KEEP CALM AND CARRY ON DE-RISKING

De-risking report 2021

January 2021

Willis Towers Watson

In 2020 WTW was the lead adviser to:

20 buy-ins
for 19 schemes

Three £1bn+
buy-ins

Twelve £100m+
buy-ins

5 longevity swaps

Deals with **all 8** insurers

Over £23bn
of completed deals

Longevity swaps covering
£14.7bn of liabilities

£8.6bn of bulk annuities completed

Source: Willis Towers Watson, December 2020

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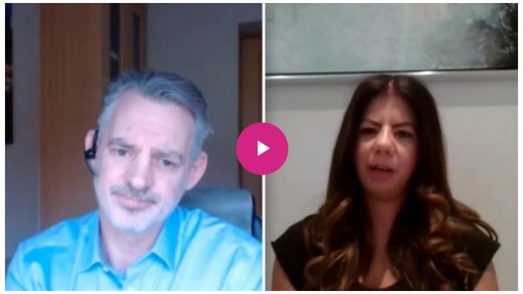
Welcome to Willis Towers Watson's 2021 de-risking report in which our experts look at the current hot topics and key themes in the bulk annuity, longevity hedging and superfunds markets and predict what trends may emerge in this market over the next year.

2020 was another incredibly busy year in the bulk annuity and longevity hedging markets. We were delighted to lead transactions for clients of all sizes, ranging from the £2.5m PPF+ buyout for the BHS Senior Management Scheme (which you can read more about on page 8) to the largest transactions of 2020 with both a £3.3bn confidential buy-in (the market's largest bulk annuity) and £10bn of longevity swaps for the Lloyds Banking Group pension schemes (the market's largest longevity swap). Overall, we led 25 deals covering more than £23bn of liabilities.

As well as hearing from our experts in this report, in early December 2020 I filmed a discussion with Uzma Nazir, Head of Structuring at Pension Insurance Corporation (PIC), in which we debated what the top three trends in the market were, as well as sharing some of our memories from 2020. The video of this discussion is embedded in the link below and we hope you find this an interesting overview of the key issues in the market.



The top three trends in the de-risking market for 2020

In our discussion, Uzma and I concluded that our top three trends in the market for 2020 were:

1. **COVID-19** – We couldn't not mention the on-going pandemic in our key themes. In spite of the pandemic, 2020 was the second biggest year on record in the bulk annuity market and the pricing achieved on deals was some of the most attractive ever seen in this market. Uzma and I agreed that COVID-19 hadn't had a significant impact on the total volumes written in 2020 but the longer-term impact of COVID-19 on longevity pricing is still unclear and so will be one of the key points to watch in 2021 and beyond.
2. **Transaction sizes** – We haven't seen the repeat of the mega-deals of 2019 but we are continuing to see large transactions in this market, with five schemes completing bulk annuities over £1bn in 2020, including three that were led by Willis Towers Watson. Further, Uzma commented that, from PIC's perspective, £500m deals are coming to be seen as "medium-sized" deals.
3. **PPF+ buyouts** – There have been several examples this year, including the Old British Steel Pension Scheme, where, following sponsor insolvency, schemes have managed to insure benefits for members in excess of the level of compensation that would be provided by the Pension Protection Fund (PPF). In a continuingly challenging environment for many sponsors, this is a theme that we (unfortunately) expect to continue.

These trends and other topical articles, including those that didn't quite make our top three trends, on schemes with a surplus on buyout and Third Party Capital Solutions, are commented on further in the remainder of our report.

We would welcome the chance to discuss further with you how you can take advantage of opportunities in this market for your scheme.

Ian Aley
Head of Transactions

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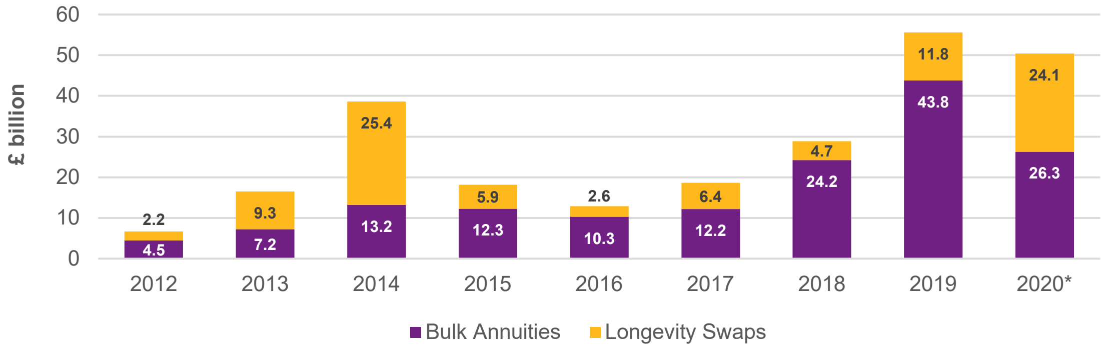
Despite the challenges of the year, the high level of bulk annuity and longevity hedging activity seen in the last few years continued in 2020, with over £50bn of liabilities transferred to the insurance sector. In addition, the Pensions Regulator's announcement in June on how it will oversee and authorise superfunds has opened up further options for sponsors and trustees looking to secure member benefits. **Jenny Neale** looks back at the trends of 2020.

Activity in the market during 2020

2018 and 2019 showed a stepped increase in the volume of bulk annuity business relative to previous years, in part due to a period of consistently attractive pricing and an improvement in schemes' funding levels. 2020 continued that trend, with over £26bn of liabilities transferred to the insurance market through a buy-in or buyout, and longevity swaps put in place for a further £24bn of liability (as shown in Figure 1).

Around two-thirds of the liabilities secured through bulk annuities in 2019 – some £30bn – were for deals of over £1bn, which affected the dynamic of the market and meant that, on occasion, some smaller schemes found it harder to access the market as resource constraints meant that insurers focused their efforts on larger transactions. In contrast, less than half of the liabilities secured through bulk annuities in 2020 – around £10bn – were for deals in excess of £1bn, meaning smaller and mid-sized schemes were able to get much better traction with insurers.

Figure 1 – Volumes of business by year



Source: Willis Towers Watson, December 2020

* Transactions led by Willis Towers Watson or publicly announced to date

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Figure 2 – Transactions in 2020

	Led by WTW	
	Number of transactions	**Liability insured (£bn)**
Buy-in / buyout		
- Less than £100m	8	0.4
- £100-500m	8	1.6
- £500m +	4	6.6
Bulk annuities total	**20**	**8.6**
Longevity swaps	**5**	**14.7**

Source: Transactions led by Willis Towers Watson and publicly announced to date, December 2020

The longevity swap market in 2020 was close to its largest year on record for the size of liabilities secured. This was, in part, due to the level of pricing seen – pricing for longevity swaps was very attractive and favourable relative to historic prices.

2020 also saw two longevity swaps transferred from a pension scheme to an insurer as part of a buy-in or buyout (otherwise known as a novation). These transactions demonstrate how longevity swaps can form a useful part of a de-risking plan without hindering the opportunity to convert to buy-in or buyout when asset values determine the time is right, providing the longevity swap terms are appropriately negotiated at the outset. One of the novations was as part of a £1.6bn buy-in for the Merchant Navy Officers Pension Fund in February, which you can read more about in our case study on page 18.

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The impact of COVID-19

Of course, 2020 wasn't without its challenges. As can be seen from Figure 3, however, the economic and investment environment at the start of the first lockdown also created some great opportunities for schemes that were able to transact quickly, due to a material widening of credit spreads. To put this in context, by transacting at the optimal time, a scheme transacting a pensioner buy-in could have saved up to 5% relative to transacting a few months earlier, which for some schemes helped bridge the gap to buyout. Mostly, the pricing opportunities were of benefit to those that were already exploring a buy-in with the market, but some schemes were able to move quickly due to an established relationship with an insurer from a previous deal. During Q2 alone, we completed 9 buy-ins, and over the course of the year, we transacted at least one deal with each of the UK's eight insurers active in this space.

Whilst longevity pricing remained very attractive over the year, the impact of COVID-19 on longer term life expectancies is still uncertain, and may not be known for many years, if not decades. On page 9, Sadie Scaife considers the mortality trends seen in 2020 and the impact this might have on future insurance pricing.

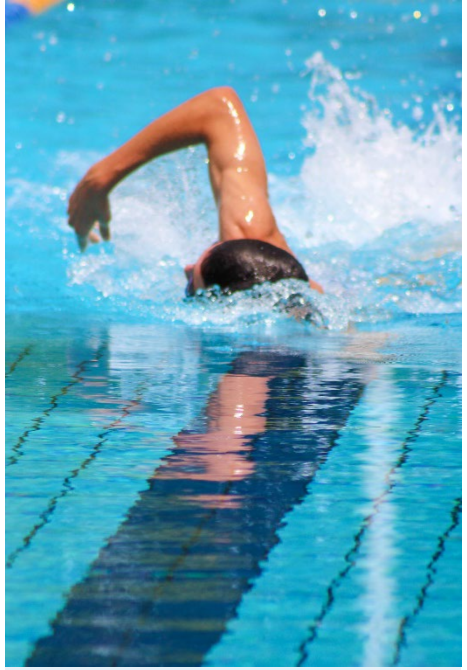
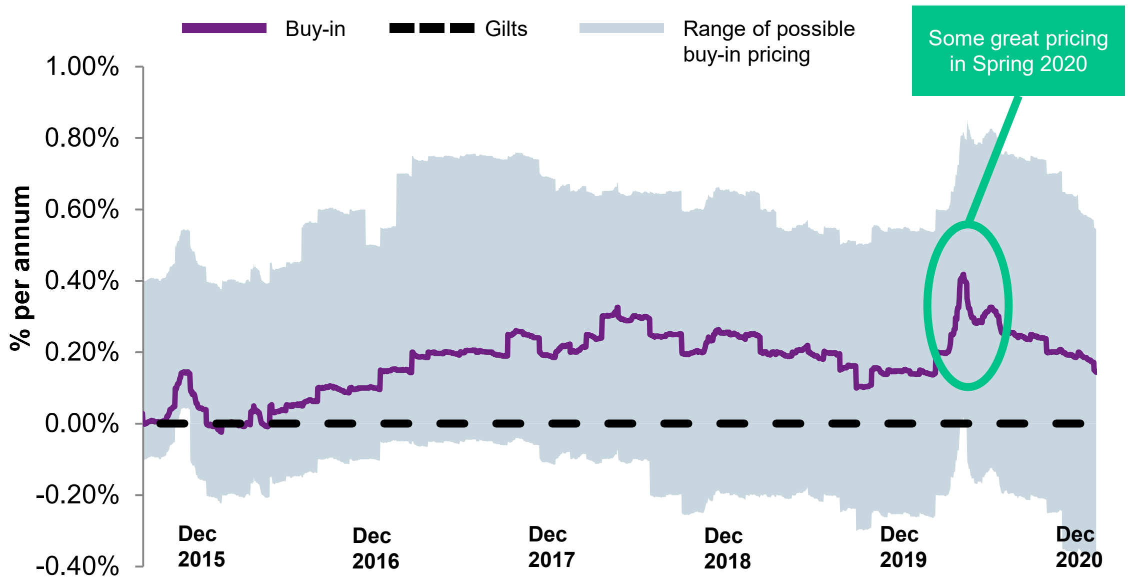


Figure 3 – Pensioner buy-in pricing over recent years



Source: Willis Towers Watson, December 2020

Despite a challenging year, it is reassuring to see that the insurers' financial strength remains strong due to their low risk investment strategies and their prudent capital and regulatory regime. On the more practical side, clients and insurers were able to adapt quickly to the new working environment, including agreeing appropriate procedures for signing remotely, agreeing a reserve trustee to stand in if necessary, and monitoring and managing risk associated with the particularly volatile market conditions in the run up to signing. You can read more about our memories from the first lockdown on page 11.

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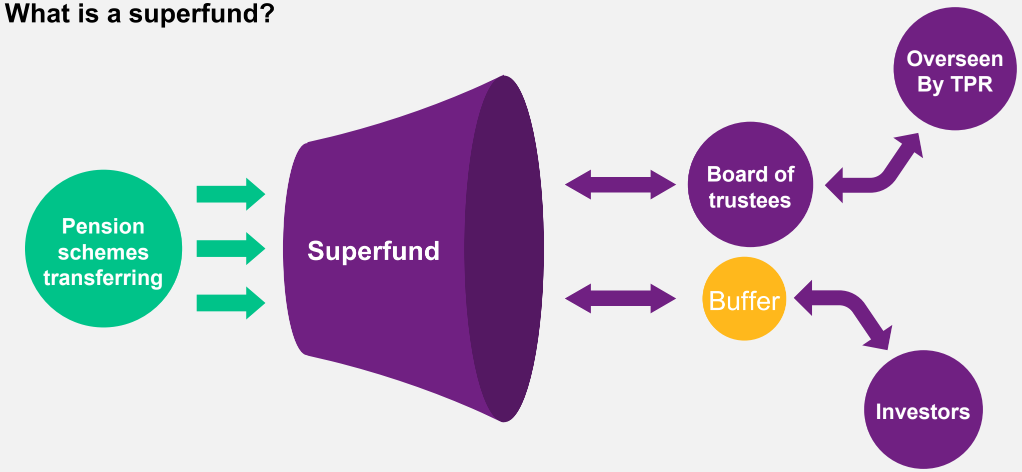
What about superfunds and capital backed solutions?

2020 also saw progress in the possibility of using a superfund as an alternative to the traditional insurance market. In June, the Pensions Regulator published guidance setting out how it will oversee superfunds until a permanent regulatory regime is legislated for, as well as setting out standards of what it will want to see in advance of each transaction.

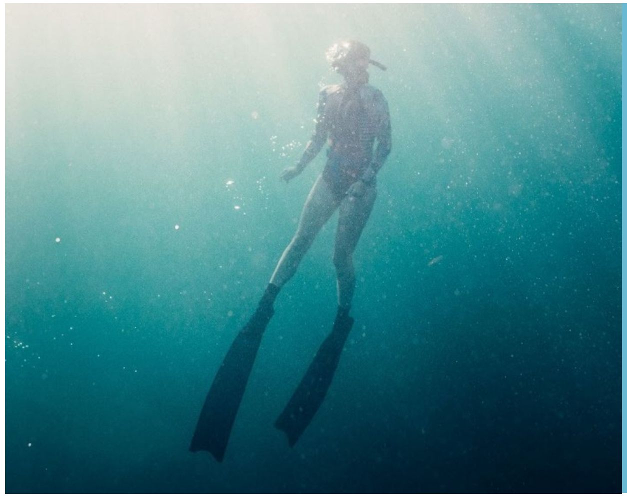
Willis Towers Watson has carried out feasibility studies for a number of clients, and based on this, it's reasonable to say that superfunds are likely to suit only a subset of clients at this time. However, for those in the right circumstances, a transfer to a superfund may allow members' benefits to continue to be paid in full with the additional protection of the capital invested.

As an alternative, some schemes that wish to retain the link to their sponsor have explored capital backed solutions to provide reassurance that pensions can still be paid in downside scenarios. Tom Ashworth and Will Griffiths provide more detail on these solutions and the key considerations for pension schemes on page 25.

What is a superfund?



A superfund is a pension fund, regulated by the Pensions Regulator, and set up to consolidate defined benefit pension schemes. They are designed to have a high probability of meeting benefits in full, but with a lower level of security – and hence a lower cost than insurance buyout. Like a buyout, once complete the link with the scheme and sponsor is typically broken with the superfund taking responsibility for paying pensions.



In summary, 2020 continued the high levels of buy-in, buyout and longevity hedging activity seen in recent years, but there were also significant steps forward in possible alternative end-game solutions. With the true long-term effects of COVID-19 still to be seen, what does this mean for the insurance market? What are the issues for schemes to consider if they have a surplus on buyout? Or for those that are further away from their end-game, how should the management of longevity risk be integrated into the investment strategy? Read on to hear from our experts.

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Case Study - BHS Senior Management Scheme – achieving excellent member outcomes in a £2.5m PPF+ buyout

In 2020, we helped the Trustees of the BHS Senior Management Scheme (the Scheme) to exit the PPF assessment period and to secure an insurance policy with Legal & General (L&G).

The outcome for members was excellent – through a well-run process we were able to help the Trustees to secure benefits close to the benefits from the Scheme and significantly in excess of those payable by the PPF. The key points were:

- We worked with the Trustees to identify an insurer to work with exclusively – given the small asset size of the Scheme and the complexity, an exclusive process ensured that the insurer was committed to the deal and was able to work flexibly with the Trustees.
- The Trustees established a priority order of Scheme benefits to reinstate compared to the reduced PPF benefits with the aim of ensuring that the final benefits met members' needs. We worked collaboratively with L&G through this process to ensure the member's share of fund could be used to secure benefits according to this priority order.
- The Scheme had appointed Independent Trustee Services (ITS) as an independent trustee. This had two key advantages for this transaction – ITS was able to leverage their wider market relationships and the transaction was able to proceed quickly and efficiently despite the iterative nature of the process for determining the benefits to be secured.

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COVID-19 and the longevity hedging market

COVID-19 impacted every aspect of our lives in 2020. **Sadie Scaife** considers how the longevity hedging markets were affected and what the longer-term impacts may be.

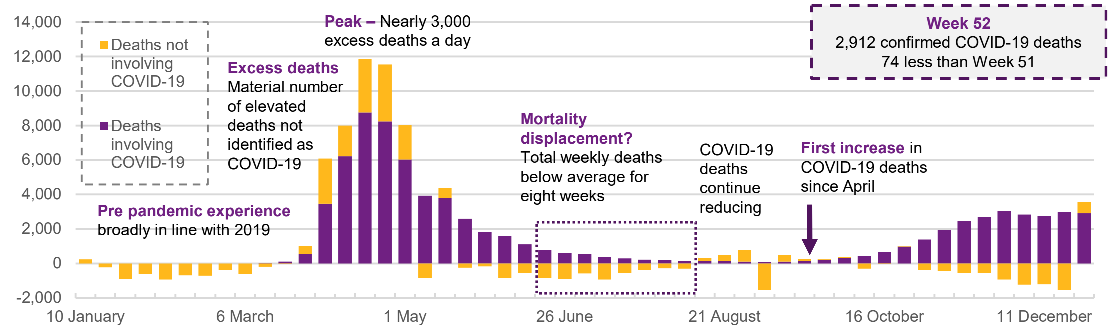
As shown in Figure 4, the reporting of death numbers in the UK in 2020 provided a shocking picture, with COVID-19 deaths reaching over a thousand per day in the first peak of the virus with total deaths of double the five-year average in the worst weeks. The scale of the number of excess deaths from the second wave is still emerging in 2021 but what is clear is that there was an increase in mortality rates of almost 15% in 2020 compared to 2019.

During the early weeks of the pandemic, it seemed challenging enough to continue normal life, let alone contemplate undertaking a significant transaction. However, we helped many of our pension scheme clients to do just that.

Volatility in the pricing of corporate bonds provided opportunities for bulk annuity providers to purchase assets at lower prices, allowing schemes who were ready to transact to lock into very attractive bulk annuity pricing. Many of our clients were in that position, and despite some logistical challenges of getting those first lockdown transactions completed, which we share some memories of on page 11, they secured very favourable terms.

On the surface, hedging longevity risk during a global pandemic may seem counterintuitive, and we worked with our clients to help them to understand the possible outcomes for a range of scenarios during the initial peak so they could take an informed view on the benefits of proceeding with planned transactions or stepping back. For several larger schemes this included monitoring death numbers and causes of death on a weekly basis, whereas for smaller schemes we looked at liability impacts of shocks such as:

Figure 4 – Excess deaths – weekly deaths versus 5-year average (England and Wales only)



Source: Office for National Statistics

0.2%

The financial impact of **15%** higher death rates in 2020 on pensioner liabilities, equivalent to **90,000** extra UK deaths

0.8%

The financial impact of a "Spanish Flu" size impact in 2020 on death rates on pensioner liabilities, equivalent to **300,000** extra UK deaths

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As part of our analysis it was interesting to observe that, in general, pension scheme members were slightly less affected by COVID-19 than the general England and Wales population, and also that the impact varied materially from scheme to scheme, possibly due to the regional variances that were observed in the excess deaths from the first wave.

What's much harder to quantify is the impact on future improvements in longevity, directly and indirectly, due to the pandemic. We are all hopeful that another national lockdown whilst vaccination programmes are rolled out will begin to bring death numbers down in the coming weeks, whilst some of the increased hygiene awareness, healthier habits and a continuing degree of social distancing, particularly when showing signs of illness or for more vulnerable groups, could mean successive years have lighter deaths experience. Conversely, repeating 'waves' of the pandemic and knock-on effects on the treatment of other diseases, coupled with the implications of economic slowdown resulting in less spending on health and care, could reduce the scope for future improvements in longevity. So, although the risk is arguably more weighted towards lower life expectancies due to COVID-19, the level of uncertainty is certainly elevated. In addition, it is likely to be several years before there is a level of understanding of the impact for pension schemes.

Overall, over the course of 2020 we saw the cost of longevity reinsurance stay relatively constant and in some cases reduce marginally – see Figure 5. On one hand, the insurance and reinsurance market has been characteristically cautious when it comes to updating longevity assumptions to reflect the impact of the pandemic, with most holding pricing assumptions constant throughout 2020. This is in line with the Continuous Mortality Investigation's (CMI) core parameterisation of CMI2020 in which it is placing zero weight on 2020 experience. Overall, CMI2020 is likely to reduce life expectancies by around 0.3%-0.4% compared to CMI2019, which places CMI2020 more in line with CMI2018. In addition, falling risk-free yields put upwards pressure on reinsurance fees. However, increased competition from new providers and falling bulk annuity volumes from the highs of 2019 put downwards pressure on pricing, and several of our clients managed to achieve longevity swaps at minimal cost relative to their Technical Provisions assumptions.

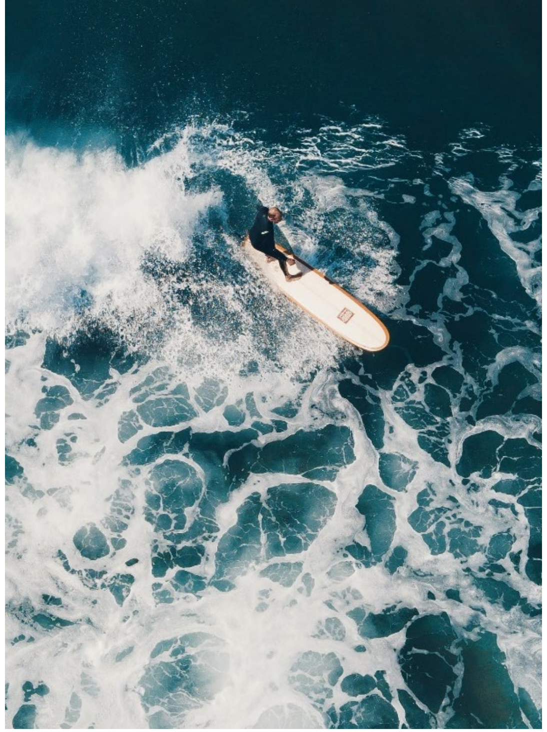
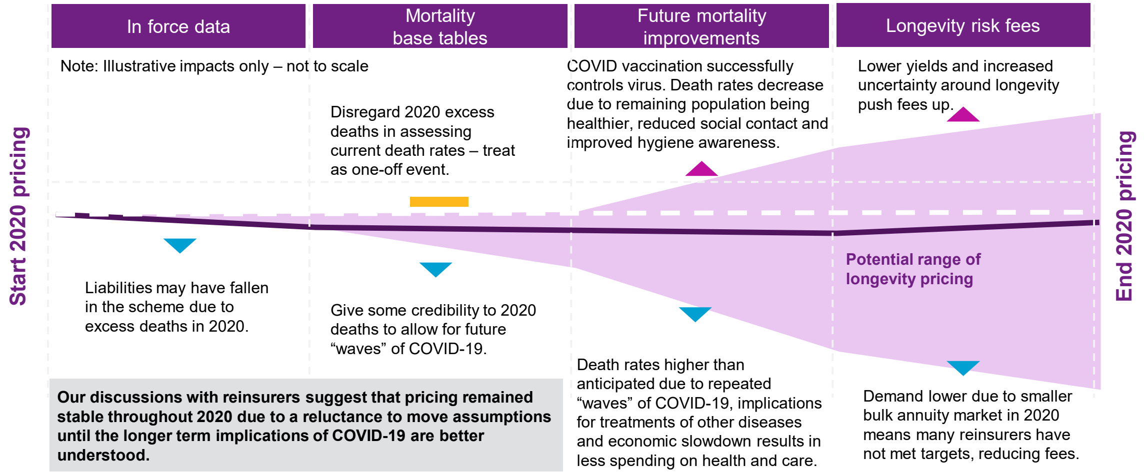


Figure 5 – Impact of COVID-19 on pricing of longevity risk



For schemes with a long time horizon or other de-risking to prioritise, it could be argued that retaining longevity risk until the longer term impact of COVID-19 on life expectancy is more certain may be the right strategy. But for schemes who are close to reaching their 'end game', be that buyout or run-off, pausing is unlikely to significantly reduce costs, whereas volatility in asset markets may provide very attractive bulk annuity pricing for schemes who are ready to act. In addition, the results of Willis Towers Watson's Emerging Trends in DB Pensions Survey 2020 showed that 40% of pension schemes are expecting to complete a de-risking transaction within the next three years, so there is certainly the potential for upward pressure on pricing due to supply and demand dynamics in the market.

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On 23 March 2020, the UK announced it was going into lockdown, thrusting us into a new way of working overnight. As a team and as an industry we had to adapt to a virtual working environment and some new challenges this introduced. Here are some of our team members' memories from this period, including a few of the funny moments!

Ian Aley

"The move to video conferencing post lockdown has brought a new dimension to negotiation strategies. On my first all-party contract negotiation video call post lockdown, our side all turned up with our cameras on to try to recreate the experience of the negotiations taking place around a table, whereas the "opposition" deliberately had their cameras off…
an interesting tactic!"

Lucy Wilson

"I will not forget the Reckitt Benckiser transaction, a £415m buy-in, and the first for the scheme which signed on the second day of lockdown. The extreme volatility in the markets at the time meant we were monitoring pricing on a daily basis, sometimes many times a day. There were hurdles to overcome, often technology related, with intermittent wi-fi and temperamental home scanners, but we kept calm (on the surface at least!) and with great collaboration from all parties, everyone stayed focused until we'd achieved a really good outcome for the Trustees."

Will Griffiths

"Electronic signing was being used to sign the contract on one of my buy-in transactions. When the time came, we had a worrying ten minutes when we thought the electronic signing wasn't working. The insurer was left a little red-faced when it turned out they'd simply forgotten to check the document in!

Separately, I feel like there was definitely a reduction in the number of men attempting to grow beards once Teams got rolled out…. (myself included!)."

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Tom Ashworth

"I recall running my first virtual insurer selection day one week into lockdown. Despite several dry runs with each insurer in advance (to help navigate any technical teething issues), we still had one insurer's connection intermittently cutting out during their actual presentation. In the end, we had to make the call to defer their presentation to the following week. Fortunately, video conferencing capabilities have come on a long way since then!"

Suzanne Vaughan

"Project Gemini was a £40m full-scheme buy-in signed on 7 April. This was a deal that had been temporarily put on ice, but due to the amazing pricing we saw coming through at the start of the first lockdown we were able to work with the insurer and scheme to reduce the premium substantially, reducing the cash contribution required by the Company by nearly £10m. During those terrible times, it was great to feel I was doing something useful by helping this scheme take positive steps to increase security for the members."

Gemma Millington

"The biggest challenge for me was juggling work with caring for my son. During April/May/June, I attended several internal calls and a few insurer calls whilst out walking and pushing/carrying my son. This was one way of keeping on top of work commitments when the nurseries were shut!"

Louise Lane

"As a team we kept in touch and demonstrated our competitive streak with virtual scavenger hunts, escape rooms and quizzes, sometimes gate-crashed by the 'next generation' eager to join in!"

Shelly Beard

"A lasting memory for me is some of the examples of camaraderie that kept us all going during such a challenging time. On one project, a lawyer jokingly reminded the client to keep the signing page safe and not use it as toilet roll (this was during the toilet roll shortage)! On another project, the lawyer, pensions manager and I exchanged photos of us toasting the deal after signing in our own mini celebration."

Danielle Feingold

"On Project Zeta, two buy-ins covering £350m of liabilities that signed in May, we had an interesting signing experience! Electronic signatures couldn't be used on this deal, and late in the day it came to light that one of the trustees didn't have access to a printer. The group brainstormed possible solutions – with ideas including investing in a moped, a meeting in a car park, or Willis Towers Watson ordering a printer to be sent to the trustee's house. In the end the trustee found access to a printer and everything was signed in wet ink and scanned back. However, I very much enjoyed the creative solutions we came up with!"

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Integrating management of longevity risk within the investment strategy

Hedging a scheme's other liability risks (interest rates, inflation and currency) first and leaving management of longevity risk to the end of the journey plan can expose the scheme to considerable market risk, potentially increasing the overall costs should the cost of longevity hedging increase over time as capacity is used. **Suzanne Vaughan** considers how longevity risk can be integrated within the wider investment strategy risk framework.

When considering a holistic hedging programme, including longevity risk, it is important to consider:

- the optimised journey plan to the scheme's preferred end goal (considering scheme funding, liability duration, risk appetite and other specific features);
- how much of the risk budget to allocate to longevity risk; and
- the wider investment framework to ensure an optimal risk and return ratio is achieved.

The following four step approach can be used to integrate longevity risk within the investment strategy:

1 Consider the minimum longevity risk range

2 Set long-term target longevity hedge ratio

3 Set current conditions longevity hedge ratio

4 Agree design/ implementation of the longevity hedging strategy

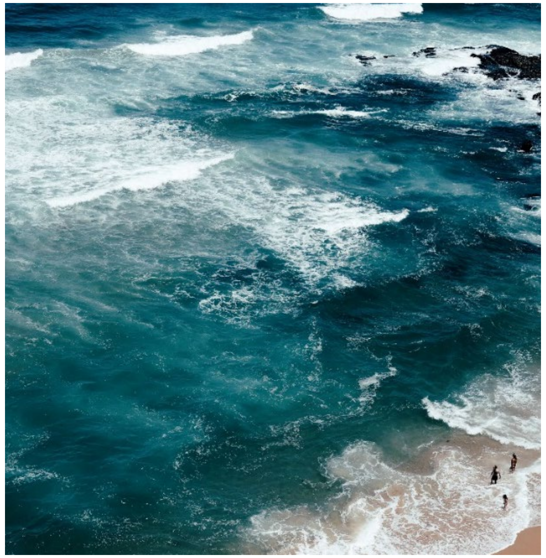
1. Consider the minimum longevity risk range

Longevity is a single-factor risk affecting all of the liabilities, so adverse experience will have a material impact on a scheme's fortunes. Members will either live longer than expected or they won't - compare this to equity risk where returns are derived from a wide variety of sources (stocks, sectors, countries etc). We believe unrewarded risks, such as longevity, should be minimised by hedging if it is cost effective to do so.

2. Set long-term target longevity hedge ratio

Although risk is minimised at high levels of longevity hedging, target hedge ratios are likely to be lower (at least initially) reflecting wider factors such as:

- **The duration of the liabilities.** Specifically, at least initially, it is likely that the shorter duration pensioner liabilities will be hedged, as although it is possible to hedge/buy-in deferred members the costs are typically higher reflecting their longer durations and optionality of benefits at retirement.
- **The need for return-seeking assets**. For schemes which need to run significant levels of investment risk to close the funding deficit, the capital available to hedge longevity risk is likely to be limited.
- **Funding impact**. If there is any negative overall impact that cannot be managed by the scheme.
- **Most efficient use of de-risking budget**. For example, it may be more efficient to reduce investment risk rather than longevity risk and vice versa, depending where in the de-risking journey the scheme is.



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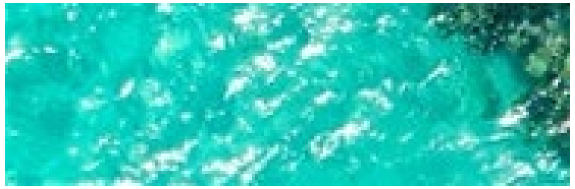
3. Set current conditions longevity hedge ratio

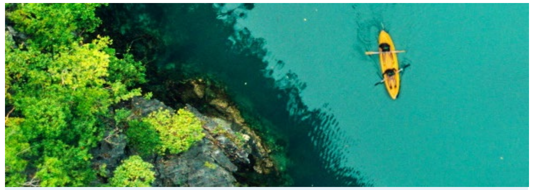
Whilst there is a cost to hedging longevity (like any other risk), we believe now is a good time for schemes to hedge longevity risk, with attractive pricing in the market. It could therefore make sense for schemes to stretch the target they would have otherwise selected. The supply for longevity hedging, which is also used by insurers to support the writing of buy-in and buyout deals as well as their individual annuity business, is currently dictated by the global reinsurance market. Reinsurers have appetite for longevity risk to offset the mortality risk (life insurance) they hold on their books and to provide diversification against other types of risk (for example property and casualty). As more longevity risk is hedged, the marginal benefits to the reinsurer are likely to reduce and prices may increase. This potential increase in pricing may happen sooner if the pace of demand increases materially.



4. Agree design/implementation of the longevity hedging strategy

Which of the two key implementation routes (buy-in or longevity swap) is most appropriate for a scheme depends on a number of factors, and in some instances a combination of approaches may be optimal. Particular consideration will need to be given to the impact on the investment strategy for example taking into account the capital intensive nature of a buy-in and the possible restrictions this places on the levels of collateral needed to support other hedges and on the extent to which a scheme can take advantage of other illiquid opportunities (e.g. secure income assets).

In our experience there can be real advantages in phasing the longevity hedging for a scheme. Firstly, part of the longevity risk can be removed immediately, with the rest managed over time as members retire and de-risking increases investment flexibility. This can be achieved by hedging all or a subset of the current pensioner liability (for example insuring say every second pensioner). Secondly, it results in cost averaging, smoothing out volatility in market pricing. Thirdly, building a relationship with the insurance market and building the knowledge and operational structures to undertake transactions means the scheme is "transaction ready" when further opportune market or scheme conditions arise.



Putting this integrated approach into practice

Recognising the importance of integrating longevity risk within a scheme's investment strategy, we are increasingly seeing clients delegating implementation of the agreed investment and de-risking strategy to Willis Towers Watson under our fiduciary investment offering. With UK fiduciary investment management experiencing strong growth, reaching £200bn of assets under management, we expect de-risking longevity under this type of approach will become increasingly commonplace. I had the pleasure of working with a client under this model over the last 18 months, and would call out two key advantages:

- the speed of execution and agility surrounding this, means schemes have better access to great pricing when such opportunities are presented (for example during the unprecedented market turmoil of the first lockdown of the pandemic), and
- all transaction execution risks are fully mitigated, with no risk of anything falling between the gaps of two advising parties.

Member outcomes benefitted as a result, and importantly the scheme achieved the right buy-in transaction at the right time for the scheme's overall journey plan. More information on this project is set out in the case study that follows.

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Case Study – Project Stingray: An integrated buy-in within our fiduciary investment offering

The goal

The Sponsor and the Trustee agreed they were on a path to full buyout with an insurer. When Willis Towers Watson was appointed as fiduciary manager, we modelled the scheme's specific characteristics, plotted the optimised journey plan, taking full account of the varying investment and transaction drivers, to show that full buyout could be achieved within 10 years. Further, the modelling showed that, critically, all of the risk relating to pensioners could be removed immediately via a buy-in, whilst leaving (1) sufficient assets to generate returns for the journey plan; and (2) a residual population that would have an attractive pensioner/non-pensioner balance at the point of eventual buyout.

Mobilising the buy-in workstream

The buy-in workstream mobilised straight away, setting a pricing target that aligned with the holistic strategy to achieve buyout in a reasonable timeframe and the wider investment portfolio.

With excellent engagement from five leading insurers in an extremely busy market, the project went from insurer selection, to the preferred insurer going on risk in around 6 weeks. Considering longevity risk in this integrated way, not only gave certainty on the right strategic approach to de-risking, but meant greater efficiency and clarity of execution with a "one-team" accountability mindset.

Additional benefits from the integrated approach

The investment portfolio changes, identified as part of the fiduciary investment implementation, were aligned to be implemented at the same time as the buy-in, reducing transaction fees and driving efficiency.

What our client told us

"We were delighted with the outcome of our recent buy-in, which was delivered within the integrated Willis Towers Watson fiduciary investment offering. Willis Towers Watson embedded a team of multi-disciplined professionals to deliver our objectives, we were delighted with their dedication to a "one-team" client service mindset. We appreciated having one point of contact, with one set of accountabilities as we implemented our goal. The innovative fee structure also represented excellent value for money, including streamlined pre-negotiated legal and commercial contracts with a leading law firm."

Trustee Chairman, Project Stingray, a (confidential) pension scheme in the services sector

1 One objective

2 One team

3 One set of accountabilities

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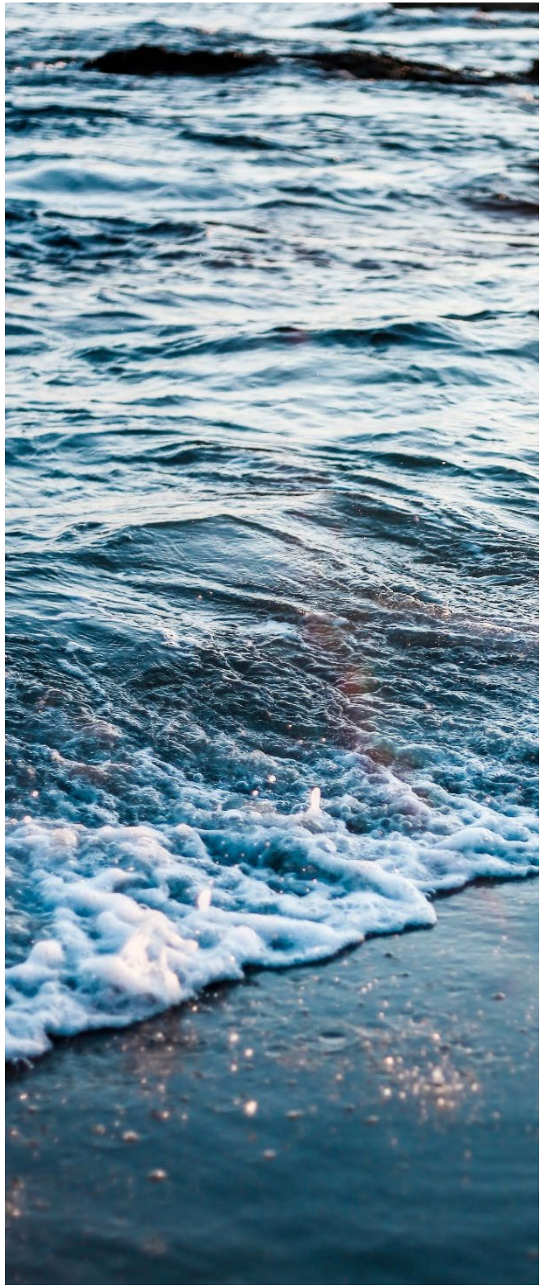

Innovation in the UK de-risking markets

Since our team was involved in the first buy-ins in 1999 and the first longevity swaps in 2009, the UK de-risking market has greatly developed.

Katherine Gilder reflects on the evolution of the market and speculates on where we might see future innovation.

The evolution of the market

In the early years of the bulk annuity market, each transaction was necessarily bespoke given there was little by way of precedent. Over time, as insurers and advisers have gained experience, more standardised market terms have been used as a starting point for negotiations and an established practice for execution has evolved. Insurers have also needed to streamline their processes in order to reduce costs, remain competitive and keep up with the increase in demand from pension schemes.

The other key development in the bulk annuity market in recent years has been the increase in deal size. Up until relatively recently, many schemes thought that multi-£bn buy-in and buyout deals weren't possible and the largest schemes would need to run off. Over the last couple of years there have been several £3bn+ deals as well as the prospect of even bigger transactions.

There have been far fewer longevity swap transactions, with at most five or six swaps completing in any individual year since 2009. Initially, the cost of hedging longevity risk for smaller schemes (less than, say, £500m of liabilities) was relatively expensive, reflecting the additional risk associated with smaller populations and the lack of credible mortality experience data. This meant that the implementation of a longevity swap was only really an option for the largest pension schemes. However, the increased size and regularity of deals over the last few years, including the regular flow of deals from bulk annuity providers reinsuring their longevity risk post Solvency II, has opened up opportunities for smaller schemes to benefit from big-scheme pricing, making longevity hedging more attractive. In addition, longevity hedging contracts for smaller schemes are increasingly streamlined, meaning that contracts are much easier to put in place and run than was the case historically.

In 2017 we advised the sponsor in relation to the transition of the first longevity swap from a pension scheme to an insurer (otherwise known as a novation) as part of a bulk annuity transaction. Prior to this, many pension schemes had avoided entering into a longevity swap due to a concern that this may act as a barrier to buying out the liabilities. Since that first novation, we have seen several more, which has helped to alleviate that concern and longevity swaps are now very much seen as a stepping stone towards buy-in rather than an alternative.

Finally, over recent years we've seen the options available to trustees for delegating responsibility for paying benefits to members go far beyond bulk annuities. Jenny Neale highlights the progress that we have seen in relation to the regulation of superfunds on page 7 and Tom Ashworth and Will Griffiths talk more about the growth of capital backed solutions on page 25.

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So, what's next?

It's clear that there has been significant evolution in the de-risking markets since their inception and they are likely to continue to evolve to meet the changing needs of pension schemes. In the future, we may see innovation from:

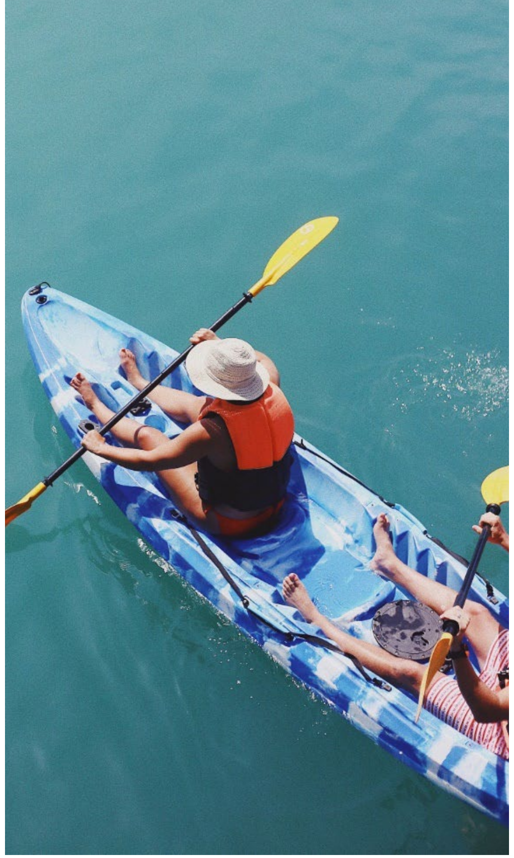
1. **Something entirely new** – for example, the first transaction from a superfund. Following the Pensions Regulator's guidance in June setting out how it will oversee superfunds until a permanent regulatory regime is legislated for, we expect that the first two superfunds that have launched, Clara Pensions and The Pension Superfund will now seek authorisation and complete their first transactions possibly in early 2021. Whilst a superfund won't be suitable for all pension schemes, for some it will allow members' benefits to continue to be paid in full with the additional protection of the capital invested;

2. **The adoption of an approach already trialled by another sector** – for example using funded reinsurance, whereby both the longevity and asset risks associated with defined benefit pensions is transferred to a reinsurer but with more capital efficiency than a buy-in due to there not being an upfront premium.

   In addition, in the past, when schemes have considered the market options for hedging deferred longevity risk they have typically found the cost and the additional complexity of hedging benefits that are uncertain in size and timings (due to member options) relatively unattractive and decided to focus on hedging pensioner longevity risk. More recently, we have seen the longevity reinsurance market to be more competitive for deferred liabilities, and have worked through a number of structures for dealing with the timing uncertainties. We have also seen that as funding positions have improved, and schemes are looking to adopt a fully cashflow matching investment strategy, there is more appetite from trustees to hedge non-pensioner longevity risk, particularly where a large proportion of the risk in relation to pensioners has already been removed. We therefore expect the first non-pensioner longevity swap to complete in the short-term.

Summary

The market has evolved significantly from the early buy-in and longevity swap transactions. With increasing demand from pension schemes, and a competitive marketplace, it is certainly likely to continue to develop. I'm looking forward with interest at how all market participants respond to meet changing needs and the creative solutions that are developed.



A reputation for innovation

Willis Towers Watson has a history of innovation and embracing new ideas. For example, we were the lead adviser in respect of:

- The first collateralised buy-in
- The first all-risks buyout
- The first captive buy-in
- The first buy-in for multi £100ms
- The first software tracking system used by an insurer to track live insurer pricing
- The first umbrella contract for repeat buy-in transactions
- The first longevity swap
- The first streamlined longevity swap with Legal & General
- The first novation of a longevity swap
- The first longevity swap using a captive, which was a Guernsey-based cell. We subsequently led the first longevity swap using a Bermudan captive

Our Longevity Direct offering was the first ready-made captive for pension schemes to access the longevity reinsurance market

135 pension schemes and six insurers/reinsurers use Willis Towers Watson's market-leading Postcode Mortality Tool

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Case Study - The Merchant Navy Officers Pension Fund (MNOPF) novates longevity swap to £1.6bn buy-in

The MNOPF Trustee has had a well-defined journey plan for many years, with a target of securing the liabilities. This has helped the MNOPF to have a long and successful history of de-risking transactions – it has reduced risk at the right time and achieved excellent pricing from the insurance market.

The MNOPF's de-risking journey started in 2009, when they transacted their first buy-in, and the first stage completed in 2012 when the MNOPF Trustee completed a successful buyout of the Old Section. Transactions for the remaining DB Section began in 2014 through an innovative longevity swap, the first longevity swap to use a ready-made Guernsey-based captive. Following positive investment performance, the Trustee was able to start annuitising parts of the Fund in 2017. The first step was a £490m buy-in with L&G for recent retirees, seizing particularly attractive pricing in the market at that time, followed in February 2020 by the Trustee purchasing a buy-in policy with Pension Insurance Corporation (PIC) for the pensioners and dependants covered by the longevity swap they had put in place in 2014.

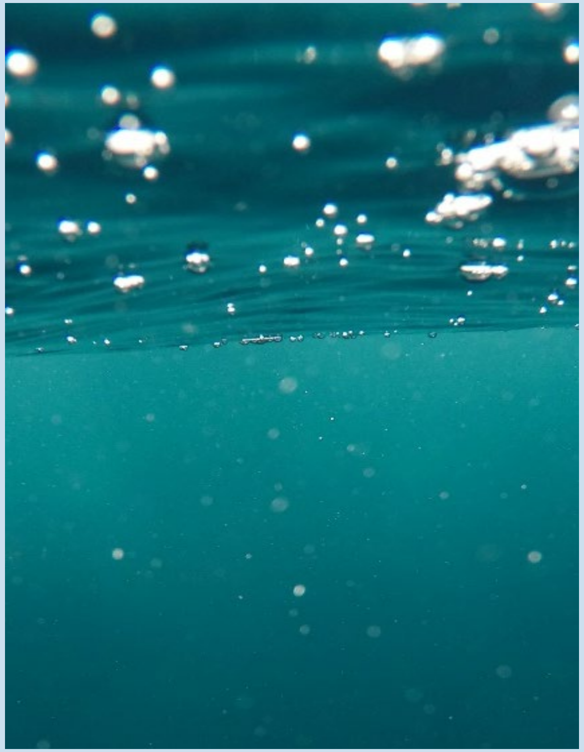
The buy-in in 2020 was notable for several reasons – including being one of the largest bulk annuities of 2020. Two features particularly stand out though:

Efficiency of novation

As part of the transaction, the ownership of the longevity swap was novated from the Trustee to PIC. The combination of (1) anticipating that a buy-in would be undertaken within the 2014 longevity swap documentation; and (2) the use of a Guernsey-based captive insurer to intermediate the original longevity swap, meant the novation process was very streamlined – in fact it only took a few weeks from agreeing to proceed with PIC.

Pricing achieved

Because the Trustee had already hedged longevity risk, this fed through to significantly improved buy-in pricing. In fact it was some of the best buy-in pricing we have ever seen and improved the Fund's funding level by over 3%. Achieving this pricing did require discipline from the Trustee though – the Trustee knew that their deal, with its existing longevity swap, would be very attractive to the insurance market and used this knowledge, working with Willis Towers Watson, to set a stretching price target. The Trustee then monitored the market until PIC were able to meet the target price – whilst the Trustee did receive other offers in the meantime, they waited until the right deal emerged.



Rory Murphy,
Trustee Chair of MNOPF, *said:*

"It was very important to the Trustee that our longevity swap deal was flexible, future-proof and capable of being converted to a buy-in if needed. The work put in by Shelly Beard and the team at Willis Towers Watson and our other advisers in 2014 has now paid off. This buy-in enables us to more effectively manage the risks faced by the fund as a whole and provides greater certainty to members that their benefits will continue to be paid in full from the Fund."

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Pension scheme surplus on buyout

The number of pension schemes with buyout surpluses or close to having a buyout surplus, has more than tripled over the last five years[1]. Whilst a surplus is a nice problem to have, **Costas Yiasoumi** considers the additional issues and considerations when it comes to transacting a bulk annuity for such schemes.

Of course a scheme with a buyout surplus does not have to buyout. There is nothing in legislation that says such a scheme needs to buyout and neither does the Pensions Regulator say that. Based on the specific circumstances there may be very good reasons not to undertake a bulk annuity transaction of any type, and to instead continue running the scheme on.

However, in circumstances in which a buyout is deemed the way forwards, our seven top tips based on the issues and considerations we've come across when advising clients are:

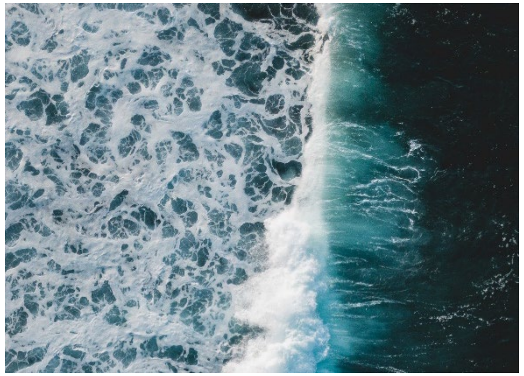
1. **Get legal advice, early:** It goes without saying that it's crucial to obtain legal advice on ownership of any buyout surplus. Must it be used for member enhancements, must it be paid to the company (net of tax), and who decides? Who has the power to trigger wind-up? The balance of powers within the scheme will be critical here and there may be a need for discussions and negotiations between the trustees and the company.

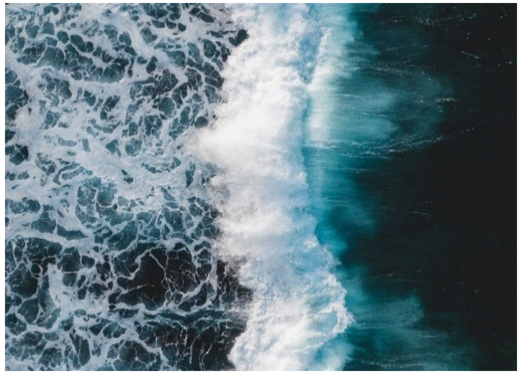
   Without getting this tackled early, there is the potential for delays, missed opportunities and inefficiencies along the way.

2. **Avoid an 'accidental' surplus:** Many trustee boards have been surprised to find they have a buyout surplus and could have completed a buyout some months or years ago. It's really important to obtain tailored buyout estimates that indicate the likely outcome of a competitively run and well negotiated bulk annuity purchase process, based on actual market conditions and insurer appetites. A scheme actuary's estimates for funding purposes are exactly that, for funding purposes, not for gauging and planning the outcome of an actual transaction.

   Tailored estimates should be obtained sufficiently early and before full buyout funding is attained so that the trustees can plan ahead.

3. **Engage the company early:** The natural assumption is that the sponsor will welcome the trustees undertaking a buyout, even more so where it could receive some of the surplus. However, that will not always be the case. It's critical to engage the company so it can mitigate unintended consequences. For example, a buyout may cause significant and unwelcome swings in the company's published financial statements. Although trustees should act in the best interests of members, the company's views are important and its goodwill vital when it comes to the exercise of specific scheme powers and in areas such as post winding-up indemnities.





1. Source: PPF Purple Books 2020 and 2015

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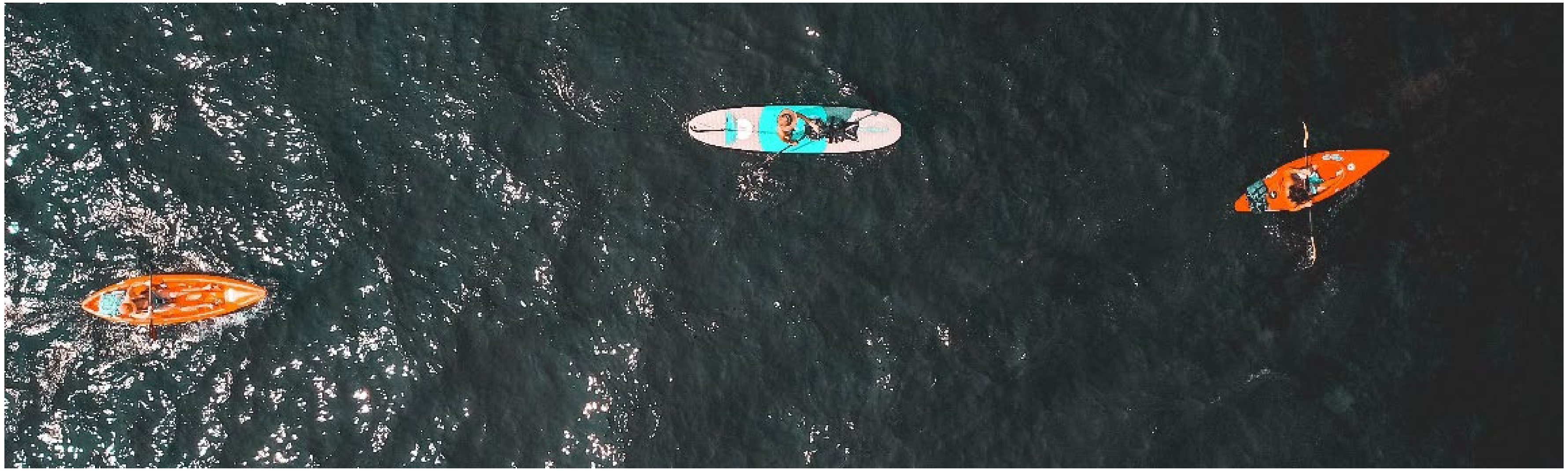

4. **Buy-in or buyout?:** Most buyouts start with a full buy-in covering all the members. After a period of data cleansing and other tidying up this buy-in is converted into individual annuity policies for each member – the buyout – after which the scheme is wound up. A common question from trustees is whether it is in members' interests to forgo this final step. Instead the trustees would continue to hold the full buy-in policy as a matching asset that will precisely pay the trustees the pensions due to members each month. The point is that in the event of the insurer ever defaulting and for some reason the Financial Services Compensation Scheme not covering this, then the trustees would still have the sponsor to fall back upon, therefore offering an extra layer of security to members. There is no right or wrong answer here. Quite often it can come down to the balance of powers within the scheme, the sponsor covenant and the trustees' appetite to continue running the scheme in such circumstances.

   The likelihood of an insurer defaulting is considered remote but, nevertheless, where a sponsor is particularly strong it can be a pertinent question to tackle early.

5. **Don't set the bar too low:** The existence of a surplus shouldn't change the approach to negotiation – which should be robust and aim to get the best possible pricing. The end recipients of the surplus, whether that is the members or the company, will benefit directly from improved insurer pricing. An experienced transaction adviser will know when pricing has been optimised, and not stop negotiating before this point.

6. **Deal with surplus enhancements smartly:** When members are entitled to some or all of any surplus, the question arises of how to allocate that surplus. For example, should that be by topping up members' defined benefits on an equal percentage type basis or equal pound amount per member, insuring enhanced pension increases or some other method? This will require detailed legal advice on the duties of the trustee and requirements of the scheme rules, careful engagement with the insurer, documentation in the insurance contract and considerations covered such as whether the insurer can hold the price for the surplus component even if it is not allocated for some years.

7. **Joint working group (JWG):** No top seven list would be complete without mention of a JWG. The role of the company has been mentioned several times above. The company and its advisers are a helpful sounding board and ally in any complex transaction. A regular JWG will ensure effective communication, collaboration, speed of decision making and momentum in any buyout process.

By following our seven top tips (and more!) trustee boards and companies can ensure that a surplus remains a nice problem to have and becomes a pleasant one to tackle.

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We know with certainty that society is facing big changes in the future, and one of these is climate change. Whilst ESG is much broader than climate change, over 2020 barely a day went by when climate change wasn't in the news, and actions being taken by bulk annuity providers are dominated by an environmental focus. **Hazel Kendrick** considers what changes we are seeing in the pensions industry and in particular shares the results of our latest ESG survey of UK bulk annuity providers carried out in Autumn 2020.

The UK government's commitment to net zero emissions to reduce the threat of climate change by transitioning to a lower carbon economy continues to make the headlines. In the US, the incoming Democratic party has made commitments to making America a clean energy superpower. In the autumn of 2020, China announced to the UN General Assembly in New York that it will target carbon neutrality by 2060, which, given China's global emissions count for nearly a third of the world's carbon dioxide emissions, is a significant step forward.

Focus from politicians, actions by regulators, and the demand from investors could be the thing we have been waiting for since the first climate change public reviews and policies announced in the early 1990s. Since then, as shown in Figure 7 on the next page, we've had the Paris Agreement in 2015 - and what a long road it has been before we are finally, I hope, seeing real change!

At the launch of the UK Government's ten point plan for a green industrial revolution in November 2020, Prime Minister Boris Johnson said: "Although this year has taken a very different path to the one we expected, I haven't lost sight of our ambitious plans to level up across the country. My Ten Point Plan will create, support and protect hundreds of thousands of green jobs, whilst making strides towards net zero by 2050."

Figure 6 - ESG factors

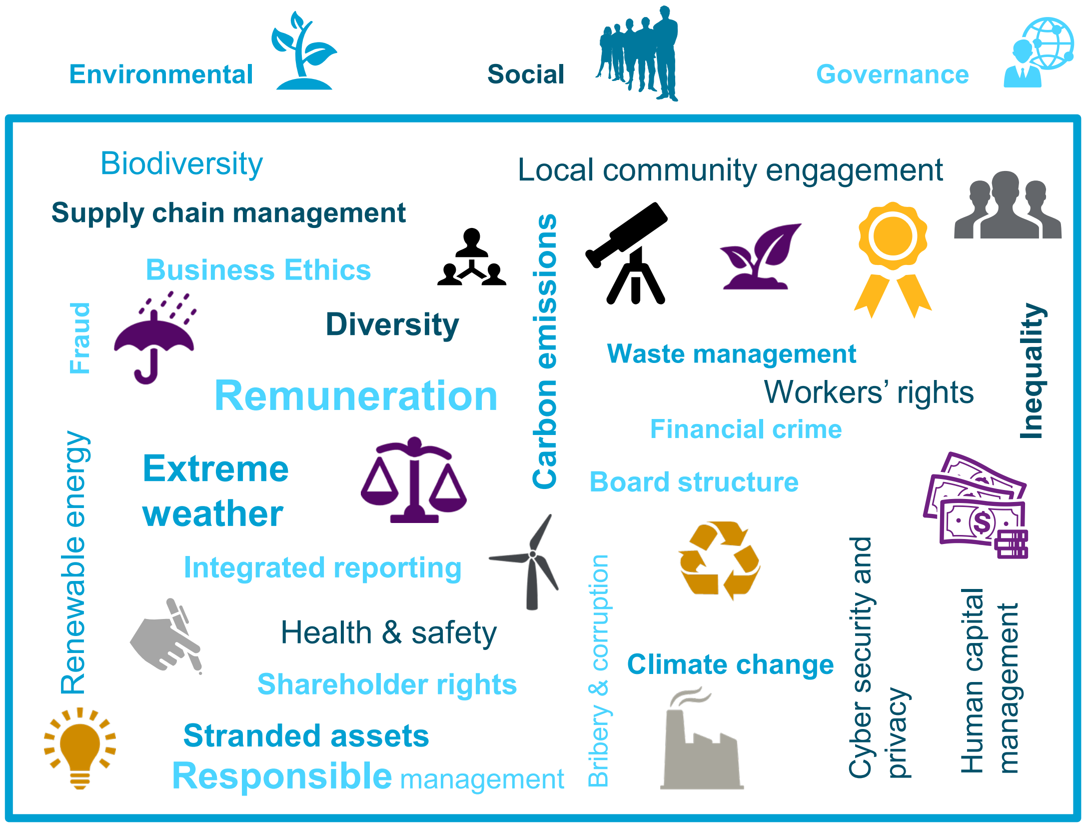

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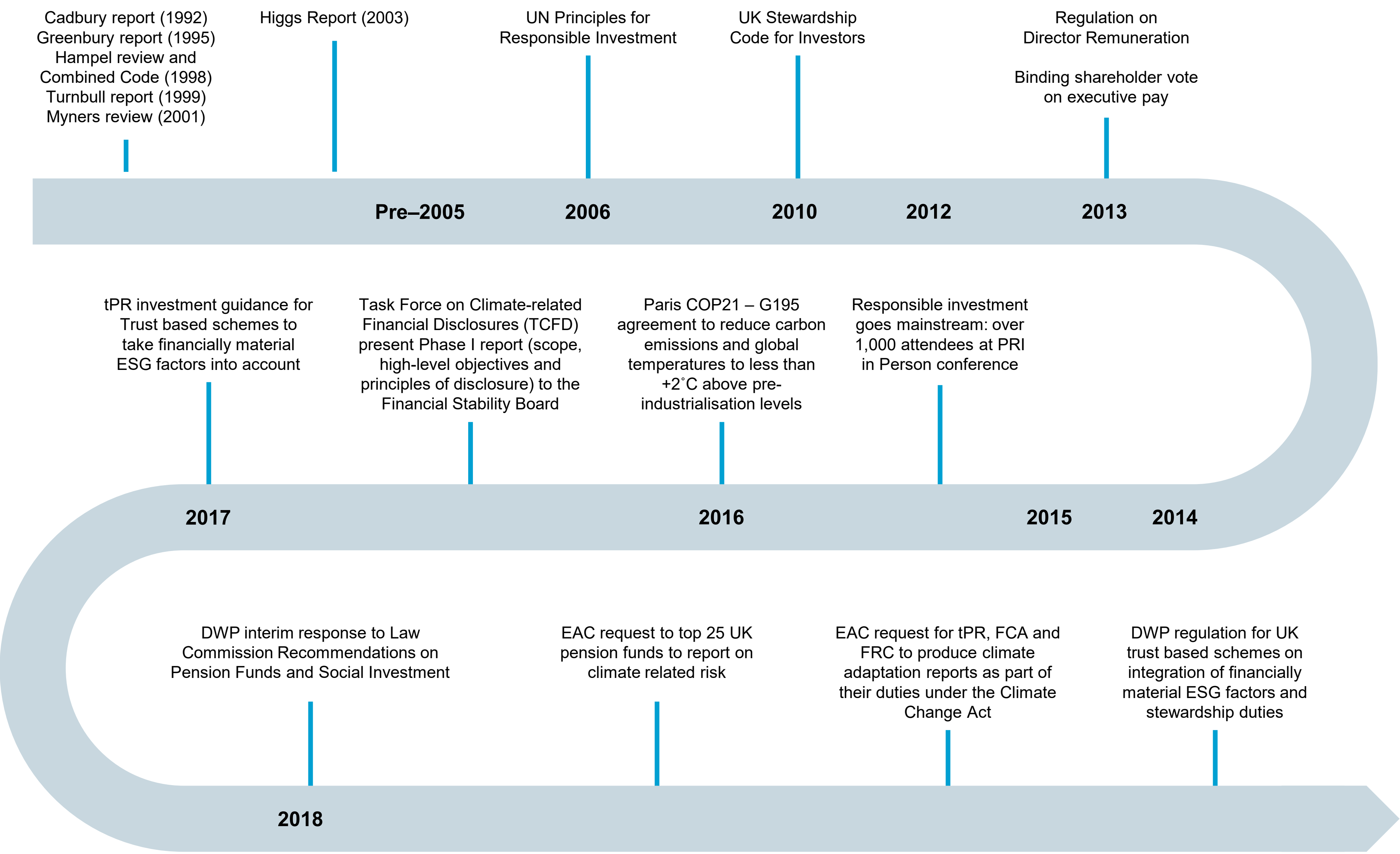
Figure 7 – Evolution of sustainable investment regulation and initiatives in the UK



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The pensions industry

For us in the pensions industry, for some time, there have been headlines about trustees' fiduciary duties to actively address environmental risk in asset portfolios and more recently, we are being implored to assess the impact on pension fund liabilities and covenant. In 2019, the Pensions Climate Risk Industry Group was set up and, in 2020, the Department for Work and Pensions published a consultation on occupational schemes taking action on climate risk. Whilst the outcome of this is awaited, a number of large schemes are proactively tackling the climate change threat, and making public statements about doing so.

It is impossible to think that as/when these schemes progress on their de-risking journeys that they will not expect insurer and reinsurer attitudes and actions to reduce climate threat to align with best practice.

Large pension funds are recognising the impact of climate change threats to meeting long-term commitments, for example, the BT Pension Scheme announced in autumn 2020 that it aims for its entire £55bn portfolio to be net zero over the next 15 years, by 2035.

The government's National Employment Savings Trust (NEST) announced in 2020 a forward-looking statement of actions it is taking to align its investment portfolios to halve carbon emissions by 2030.

Bulk annuity providers

The Willis Towers Watson transactions team are taking the lead on engaging with bulk annuity insurers on their ESG strategies. The insurers know that we expect material progress on embedding and living by ESG policies to be made, and that our clients will demand it as an important aspect of their preferred provider selection process.

As part of the role Willis Towers Watson has to help, influence and shape progress across the industry and as signatories of the Principles for Responsible Investment (PRI), we are actively engaging with and encouraging insurers to develop and implement good sustainable investment practices, including becoming PRI signatories themselves. Alongside this, we are carrying out an assessment of insurer's policies and their progress.

As part of our latest survey of UK bulk annuity providers carried out in Autumn 2020, the majority are signatories to the PRI, and where they are not yet signatories, they have told us that they will be imminently. Those providers cover around £225bn of annuities. All responders have at least one individual dedicated to ESG analysis, but the resources employed by our responders varies hugely – from one person to a team of over 20.

Consideration of ESG risks for investments are embedded within the investment process for all our responders. 80% are either already disclosing in line with the Task Force on Climate-related Financial Disclosures (TCFD) framework or will start doing so in 2021, which represents a remarkable step up by insurers on environmental issues! TCFD has now become increasingly recognised as a board room agenda item and governments around the globe are helping push its adoption.

It is very encouraging that ESG has c-suite leadership commitments behind it, with ESG being a formal part of the CEO/CIO's role for 80% of our responders.

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COVID-19 has demonstrated the art of the possible

A further area that insurers are giving attention to is their limits on environmental exposures. Not only are insurers thinking about this and integrating coherent policies into practice, 2020 has given a very helpful platform for TCFD on Scope 3 greenhouse gas emissions by their businesses. Emissions from buildings, use of electricity, business travel, waste disposal etc. have materially declined in the advent of so many staff working from home, giving a lens through which to look at what businesses can achieve. This opportunity is certainly making insurers think, and instead of just working on transitioning to decarbonised investment portfolios, some are looking at how they can stop their Scope 3 emissions rating shooting up to pre-COVID levels.

Progress to a cleaner future…

2020 has seen an astonishing trend for insurers making commitments for net-zero targets, and 60% of respondents report publicly on both the positive and negative impacts of their investments on society and the environment, either directly or via their asset managers. One large insurer is leading the way with a public decarbonisation plan that aligns with the Paris Agreement. The next steps include driving up the effectiveness of the various policies relating to screening/exclusion of investments in particular businesses, and in policies regarding stewardship expectations for issuers.

Whilst there remains much to do, the steps that the bulk annuity insurers are taking are very positive – the significant focus of insurers on climate and their keenness to demonstrate this in their strategies is certainly pointing in the right direction.

Bulk annuity providers should continue to be encouraged by trustees and other pensions leaders to carry on driving forward. We need to ensure that ESG credentials are embedded into bulk annuity provider and reinsurer selection processes.

Trustees often value insurer brand. Going forward, trustees and other pensions leaders are likely to start linking an insurer's ESG behaviours to the view of the strength of the insurer's brand – so an insurer with top tier ESG credentials could enhance their brand image.

What next?

Our latest survey of UK bulk annuity providers took place in the year that the Black Lives Matter social movement opened our eyes to many social issues that need to be addressed – and the strong focus on environmental sustainability is the tip of the ESG iceberg. As insurers, industry, investors and the world continue progress on E, whilst maintaining the focus already on G, I hope that they also pay greater attention to the final piece of the jigsaw, Social policies, in 2021 and beyond.

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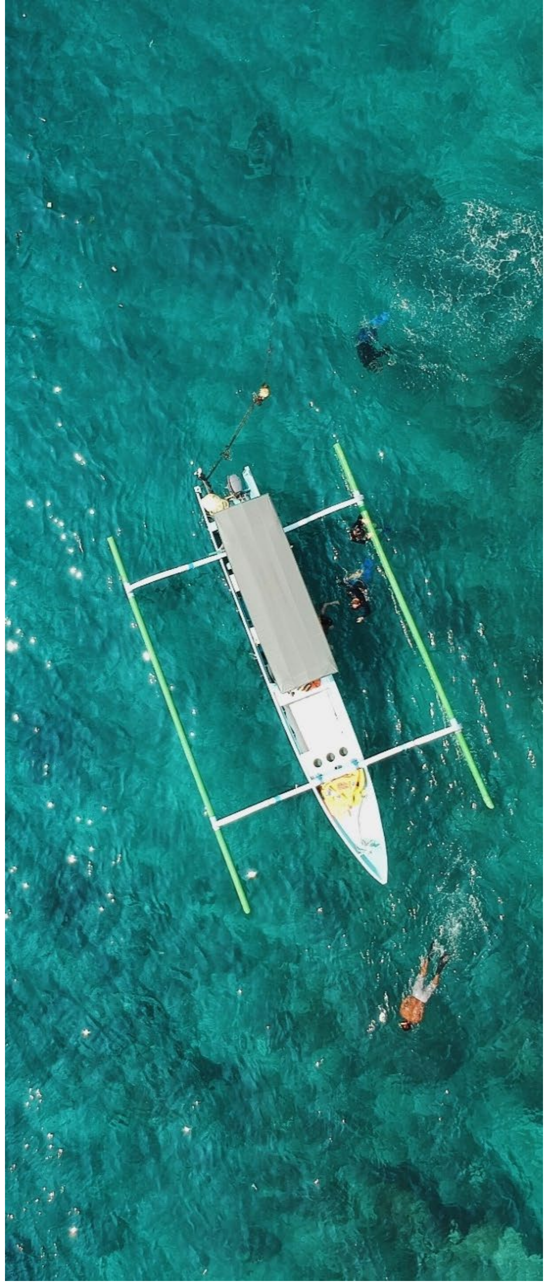

New kids on the block – a look at Third Party Capital Solutions

2020 was another breakthrough year in pensions, where we saw the first arrangement in which third party capital was provided directly to help a pension scheme support its journey to buyout.

In this article **Will Griffiths** and **Tom Ashworth** explore Third Party Capital Solutions (TPCSs), looking at how these may be used to benefit both pension schemes and their sponsors.

Investors taking on pension liabilities and putting their own money in to back these with a view to making a return is neither new (bulk annuity providers) or an area that hasn't seen recent innovation (superfunds). However, TPCSs takes this in a new direction by offering schemes a "helping hand" in the form of a capital buffer to support the journey plan of the pension scheme, while retaining the link between pension scheme and sponsor.

Figure 8 – Comparison of solutions for defined benefit pension schemes

	Capital injected by provider?	Trustee remains in place?	Sponsor link remains in place?	Flexibility to change strategy in future?	Supported by pension or insurance regime?
Run-off	N/A	Yes	Yes	Yes	Pensions
Third Party Capital Solutions	Yes	Yes	Yes	Limited	Pensions
Superfunds	Yes	No	Yes or No	No	Pensions
Buy-in	Yes	Yes	Yes	Limited	Ultimately pensions
Buyout	Yes	No	No	No	Insurance

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How does a TPCS work?

One approach is for a 'capital buffer' from the capital provider to be held outside of the pension scheme and structured in such a way that it is paid into the scheme if pre-agreed funding thresholds are not met at agreed dates in the scheme's journey plan.

In this article, we have focused on a TPCS that is structured to support a journey to buyout, but many of the aspects covered are equally relevant to a TPCS designed with a self-sufficiency end game in mind.

With the funding target and time period to reach this target in mind, the capital provider will agree with the trustees an investment strategy, which will also need to make allowance for providing a return on the capital provided. Once the investment strategy has been agreed, the trustees will typically not be able to change it without the agreement of the capital provider. Other actions during the journey plan may also need to be agreed – for example member option exercises.

With the TPCS in place, the pension scheme will otherwise operate as normal. The trustees, the sponsor and both parties' advisers will continue with the same responsibilities as previously.

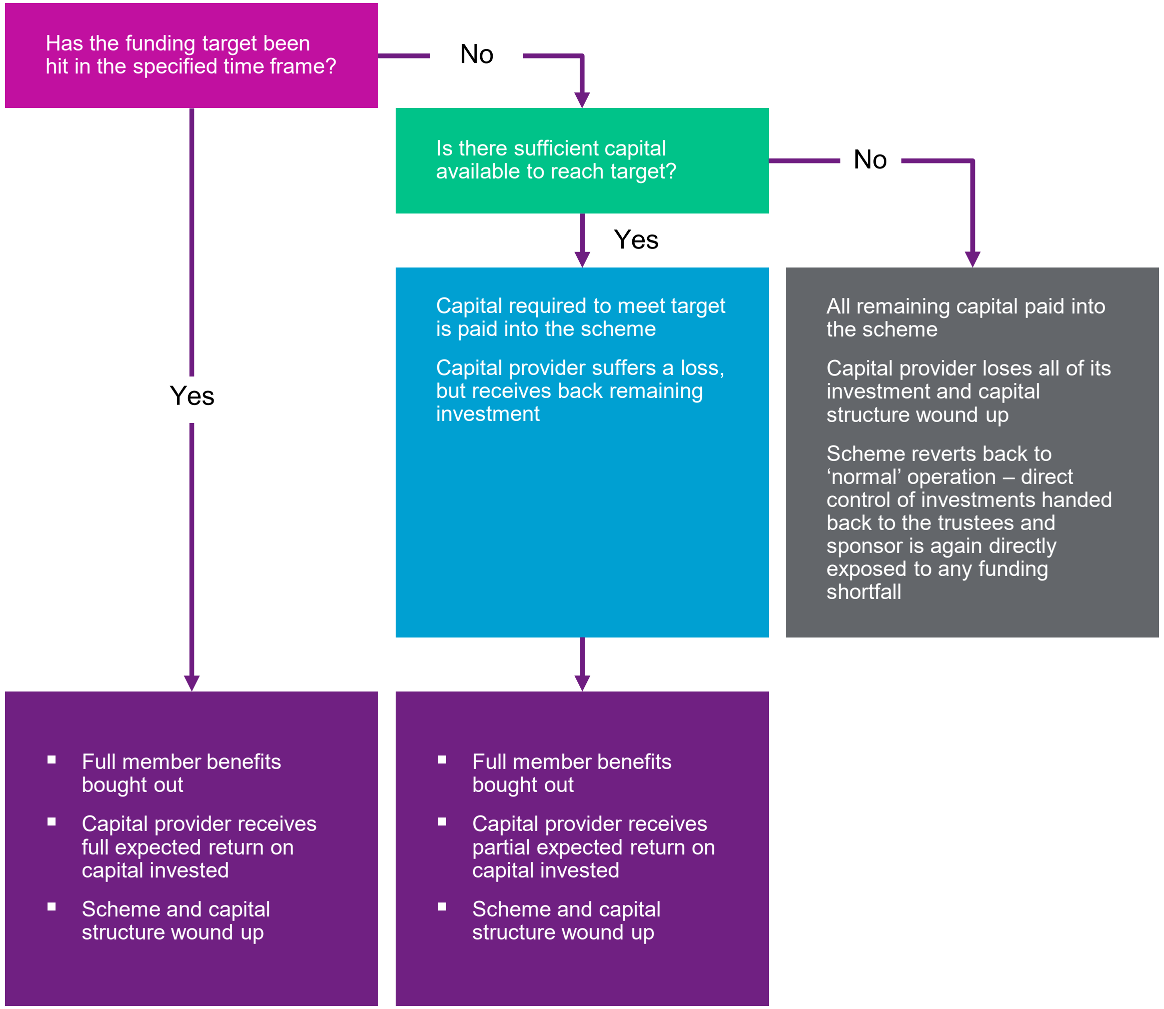
There are some key pros and cons of using such an approach, as summarised in Figure 9.

Figure 9 – Pros and cons of using a TPCS

Greater certainty	▪ Capital buffer provides the pension scheme with additional protection against downside risk ▪ The availability of the capital buffer provides the trustees with greater comfort to target higher returns on investments ▪ Potential for a reduction in sponsor contributions
Sponsor protection	▪ Sponsor enjoys greater certainty regarding the requirements the pension scheme places on the business ▪ Sponsor benefits from the downside protection afforded by the capital buffer
Risks	▪ Control of the investment strategy is passed to the provider of capital limiting the ability to react to events or change course ▪ The downside is only protected to the extent of the capital buffer. Should the buffer be exhausted, the scheme is exposed to further downsides

At the end of the agreed period there are then broadly three possible scenarios (as illustrated in Figure 10). Two of these will lead to the benefits being bought out in full, but only one leads to the capital provider making their expected return.

Figure 10 – Possible outcomes under the TPCS



How does a TPCS compare with the alternatives?

The two other options available to pension schemes who can't yet afford buyout (over and above the 'normal' direct funding of a pension scheme by the sponsor) are either to break the link with the sponsor and transfer the liabilities to a third-party superfund or for the sponsor to agree to put in place some form of contingent funding.

The barriers to a third-party transfer are often significant – the pension scheme can't afford buyout or the trustees don't want to lose the sponsor covenant by moving to a superfund.

Likewise, contingent funding from the sponsor may bring its own challenges for sponsors – for example, tying funds up in an escrow account means they can't be used elsewhere to support the business and lenders (either current or future) will look negatively on assets which have been promised elsewhere in the event the sponsor gets into difficulty.

This leaves a space for a TPCS to play a role where the scheme is not fully funded on buyout, and the sponsor is not able to / would prefer not to provide additional support to the scheme (either directly or contingently) in order to support the scheme taking additional investment risk in order to progress along its journey plan.

It is worth bearing in mind with TPCSs that, unlike the bulk annuity market, it is likely that the products available are not identical products nor are they likely to be provided by similar organisations, making comparisons more challenging. This feature will mean sponsors and trustees will need to complete detailed due diligence before entering into a TPCS. However greater freedom to structure a TPCS may well enable pension schemes to negotiate terms that best meet their specific need.

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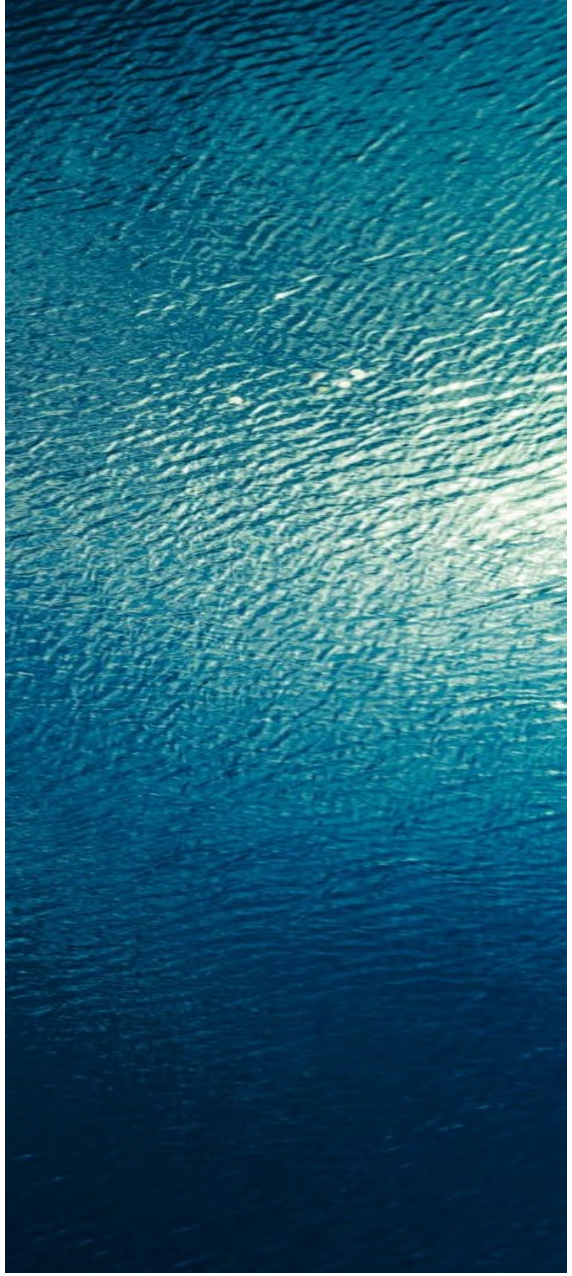

Pension scheme characteristics that TPCSs will favour

From our discussions with a number of capital providers actively considering these deals, a pension scheme which meets the following criteria will be attractive to them:

- Total liabilities in the range of a few £10m to a few £100m
- Around 85% funded on buyout
- A significant proportion of the total liability is in respect of deferred members
- Relatively robust sponsor so as to reduce the likelihood of needing to deal with the complexities in the case of sponsor insolvency

Such a pension scheme would achieve the balance of offering the capital providers with sufficient opportunity to make a return on their investment, whilst at the same time being in a position that putting in place a TPCS is beneficial to both the trustees and sponsor.

Conclusion

While still a new area, it would already seem that the right TPCS will be an attractive proposition to some trustees and sponsors. For pension schemes where this is the case then we believe the two key areas to assess will be:

1. Does the additional security from the capital buffer provide a fair trade off for handing over control of the pension scheme's assets, or would maintaining the status quo be preferable?
2. Are the trustees and sponsor comfortable with both the counterparty and the contractual terms they are offered?

2021 is likely to be pivotal for the development of the TPCS market – having already had the first case of this type completed, will this momentum be built on and the solutions available get further refined or will activity fizzle out? Based on conversations with clients, we expect this to be an area that many pension schemes now start to give serious consideration to.

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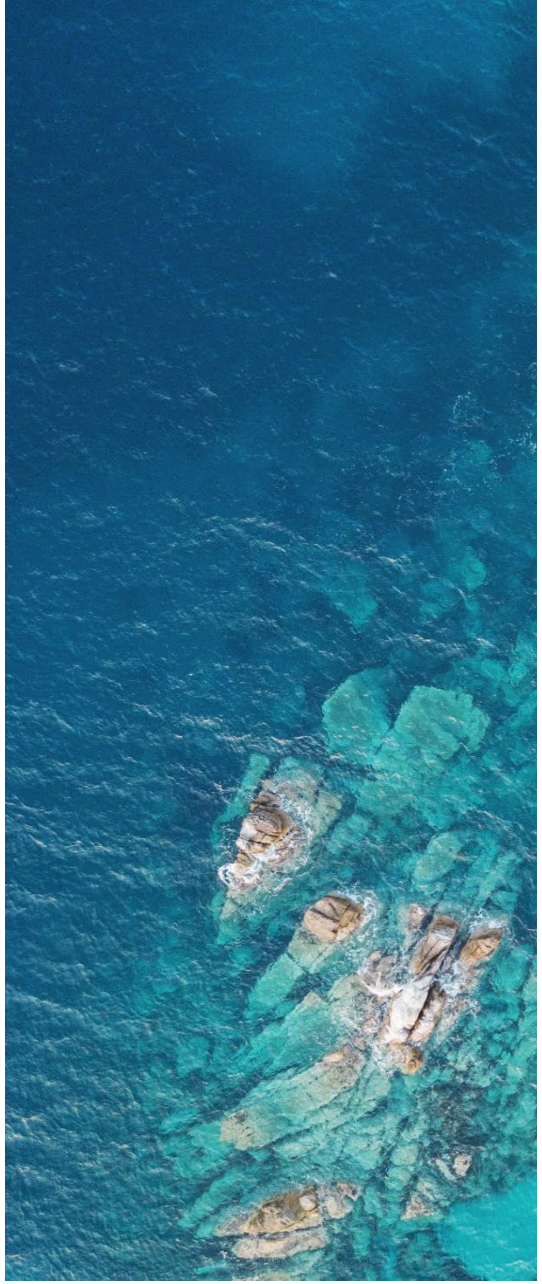

Predictions for the 2021 UK de-risking market

Louise Nash and **Matt Wiberg** share their predictions on what we might see over the next year in the buoyant de-risking markets.

Prediction 1 – market volatility to create opportunities for fast movers

Our first prediction is very much based on a trend demonstrated in 2020. The COVID-19 pandemic caught the world and investment markets by surprise and we saw some of the biggest falls, recoveries and changes in investment yields that have been seen in many years. This gave rise to some short periods when bulk annuity pricing was at incredibly attractive levels, driven by credit spreads widening.

Many of the schemes that were actively monitoring or engaging the insurance market over this period, were able to adapt to the new working environment rapidly and had asset strategies that allowed them to move quickly, which enabled them to achieve buy-in pricing that exceeded their expectations at the start of their processes. In the first half of the year, our team helped to close 14 bulk annuity transactions which locked into these prices.

Looking into 2021, the continuing pandemic and Brexit could mean another bumpy ride in investment markets. The lesson from 2020 is that volatility can create opportunity if schemes have prepared and are actively monitoring. We expect to see more schemes working in partnership with insurers to monitor market conditions, determine if and when the right time to act is and identify those windows of opportunity.

Prediction 2 – expanding universe of risk management options

Over 2020, we started to see superfund cases heading towards interim clearance from the Pensions Regulator and the emergence of new risk management structures such as capital backed journey planning and Legal & General's Assured Payment Policy offering, which completed its first deal with the AIB Group UK Pension Scheme in 2020.

Our prediction for 2021 is that we expect to see increasing use of this wider toolkit of risk management options available to pension schemes. We expect this growth to be accelerated particularly due to increasing numbers of sponsors under stress, and some schemes having experienced funding level falls in 2020.

We expect to see the first superfund deals completed in 2021 and there are several new entrants considering various offerings to schemes to provide capital in order to reduce uncertainty over the journey to buyout. With an increasing array of options to consider, schemes will need to have a clear understanding of both the art of the possible and their objectives, in order to ensure they are considering the options which are right for their situation and goals.

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Prediction 3 - Attractive pensioner longevity swap pricing

Even before the COVID-19 pandemic, in recent years, mortality rates have not shown the level of sustained improvements that we saw between 2000 and 2014. These trends have been increasingly feeding through into the pricing offered by reinsurers for longevity swaps, resulting in the lowest pricing relative to pension scheme reserves on record. The longevity reinsurance market has been incredibly competitive, and a number of reinsurers have joined this market, all of which has been driving down prices. This attractive pricing also has a positive impact on bulk annuity pricing, as currently most insurers are reinsuring longevity risk as part of any transaction. We expect these attractive prices relative to historic levels to continue into 2021.

It remains to be seen what impact COVID-19 will have on longer term expectations for mortality rates, as Sadie Scaife discussed in her article on page 9. For many schemes, the market pricing of longevity will currently look very attractive relative to their funding reserves. We therefore expect some schemes will look to lock into assumptions which are affordable against their current funding target to reduce future uncertainty as part of their wider hedging programmes.

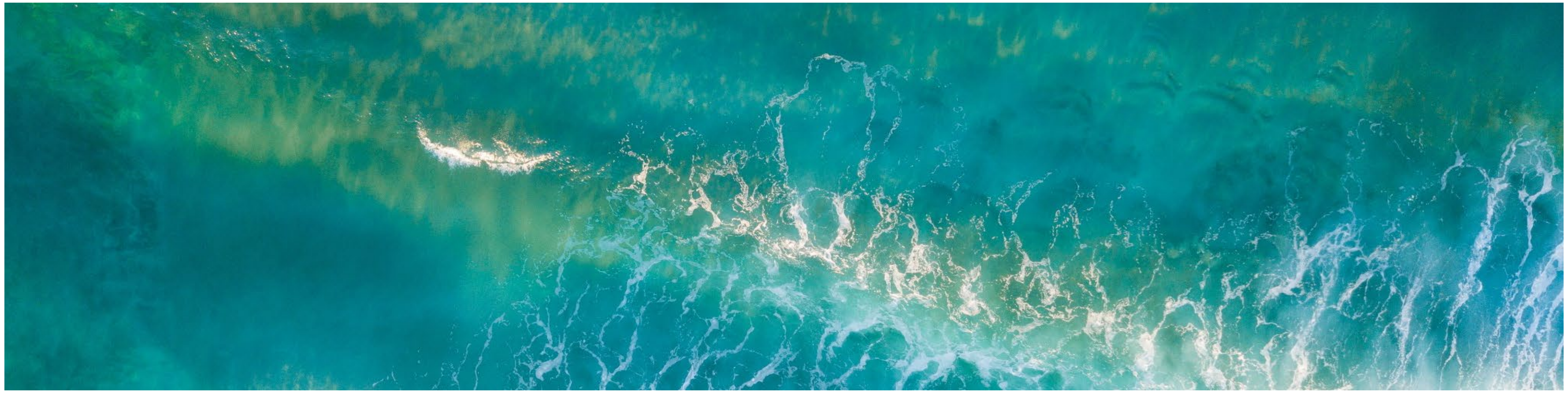
Prediction 4 - Busy market

Finally, although we certainly have been saying this every year in recent times, we predict that it is going to be another busy year in this market!

The pension scheme universe is maturing and looking to manage risk, as schemes become an increasingly legacy concern for sponsors and as funding improves. As Sadie Scaife noted on page 10, in response to the Willis Towers Watson Emerging Trends in DB Pensions Survey 2020, 40% of schemes stated that they are targeting completing a bulk annuity or longevity swap in the next 3 years.

While the quotation and execution process for these transactions is now a well-trodden path, given the volume of schemes exploring their risk management options, insurers and reinsurers still have operational constraints which will prevent them quoting on every deal in the market. In order to get the right outcome in a busy market, it is important for schemes to manage their approach carefully and consider a more targeted approach and a clearly articulated price target. This is particularly important for smaller schemes, when a number of large deals are likely to be driving activity in the market again in 2021.

We expect another year of high activity despite the funding hits some schemes experienced as part of the market volatility associated with the pandemic, with around £30bn of bulk annuities traded and £25bn of liabilities covered by longevity swaps.



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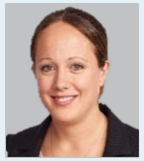

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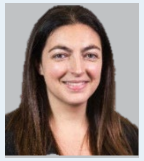

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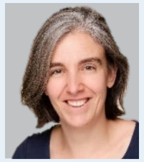

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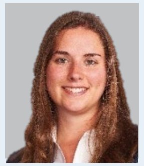

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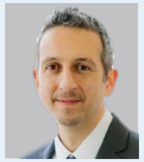

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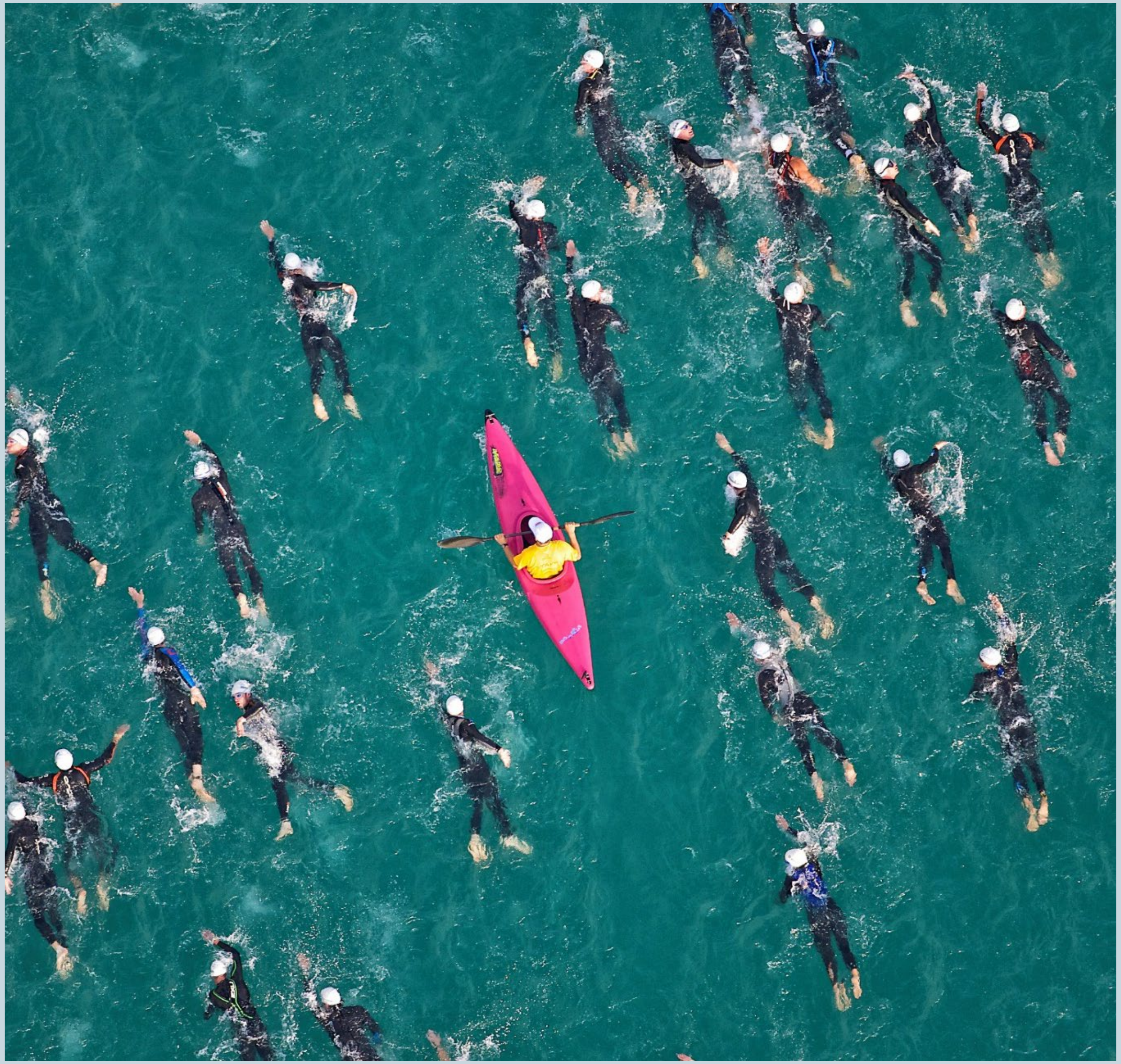

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