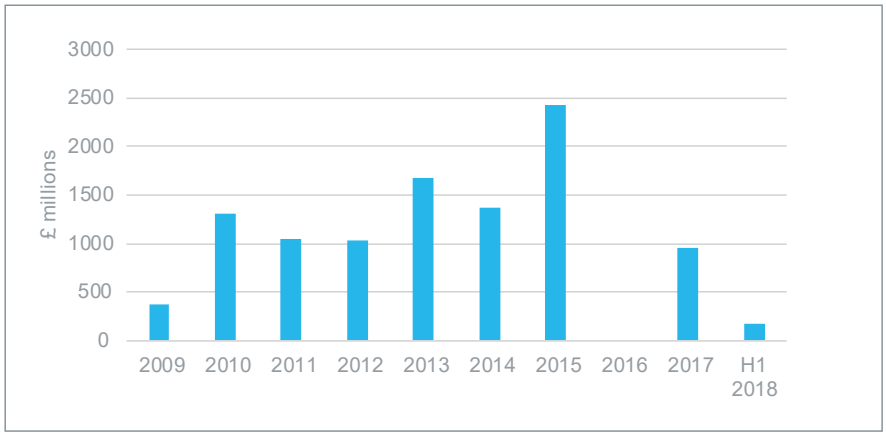
Since 2009 to end of H1 2018

Transactions completed	Value of transactions	Annual variation in transaction volume	Average transaction size
>30	>£10.3bn	£0.8bn	£313m

Twelve month period ending 30 June 2018

Market share	Number of transactions	Average transaction size
5%	3	£242m

Rothesay Life – volume of pension scheme buy-in and buy-out transactions



Noteworthy recent transactions

Earlier this year, Rothesay Life took on £12 billion of Prudential's existing annuity business.

In Q3 2017, Rothesay Life completed a £450m buy-out of the Post Office section of the Royal Mail Pension Plan.

In May 2018, Rothesay secured a full buy-out of the Toshiba pension scheme – about two thirds of the members were deferred.

Appetite by transaction size

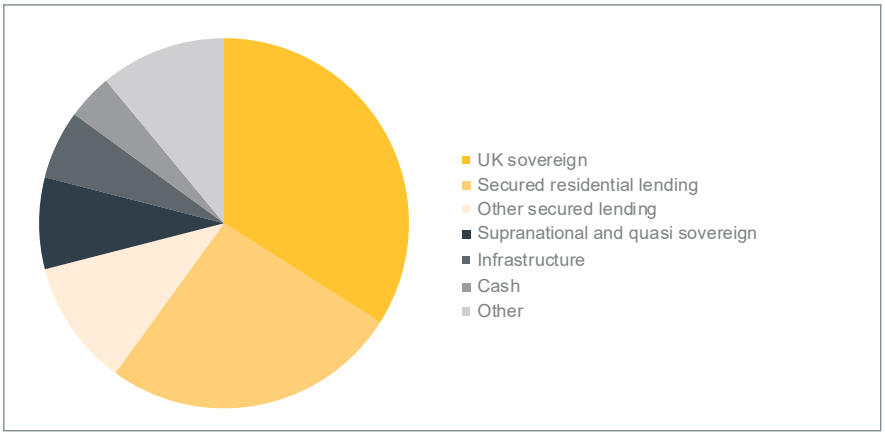
Rothesay Life

< £50m	£50m - £100m	£100m - £500m	> £500m
●	●	● ●	●

Key: ● More likely to quote ● More selective ● Unlikely to quote

Source: Hymans Robertson research

Annuity portfolio



Source: Annual Report and Accounts for 2017

Financial strength

AKG

"B" (strong)
(June 2018) Ratings are by AKG Financial Analytics Ltd and are reproduced with permission.

Moody's Insurance Financial Strength Rating

A3 (strong)
(July 2018)

Recent developments

Rothesay Life have continued to actively look to write pension scheme business despite taking on £12 billion of Prudential's existing annuity business earlier this year, evidenced by their buy-out transaction with Toshiba's pension scheme around the same time. This is in contrast to when they wrote their previous back book transaction with Aegon in 2016, following which Rothesay were not active in the market for the rest of the year while they bedded in that transaction.

Insurer summary insights

Scottish Widows

November 2018

2009 to end of H1 2018

Transactions completed	Value of transactions	Annual variations in transaction volume	Average transaction size
17	**›£3.6bn**	**£1.0bn**	**£213m**

Twelve month period ending 30 June 2018

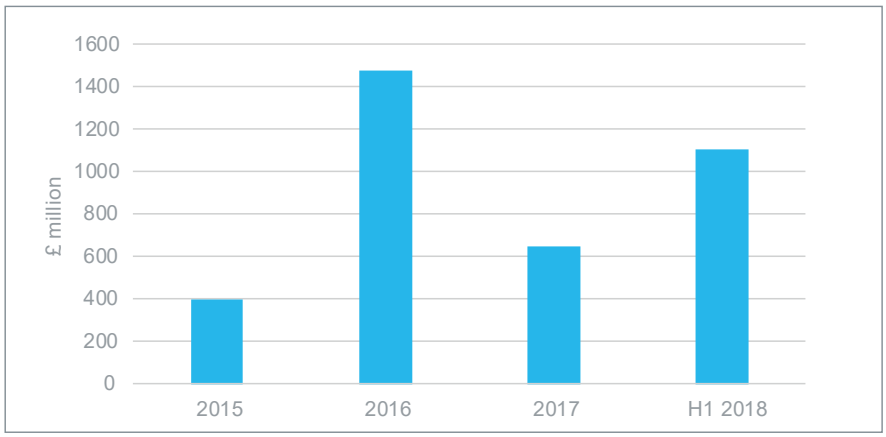
Market share	Number of transactions	Average transaction size
9%	**7**	**£192m**

Noteworthy recent transactions

Scottish Widows completed a £50m buy-in with the FTSE 250 company Greene King (for the Spirit Pension Scheme) in September 2018.

In May 2018, Scottish Widows agreed an £880m pensioner buy-in with Littlewoods.

Scottish Widows: volume of pension scheme buy-in and buy-out transactions



Appetite by transaction size

Scottish Widows

< £50m	£50m - £100m	£100m - £500m	> £500m
●	●	●	●

Key: ● More likely to quote ● More selective ● Unlikely to quote

Source: Hymans Robertson research

Financial strength

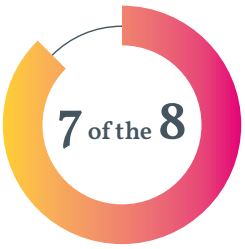
S&P Financial Strength Rating	Moody's Insurance Financial Strength Rating	AKG
A (November 2017)	**A2** (August 2017)	**"B+"** (very strong) (as at February 2018) Ratings are by AKG Financial Analytics Ltd and are reproduced with permission.

Recent developments

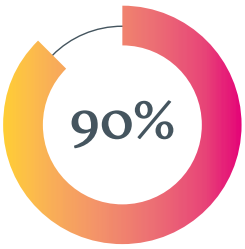
Scottish Widows recently hired Matt Wilmington as Head of Origination and Structuring, who was previously a Director in Legal & General's bulk annuity team. In May, Scottish Widows announced they had written their largest buy-in to date – an £880m pensioner buy-in with the Littlewoods Pension Scheme.

Proven experience and unrivalled innovation

The reason we look across the whole process and supply chain of risk transfer is to provide you, our clients, with the best insight, helping you achieve a better solution at the right price for you. We really understand how insurers and reinsurers work. Indeed we separately advise:

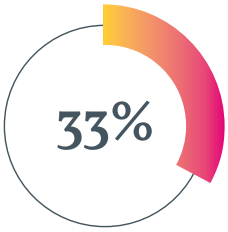


insurers who offer buy-ins



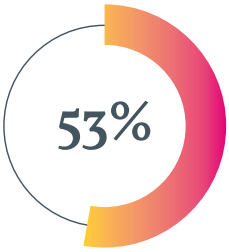
of reinsurers who hedge longevity risk

Our expertise means that we have advised on over 100 risk transfer transactions, and:



of **all** risk transfer deals (by value)

FTSE 100 risk transfer transactions



of **all** longevity swaps (by value)

transactions **over £100m** (since 2011)

Is it time to transfer risk?

Please get in touch with me or any of my colleagues featured in this report if you'd like to chat through options for your scheme.

James Mullins
Partner and Head of Risk Transfer Solutions
T: 0121 210 4379
E: James.Mullins@hymans.co.uk
@jamesrmullins

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CLUB VITA

London | Birmingham | Glasgow | Edinburgh T 020 7082 6000 | www.hymans.co.uk | www.clubvita.co.uk

Derivatives

All forms of derivatives can provide significant benefits, but may involve a variety of significant risks. Derivatives, both exchange-traded and OTC, include options, forwards, swaps, swaptions, contracts for difference, caps, floors, collars, combinations and variations of such transactions, and other contractual arrangements (including warrants) which may involve, or be based upon one or more of interest rates, currencies, securities, commodities, and other underlying interests. The specific risks presented by a particular derivative transaction depends upon the terms of that transaction and your circumstances. It is important you understand the nature of these risks before entering into a derivative contract.In general, however, all derivatives involve risk including (amongst others) the risk of adverse or unanticipated developments of a market, financial or political nature or risk of counter-party default. In addition, you may be subject to operational risks in the event that your manager(s) does not have in place appropriate legal documentation or internal systems and controls to monitor exposures of this nature.

In particular, we draw your attention to the following: -

- Small changes in the price of the underlying security can lead to a disproportionately large movement, unfavourable or favourable, in the price of the derivative.
- Losses could exceed the amount invested. There may be a total loss of money/premium. Further, an investor may be called on to make substantial additional payments at short notice. Failure to do so in the time required can result in additional loss.
- The right to subscribe is invariably time limited; if such a right is not exercised within the pre-determined timescale, the derivative may be rendered worthless.
- Not all derivatives are liquid (that is, they may be difficult or, at times, impossible to value or sell). You may incur substantial costs if you wish to close out your position. OTC derivatives in particular can introduce significant liquidity risk and other risk factors of a complex character.
- OTC derivatives may result in exposure to the creditworthiness of the derivative counter-party.
- Derivatives used as part of 'protection' strategies may still expose the investor to an unavoidable difference between the underlying asset (or other interest) and the protection offered by the derivative.