Shifting up a gear

De-risking report 2023

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1. Introduction

Welcome to WTW's 2023 de-risking report in which a number of our experts look back at activity in the pension risk settlement market in 2022, consider some of the current key themes and share predictions for the year ahead.

The bulk annuity and longevity hedging markets continue to be busy with volumes in 2022 similar to those seen in 2021. However, this does not take into account the much publicised, significant rise in gilt yields seen in the second half of the year which reduced the absolute size of pension scheme liabilities, therefore leading to smaller transaction volumes for the same populations on a like-for-like basis. In fact, after taking market conditions into account, 2022 is likely to be the second biggest year on record for the bulk annuity market.

The rising gilt yields, along with widening credit spreads (the additional return from corporate bonds relative to gilts), and improved longevity reinsurance pricing has resulted in some schemes seeing an improvement in buyout funding levels to the extent that buyout is now within reach much earlier than anticipated. We have therefore seen an increase in the number of full scheme buy-ins and this trend is expected to continue in 2023.

WTW's record in numbers

£28bn of bulk annuities and longevity swaps advised on over 2021/22

Our bulk annuity record over 2021/22

40 bulk annuities totalling **£9.6bn**

our smallest transaction

Deals completed with all **8** active insurers

£2.2bn We led the largest buyout transaction in the last 2 years

Our longevity swap record over 2021/22

£18.2bn of longevity swaps

58% market share

1st ever deferred pensioner longevity swap

Source: WTW, January 2021.

Our team is proud to continue to be at the heart of this market. In 2022, we supported trustees and corporates across all scheme sizes in navigating the market and achieving great outcomes for their buyout, buy-in and longevity swap processes. In fact in 2022 we led more deals than in any previous year – 25 transactions ranging in size from £900,000 to £5.5 billion! And with more schemes than ever planning to approach the market in 2023, our team is expecting to be very busy helping clients to achieve the right transaction for them.

It is in this context that this report provides an overview of the market over the past year and our predictions on what we expect to happen in 2023. In addition, we highlight some topical issues we expect to be important to schemes considering a transaction, including:

- The drivers behind the current attractive longevity pricing
- What the recent market volatility might mean for schemes considering a buy-in transaction
- Working exclusively with an insurer to complete a bulk annuity
- Innovative solutions to overcome illiquid assets being a barrier to buyout
- Embedding member experience in the insurer selection process

We hope you find this an interesting insight into this growing market and would welcome the chance to discuss further with you how your scheme can maximise its opportunities to manage risks in the current environment.

Ian Aley
Head of Transactions
WTW

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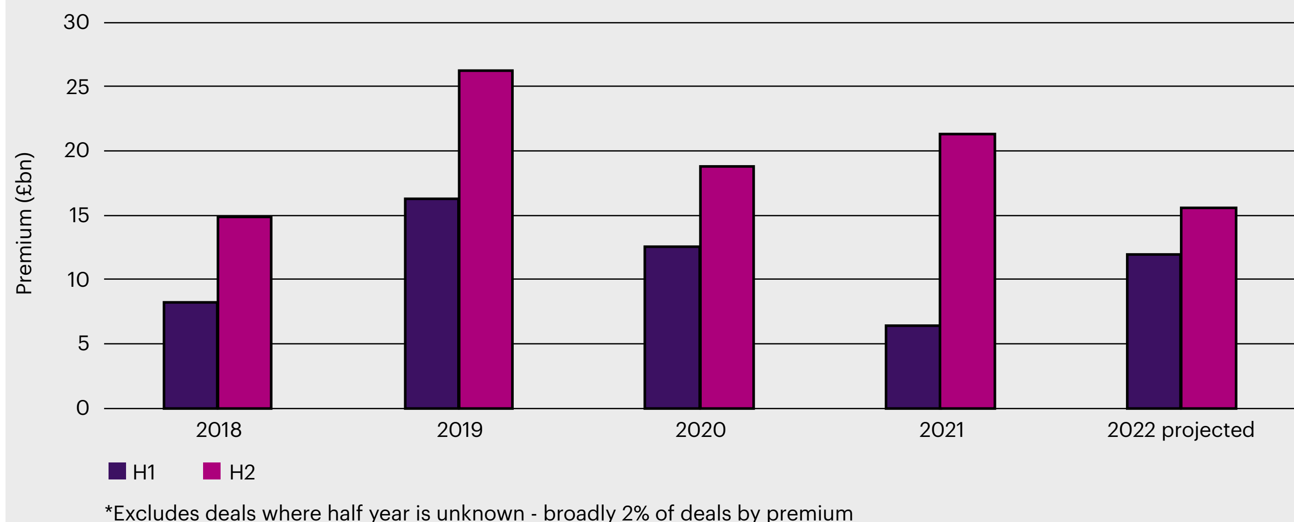
2. 2022 in review

Rhys Mellens

As has often been the case in recent years, the first half of 2022 was relatively quiet in the bulk annuity market. The second half of the year was much busier, driven by the extreme rise in gilt yields and very attractive pricing, although this busyness was masked by the impact of market conditions which reduced bulk annuity volumes. Meanwhile it was another busy year in the longevity swap market, particularly for schemes with existing longevity swaps doing further transactions. Rhys Mellens looks back at the de-risking market in 2022.



Source: WTW, December 2022. 2022 projected figures are based on WTW estimates.

The calm before the storm in the bulk annuity market

The first half of the year typically sees lower volumes in the bulk annuity market. Around £12bn of bulk annuities were written in the first half of 2022 – up from £6bn in the first half of 2021, but significantly lower than the c£22bn of bulk annuities written in the second half of 2021.

The increase in activity in the second half of the year is now a regular occurrence in the market as insurers look to hit their targets for the year. Buy-in pricing is currently the cheapest seen in over a decade, as Louise Nash explains later in this report. At the time of writing, the final volumes for 2022 are not yet known but we expect the total liabilities transferred to insurers through bulk annuities will be more than £25bn for the fourth year in a row.

Of course, insurers looking to hit new business targets was not the only driver for the growing demand for bulk annuities in the second half of 2022.

The rise of the gilt yield

After a prolonged period of historically low gilt yields, this changed emphatically in 2022. The rise of gilt yields began in the first half of the year, but really came into the limelight in September following the former Chancellor's now infamous mini-budget announcement when yields rose by 130bps in just 3 days. Yields are now back to similar levels as before the mini-budget, although this level is still some 200bps higher than at the start of 2022.

The consequences of the short-term rise in gilt yields following the mini-budget were enormous and felt throughout the pensions industry and beyond. Much of the coverage in the mainstream media focused on the liquidity issues faced by some pension schemes where the jump in yields resulted in large and sudden calls for collateral.

However, it was less reported that the general increase in yields over the year, alongside the widening of credit spreads, was generally positive for buyout funding levels, as asset values fell by less than buy-in premiums for some schemes, and a number of schemes reached their end game sooner than expected as a result. In addition, even schemes where there was no change in buyout funding level saw their buyout deficit fall in monetary terms, which made the potential to pay a one-off contribution to remove the pension scheme from the balance sheet look more attractive for some sponsors. As a result, there was a significant increase in market demand for bulk annuities, which looks set to continue.

A level playing field

Another interesting consequence of the rise in gilt yields was the impact on the amount of liabilities transferred to the bulk annuity insurers in 2022. On the face of it, 2022 was similar to 2020 and 2021 by volume of liabilities transferred, however this doesn't tell the full story. The significant increase in gilt yields over the year meant that the value of liabilities transferred by any transaction was significantly lower than it would have been a year or two before. Buy-ins that were around £1bn at the start of the year were closer to £600m several months later. The chart in Figure 2 shows the volumes of liability transferred over each of the last 5 years after being approximately adjusted to reflect average gilt yields over that 5 year period.

So after taking market conditions into account, 2022 is the second busiest year ever in the bulk annuity market.

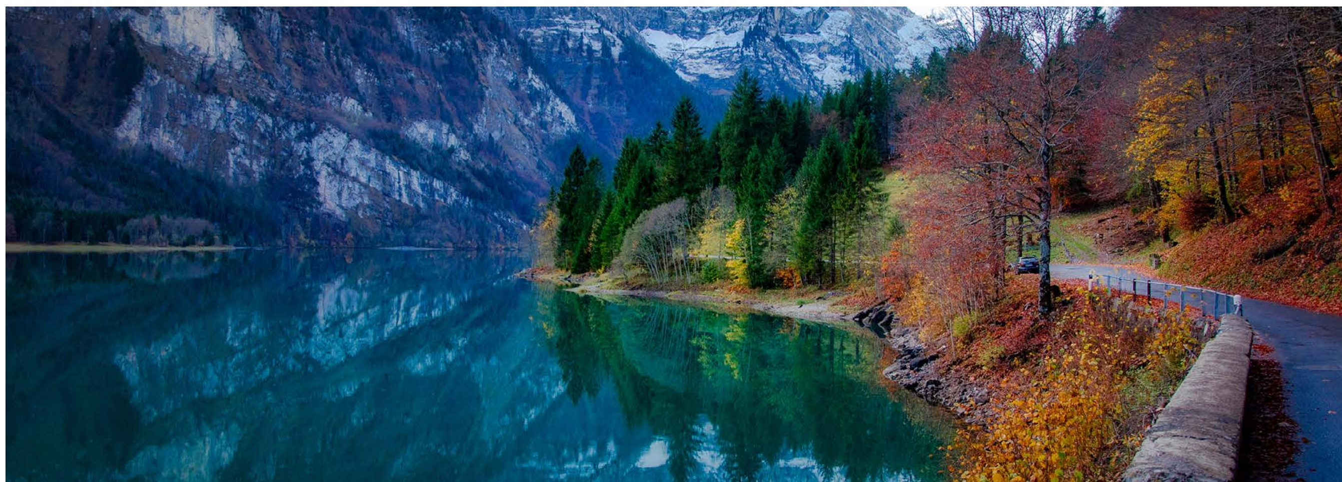
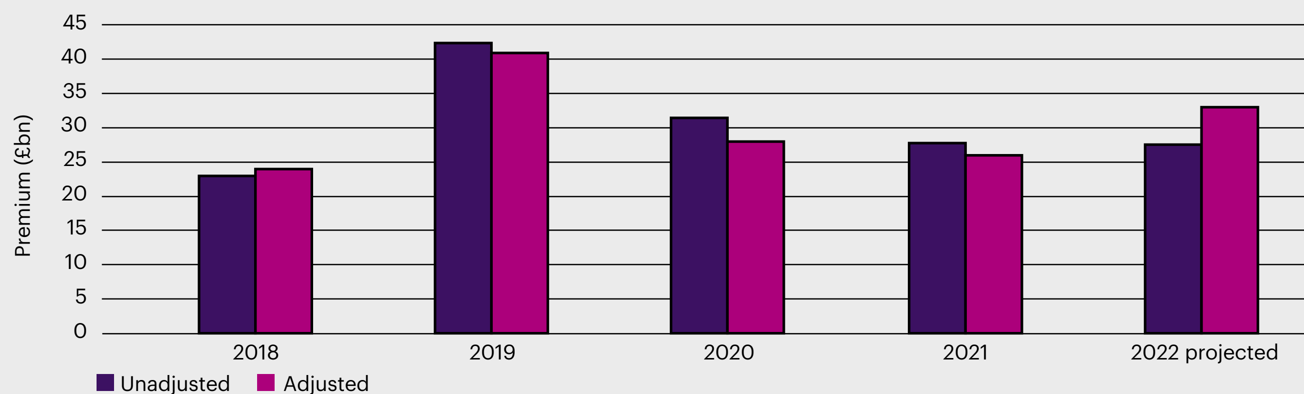
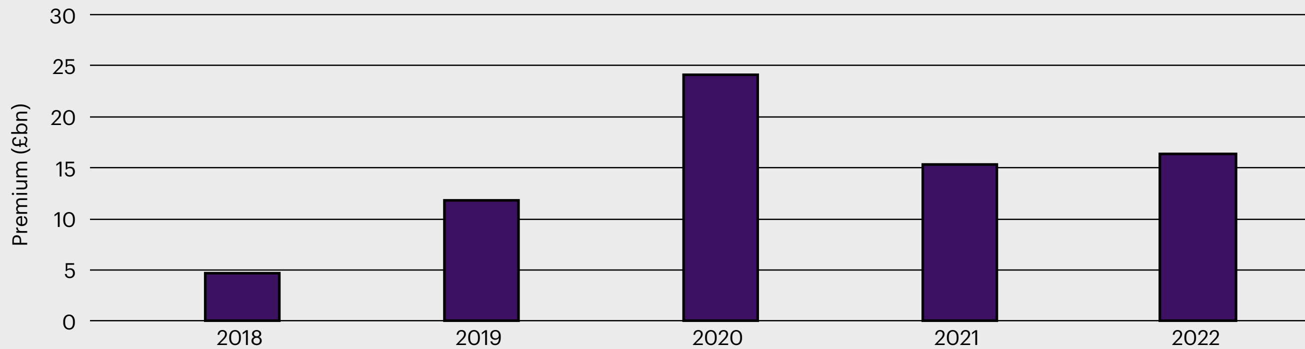


Figure 2: **Bulk annuity volumes over 2018 to 2022, adjusted to reflect average market conditions**



Source: WTW. December 2022. Unadjusted data based on publicly available information and WTW estimate for 2022, adjusted data based on average gilt yields over 5 year period to December 2022

Figure 3: **Longevity swap volumes – 2018 to 2022**



Source: WTW, December 2022

Kicking off with a bang in the longevity swap market

The year started with the announcement of the Lloyd's Banking Group Pension Schemes completing a second longevity swap for £5.5bn of liabilities in February. The longevity swap market remained busy throughout the year, driven by extremely attractive pricing, with over £16bn of longevity swaps written and more than half of these being for schemes that have previously completed a longevity swap.

We expect this busyness to continue with several longevity swaps due to be announced in 2023. Later in this report, Matt Wiberg and Filipa Eastham look at the drivers behind the reduction in the cost of reinsuring longevity risk in 2022.

Reflecting on our predictions for 2022

In last year's report, Katherine Russell made a number of predictions for 2022. Did these come true?

1. Another busy year in the market:
This was definitely the case – it's likely to have been one of the busiest years to date when viewed on consistent market conditions.

2. Transactions of all sizes:
Transactions ranged from £1m to £7bn. We didn't see the mega-transactions in the bulk annuity market that were expected, but insurer capacity for these very large deals is growing and there are record-breaking cases actively being priced in the market.

3. More schemes monitoring the market closely:
This has been brought into sharp focus by the improvement in buyout affordability over the year. Increased affordability has also meant schemes are placing more weight on selection criteria other than price – notably administration experience and ESG considerations.

4. Greater innovation:
This has also definitely been the case. Over 2022, we saw:

- L&G announce its first Assured Payment Policy, or APP, deal for a sub-£100m scheme, proving that alternative solutions can be utilised by smaller schemes;
- Insurers innovate to meet increased demand for deferred premium options, as schemes approaching buyout look to deal with illiquid assets and sponsors aim to avoid surplus being trapped in their schemes. Lucy Wilson provides more detail on this later in the report; and
- Reinsurers continue to increase capacity for deferred longevity reinsurance with most reinsurers now able to cover large proportions of deferred members – this has been a key driver for improvements in deferred bulk annuity pricing and more schemes are also now considering longevity swaps including deferred members.

Assured Payment Policy (APP)

An insurance policy offered by L&G that provides the pension scheme with protection against investment-related risk. Similar in nature to a buy-in, with the crucial difference being that APPs do not vary with longevity risk or other demographic experience.

Source: L&G

3. Update on the longevity reinsurance market

Matt Wiberg

Filipa Eastham

2022 has been another busy year for the longevity reinsurance market, in this article Matt Wiberg and Filipa Eastham look at three areas of the longevity market:

i) current pricing opportunities;
ii) ESG considerations for reinsurers; and
iii) efficiencies for pension schemes completing a repeat transaction.

Price opportunities in the longevity hedging market

Over 2022, the cost of hedging future increases in life expectancy has fallen, offering attractive opportunities for pension schemes looking to pass on this risk. Matt Wiberg and Filipa Eastham look at the drivers behind this.

Longevity risk is the additional cost of paying pensions in future if members live longer than anticipated. A longevity hedge passes this risk onto a third party. Whilst under UK insurance regulations it's a requirement that the scheme enters into a contract with an insurer, the insurer may in turn pass all of the risk onto a reinsurer. The cost for hedging future increases in life expectancy is therefore driven largely by the longevity reinsurance market, not the 'fronting' insurers.

It's therefore very good news for schemes looking to hedge longevity risk that the cost of reinsuring longevity risk has reduced materially over 2022. There are three key factors that have driven this:

1. Increased market capacity and competition

All else being equal, economic principles tell us that an increase in supply will lead to a fall in prices. A combination of new entrants to the longevity market and a universal increase in the capacity of the existing reinsurers has resulted in downward pressure on prices.

2. Rise in global yields

The significant increase in global yields over the second half of the year has led reinsurers to be able to reduce their premiums for holding longevity risk. The reasons for this are twofold. Firstly, the regulatory capital the reinsurer is required to hold is lower. Secondly, the "tail risk" to the reinsurer from changes in life expectancy is reduced as future cashflows are discounted at a higher rate.

3. Recent mortality experience

Whilst the true impact of COVID-19 on longer term life expectancies is unlikely to be known for many years, if not decades, there is increasing data supporting lower estimates of future mortality improvements. This has resulted in reinsurers adjusting their mortality assumptions downwards. Whilst we have seen a reduction in the number of deaths as a result of COVID-19 over 2022 compared to the previous two years, as the table below shows, the number of deaths in England and Wales over 2022 (at the time of writing) has still been nearly 4% higher than in 2019, pre-pandemic. In addition, the 2021 census in England & Wales is expected to lead to lower estimates of recent and future mortality improvements than previously thought, adding further weight to the argument for adjusting down mortality assumptions.

Figure 4: **Number of deaths in England and Wales compared to 2019**

Year	Number of deaths in England and Wales compared to 2019
2022	+4%
2021	+7%
2020	+13%

Source: Continuous Mortality Investigation (CMI)

Reinsurers are much quicker to factor in new data than pension schemes, and are already reflecting both of these factors in their pricing. A combination of the above factors has led to reductions in the absolute cost of longevity reinsurance over 2022, both directly through longevity swaps and indirectly as a component of the bulk annuity pricing available to pension schemes. However, for any pension scheme that is considering hedging longevity risk, it will be important to consider affordability and undertake your own value for money assessment reflecting the circumstances of your scheme and your views of future life expectancy.

Launch of WTW reinsurer ESG survey

The global push to address climate change continues to drive environmental, social and governance (ESG) issues further up the agenda for trustee boards. Since starting our annual ESG survey of bulk annuity providers back in 2020 we have seen the insurers really stepping up to demonstrate their ESG credentials.

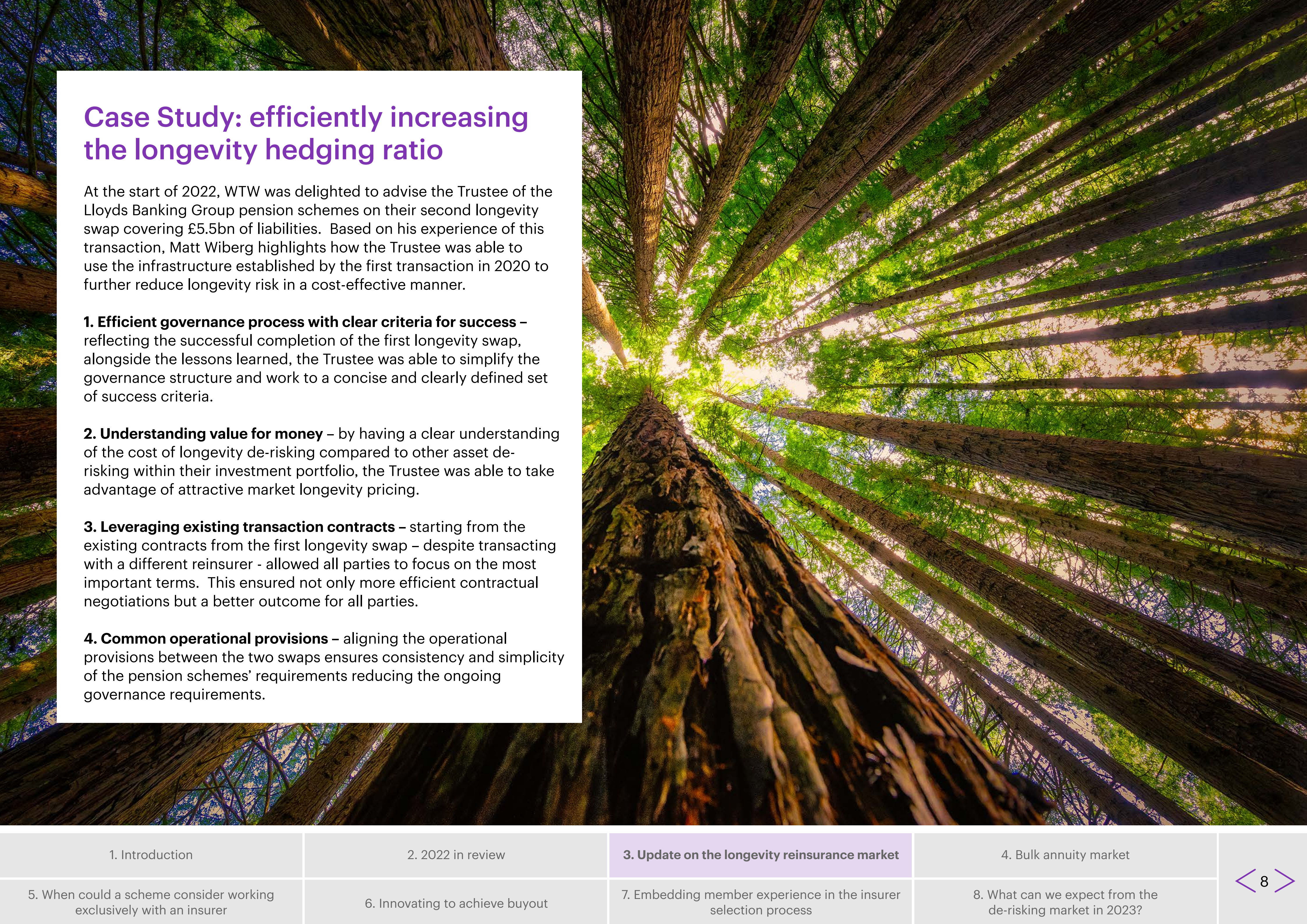
WTW is proud to help influence and shape progress across the industry and consequently, after three years of surveying the bulk annuity providers, we have extended the survey to the reinsurance market, acknowledging the important role reinsurers have in the pensions de-risking space. We were pleased with the engagement from the reinsurers and look forward to working with them to improve the ESG approach over coming years as we have seen with the bulk annuity providers.

The reinsurer's ESG credentials were assessed in four areas with a summary of the results in Figure 5.

Figure 5: **Responses to WTW's ESG research survey carried out during 2022**

	Approach to ESG	Organisation overview	Climate risk	Stewardship
Reinsurer 1	★★★	★★★	★★	★★
Reinsurer 2	★★★	★★	★★★	★
Reinsurer 3	★★★	★★	★★	★★★
Reinsurer 4	★★★	★★	★	★★
Reinsurer 5	★★	★★★	★★	★★
Reinsurer 6	★★	★★	★★	★
Reinsurer 7	★★	★	★	★★
Reinsurer 8	★★	★	★	★
Reinsurer 9	★	★★	★★	★★
Reinsurer 10	★	★	★	★
Reinsurer 11	★	★	★	★
Reinsurer 12*	★★★			

* Only part of the survey was completed



Case Study: efficiently increasing the longevity hedging ratio

At the start of 2022, WTW was delighted to advise the Trustee of the Lloyds Banking Group pension schemes on their second longevity swap covering £5.5bn of liabilities. Based on his experience of this transaction, Matt Wiberg highlights how the Trustee was able to use the infrastructure established by the first transaction in 2020 to further reduce longevity risk in a cost-effective manner.

1. Efficient governance process with clear criteria for success – reflecting the successful completion of the first longevity swap, alongside the lessons learned, the Trustee was able to simplify the governance structure and work to a concise and clearly defined set of success criteria.

2. Understanding value for money – by having a clear understanding of the cost of longevity de-risking compared to other asset de-risking within their investment portfolio, the Trustee was able to take advantage of attractive market longevity pricing.

3. Leveraging existing transaction contracts – starting from the existing contracts from the first longevity swap – despite transacting with a different reinsurer - allowed all parties to focus on the most important terms. This ensured not only more efficient contractual negotiations but a better outcome for all parties.

4. Common operational provisions – aligning the operational provisions between the two swaps ensures consistency and simplicity of the pension schemes' requirements reducing the ongoing governance requirements.

4. Bulk annuity market - will fewer schemes complete partial buy-ins after the liquidity squeeze?

Louise Nash

Buy-in transactions covering a proportion of a scheme's liabilities have traditionally been an important step taken by trustees as part of their de-risking journey to securing all liabilities with an insurer. Louise Nash explores what recent investment market volatility might mean for schemes considering a partial buy-in transaction.

In recent years, many schemes have secured attractive pricing for buy-ins, particularly for pensioner liabilities, allowing trustees to 'lock in' an investment return in excess of the yield available on government bonds. Unlike simply de-risking the investment strategy a buy-in fully hedges the risk that pension scheme members live longer than expected or that a higher proportion of members are married than expected, as well as providing an exactly matching cashflow.

Big changes in the investment market

Over the autumn, we saw big movements in investment markets with large increases in interest rates and the yields available on government bonds over very short periods. This was a result of the market reacting to the Government's "mini-budget" and, whilst yields have now resettled to their previous levels, there remains high levels of uncertainty about the longer-term economic outlook.

For pension schemes, these very fast and significant changes emphasised the liquidity risk within the investment strategies they were running. Many pension schemes operate a 'Liability Driven Investment' ("LDI") strategy, where assets are held to move in line with a chosen liability measure, which for most pension schemes means hedging against movements in government bond yields and market-implied inflation. These LDI strategies can make use of 'leverage' to achieve a higher level of interest rate and inflation hedging from a smaller pool of assets, such that the remaining assets can be invested to target returns in excess of government bonds to allow schemes to make progress with their journey plans. This leverage uses collateralised derivative products, which means that when yields go up and the scheme moves 'out of the money', the scheme is required to make assets available to act as collateral to maintain the hedging, typically in the form of gilts or cash.

What this all meant in September and October 2022 was that many pension schemes had to quickly access gilts or cash to meet collateral calls. The magnitude and speed of gilt market changes meant that some schemes were not able to liquidate assets fast enough and therefore lost part of their hedge against interest rate and inflation changes, and potentially saw decreases in their funding levels. Those schemes with high levels of leverage or without the governance arrangements to react quickly were particularly affected.

Figure 6: **Timeline of events**

21 September
US Federal reserve announces a 75bps rise in interest rates in a bid to tackle inflation.

22 September
Bank of England announces a rise of only 50bps in interest rates. UK gilt yields start to spike as this is below what the market had expected.

23 September
UK "mini -budget" confirms additional gilt issuance to fund energy price relief, the cancellation of proposed tax increases and some unexpected tax cuts for higher earners. UK gilt yields continue to spike.

26 - 28 September
Significant daily upward moves see the cumulative rise in yields exceed typical levels of collateral headroom. Some investors fail to post collateral, and their hedges are closed out, with the enforced sale of the underlying gilt collateral putting further pressure on yields and causing other investors to get into trouble.

28 September
To restore financial stability and prevent a "domino effect"' the Bank of England announces a resumption of gilt purchases targeting long nominal gilts, but only until 14 October 2022.

10 October
The BoE announces further supporting measures with a view to an orderly end to its gilt purchase programme.

14 October
Bank of England completes its programme of gilt purchases. Kwasi Kwarteng is replaced as Chancellor.

17 - 20 October
UK government overturns almost all of the 'mini-budget' policies. Liz Truss resigns on 20 October.

16 November
Jeremy Hunt, as Chancellor, unveils his Autumn Statement with £55bn of fiscal consolidation against a darkening economic outlook. Markets respond favourably.

Spot gilt yield at 25 year maturity (% pa)

Source: WTW as at 16 November 2022

The implications for investment strategies

After the dust has settled, the industry is now taking a more cautious approach on how much schemes need to hold in accessible liquid assets to be used as collateral if interest rates increase dramatically again. Thinking around the long-term framework for these strategies is still evolving, but its clear schemes will have more focus on liquidity going forwards.

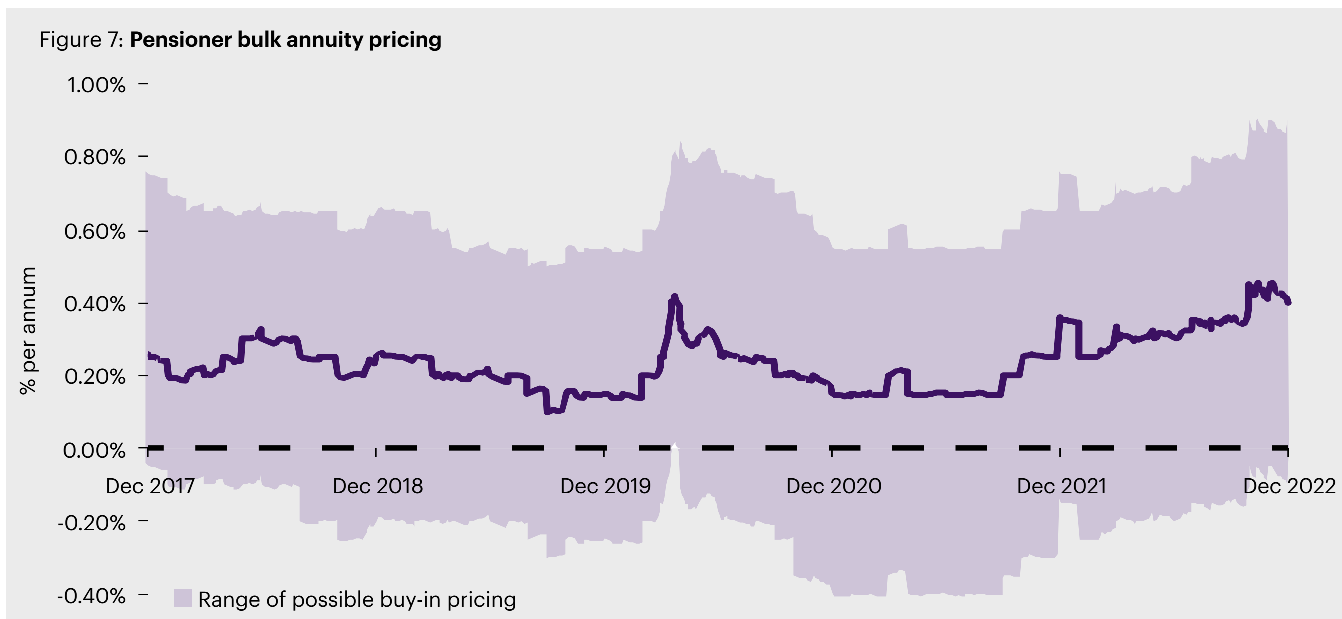
This means it is harder for schemes to both maintain high levels of interest rate and inflation hedging and invest in return-seeking assets to progress their journey plans. Introducing a buy-in into the investment strategy adds to this challenge, because buy-ins are completely illiquid and they reduce the residual pool of assets to be used to maintain hedging on the non bought-in liabilities. For some schemes these constraints will restrict the size of buy-in they can now consider to such an extent that it would no longer have a meaningful impact on the scheme's risk profile and may not be of sufficient size to attract competition and strong pricing from insurers.

What alternatives could schemes consider to manage longevity risk?

With much more market experience and standardisation of processes, more schemes may consider a longevity swap as a means of reducing exposure to longevity risk in the nearer term. A longevity swap has the benefit of protecting schemes against members living longer than expected but does not involve the initial material outlay of funds, enabling schemes to retain investment freedom and sufficient collateral assets to support LDI strategies. Matt and Filipa have written an article summarising the latest developments and pricing in the longevity swap market – please see their article for more views on the latest pricing we are seeing.

When might a partial buy-in make sense as a strategy?

Despite the potential challenges described above, we believe there are still lots of circumstances where a partial buy-in will have a clear benefit to a scheme's risk management journey.



Source: WTW December 2022

1. In a very competitive pricing environment

The pricing for pensioner bulk annuities is currently the cheapest seen in the market both in absolute terms and relative to government bond yields since the financial crisis in 2008.

If fewer schemes are in a position to approach the market for pensioner buy-ins next year due to liquidity concerns, there is likely to be strong competition from the insurers for those schemes that are able to take this opportunity. This competition, on top of already strong pricing, is likely to lead to very compelling pricing for partial buy-ins next year.

2. As part of de-risking the investment strategy

For many schemes (although by no means all) market volatility over the last few months has led to an improvement in funding position. This is particularly true where a scheme was not fully hedged against interest rate movements or where the scheme had material holdings of overseas assets where currency risks where unhedged.

For these schemes, trustees and sponsors will be considering de-risking their overall investment strategy to lock into recent improvements. This is likely to ease liquidity concerns for some schemes and given the competitive pricing environment, buy-ins could offer good value-for-money as part of this de-risking.

Buy-ins have the attraction that they provide a perfect match to liabilities, covering interest rate risk and inflation risk, perfectly matching pension increases as well as hedging longevity and other demographic risks which are not covered by LDI strategies.

3. In order to build a relationship with an insurer

A key advantage of completing a partial buy-in is that the scheme establishes a relationship with an insurer. This means that the insurer understands the scheme and its benefits, and the scheme already has terms in place with that insurer. Therefore, if an opportunity comes up where a further buy-in – covering part of all of the residual liabilities – is attractive, the scheme is ideally placed to act very quickly to lock into the opportunity, potentially within a small number of weeks, where an open market process can take 4-6 months. It also means from the insurer's perspective, that scheme is at the front of the queue for future work, making them stand out in what's expected to be a very busy market in future years.

We have seen a number of schemes leverage existing relationships to lock into a buy-in or buyout very quickly in the current volatile market conditions.

4. In order to understand the process

Undertaking a buyout is probably the most important project any Trustee Board will ever undertake. Therefore many of our clients see the advantage of using a partial buy-in as an opportunity to gain a better understanding of the market in advance. This includes understanding the insurers, their regulatory regime, the key stages in a project and also, importantly, understanding the governance process for their sponsor.

Conclusion

Overall, we expect to see fewer partial buy-ins in the market over the coming years while schemes work out their longer-term strategies for hedging and liquidity. However, the rationale for undertaking partial buy-ins can still be compelling, in the right circumstances, particularly as we expect there to be very good pricing opportunities for those schemes that are in a position to do a partial buy-in.

5. When could a scheme consider working exclusively with an insurer to complete a bulk annuity transaction?

Danielle Feingold

In a busy market it can be difficult for smaller schemes to secure interest from multiple insurers for a bulk annuity transaction, so is working exclusively with an insurer a good option for trustees? Schemes with an existing buy-in that are considering a subsequent transaction might consider working exclusively with the same insurer but how can they be confident that the pricing represents good value for money?

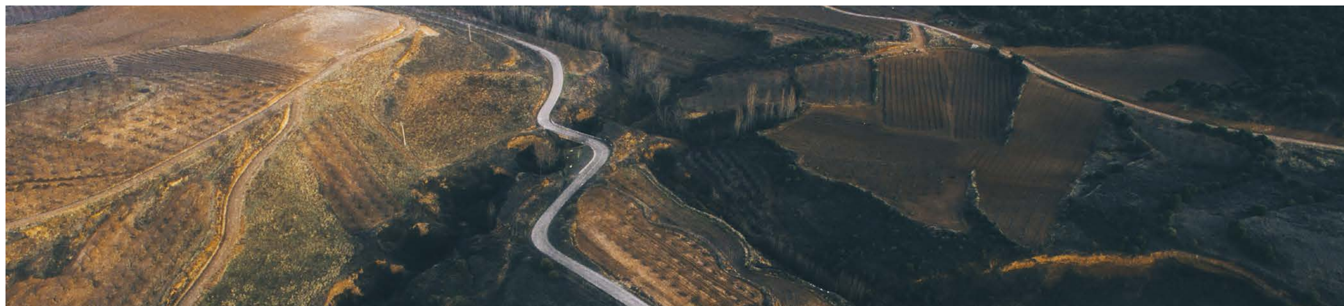
Danielle Feingold considers when it might be appropriate for trustees to work exclusively with a single insurer and reflects on two recent transactions where this approach worked very well.

Typically, the key concern for trustees and sponsors when considering an exclusive process for a bulk annuity transaction is whether working exclusively with one insurer will result in an attractive premium. Using our experience in the bulk annuity market, we have worked with a number of clients to complete exclusive transactions and believe that, if the project is approached in the right way, having a range of quotes and competitive tension between the insurers is not the only way to be confident you've achieved strong pricing from an insurer.

Key to this approach is our knowledge and experience of pricing in the market. In particular, our specialist team is able to provide comfort and guidance on the pricing received:

- We have regular pricing feeds from 6 insurers active in this market to benchmark quotations against expectations.
- We use our experience of pricing received from other live transactions to adjust pricing expectations to reflect the specifics of a scheme.
- We support our clients to set a stretching price target which represents good value, and which provides a goal for the insurer to reach.
- We have tried and tested negotiation techniques that can be used.
- If current pricing from the exclusive insurer is not yet at an attractive level, we have supported clients through a period of exclusive monitoring with the insurer. This means the insurer works hard to achieve a deal during the monitoring period, in the knowledge that if a deal isn't agreed, the process can be widened to consider the full market.
- In the case of a buyout transaction where the focus may be affordability rather than necessarily achieving the largest surplus, we work with our clients to establish an appropriate expense reserve, which alongside the scheme's assets, is used to determine a clear price target.

And of course the insurers know that we will take this approach to evaluating their pricing, which keeps them on their toes!



If the scheme can get comfortable with the process to ensure the price is competitive and attractive, we see two main scenarios where there are benefits to running an exclusive process.

1. Follow-on transaction with the same insurer

Many schemes have a strategy to transact a series of partial buy-ins over a number of years when they are able to afford to de-risk their investment strategy and when annuity pricing is attractive. For these schemes with an existing buy-in, the starting position may be considering working with the same insurer again, particularly if the previous transaction was relatively recent. There are a number of factors trustees and sponsors should consider when deciding whether this is the best approach to the project:

- **Timelines and overall strategy:**

If a transaction is working towards a tight timeline, for example because of corporate activity, a sponsor contribution that is time-limited or as a result of a potentially short-term good pricing opportunity, then approaching the same insurer is expected to be a much more efficient process. Not only as the insurer will be familiar with the scheme's benefit structure and can therefore provide a quotation more quickly but also the legal negotiations are expected to be far more streamlined, particularly if the first policy was transacted using an 'umbrella' contract.

- **Partial buy-in or buyout:**

If the scheme's intention in the long-term is to buyout and issue individual policies to the membership, then trustees often consider whether they are happy to ultimately have members' benefits secured with different insurers and this can play a role in deciding whether an exclusive process should be pursued.

- **Market developments:**

Particularly if the existing buy-in was undertaken some time ago, it is important to undertake a review of the bulk annuity insurance market upfront to reflect on the following:

- *Evolution of the insurers that are quoting and competitive* – whether that is as a result of a new entrant that wasn't previously considered (Standard Life in 2018) or a merger of two firms that now presents a different offering (Just Retirement and Partnership in 2016) or a change in an insurer's proposition (Canada Life in late 2022 expanded its offering to quote on deferred lives).
- *Changes in evaluation criteria and how insurers' are assessed* – examples of these changes include the increasing importance of Environmental Social & Governance credentials in trustees' decision-making processes or insurers' diversification of their investment strategies to better mitigate the impact of periods of market volatility.

- **Nature of the proposed transaction:**

The new transaction under consideration may have quite different characteristics to previous deals. Schemes should consider:

- *Size of transaction* – each insurer has a different target market so a deal of a different size may result in different insurers having appetite to quote or being competitive. Through WTW's insurer relationships and research, we have an in-depth understanding of how insurers' 'sweet spots' change over time and where their pricing can be optimised.
- *Membership covered* – considerations for a pensioner-only buy-in are different from those that apply to a transaction covering deferred members, so it will be important to consider which insurers will be able to provide the best coverage and price for the benefits you are looking to cover, taking into account for example facilities for Additional Voluntary Contributions or member option factors for deferred members.

Case Study: Keysight Technologies UK Limited Retirement Benefits Plan

The Keysight Trustees entered into a £250m pensioner buy-in with Just in early 2021. Through our involvement in a number of other transactions and regular dialogue with Just, we identified a great pricing opportunity to complete a follow-up transaction within a matter of months of the first deal and in December 2021 the Trustees signed a second pensioner buy-in for £60m. The strong pricing for the transaction resulted in an improvement in the Plan's funding position on its long-term target.

The Chair of Trustees at Keysight, Nick Johnson, said: "As we implemented an umbrella contract as part of the first transaction with Just, we were able to take advantage of favourable market conditions to go ahead with this second transaction."

2. Smaller schemes

Improvements in scheme funding levels mean that an already busy market is likely to become more crowded, and as such for a smaller scheme, typically less than £30m in size, insurers are sometimes only willing to work on a transaction on an exclusive basis. Working exclusively with a single insurer has a number of benefits for smaller schemes, not least it ensures good engagement from one insurer who knows that if they meet the price target, they will secure a deal.

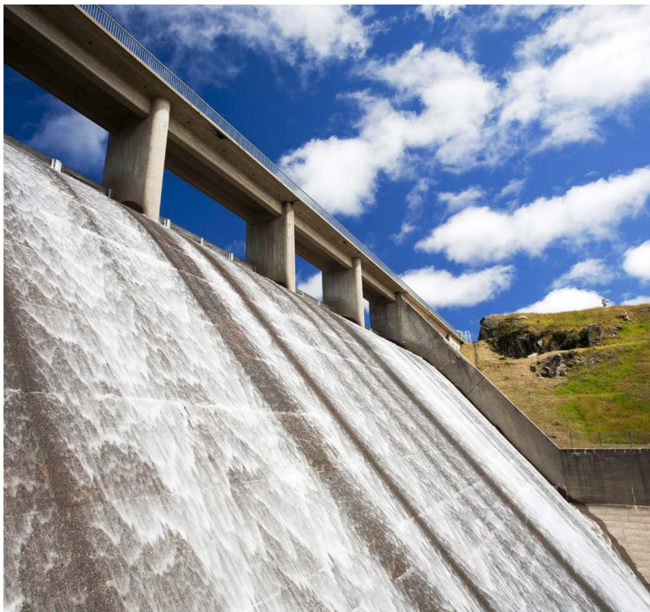
Which insurer is likely to be interested in working with a scheme on an exclusive basis will depend on a number of factors including the scheme's benefit structure, demographics and liability profile, as well as the insurer's current business volumes and the project timelines and any existing relationships with the scheme.

Trustees and sponsors may already have a strong preference for an insurer but if not, we help clients complete an evaluation of non-price selection criteria upfront to effectively bring forward the decision of which insurer is preferred for a transaction.

If the insurer is not able to put forward pricing at a level the scheme is prepared to transact at, the scheme can choose to pivot and work exclusively with a different insurer, the threat of which in itself can drive an insurer to push harder to achieve the scheme's metrics.

Conclusion

In conclusion, working exclusively with an insurer to secure a bulk annuity is an approach trustees and sponsors can consider to see whether it could support their overall strategic objectives. Whether this is an appropriate course of action is very scheme-specific but there are a number of scenarios where it can drive very strong outcomes, particularly if undertaken alongside an experienced adviser. In the decision tree below we have summarised the thought process you might undertake when considering an exclusive process.



Case Study: SIS Outside Broadcast Pension Scheme

The SIS Trustees agreed to work exclusively with Just to achieve a full scheme buy-in. In order to come to that decision the Trustee first engaged with the wider market, discounted those providers unable to fully insure the Scheme's benefits and then took into account non-price factors.

The Trustees worked with WTW and the Sponsor to establish upfront at what level the pricing would be acceptable, which enabled an efficient decision to proceed with Just once the quotation was received. In spite of the market volatility throughout October 2022, the Trustees were able to take advantage of an attractive premium that was moving in line with an agreed price lock mechanism, and which closely matched their assets, and ultimately signed the £15m transaction in November 2022, leaving an expected surplus.

Independent Trustee Ann Rigby of BESTrustees Limited said "Moving quickly to exclusivity with Just enabled the Trustees to maintain engagement from an insurer during a volatile time in the bulk annuity market and WTW engaged throughout with Just to ensure the pricing offered initially was upheld, despite the significant market movements. The Trustees are very pleased with the outcome we have achieved and are already working with Just towards the ultimate aim of moving to buyout."

Figure 8: **Possible decision-making process**

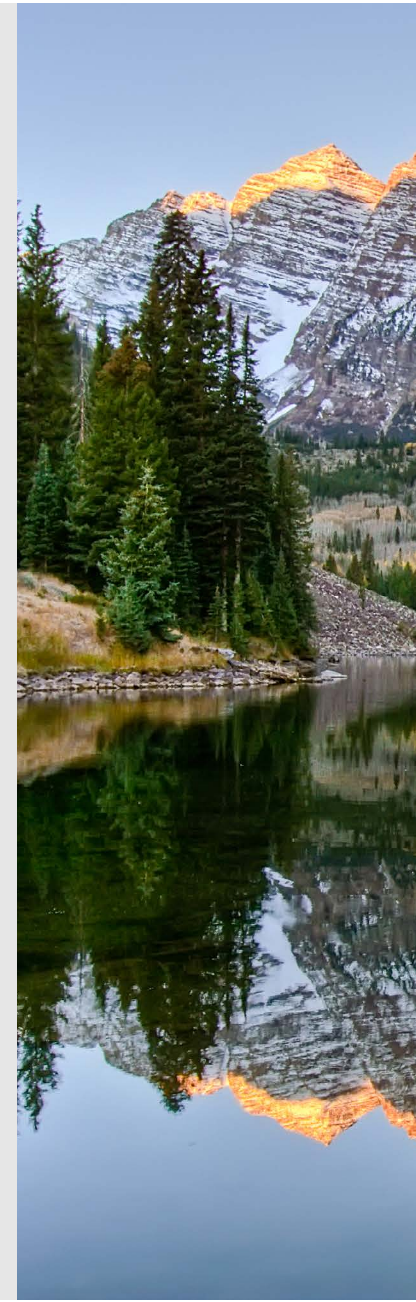
Does the scheme have an existing buy-in?

Yes → Do the trustees have a strong desire to secure all members' benefits with the same insurer?

- Yes → Consider benefits of exclusive process with the same insurer
- No → Could the insurer selection considerations be different for the new transaction?
  - Yes → Consider an open market process
  - No → Is the scheme comfortable with the approach put forward by advisers to consider if pricing attractive?
    - Yes → Consider benefits of exclusive process with the same insurer
    - No → Consider an open market process

No → Is the scheme sufficiently large to be expected to be attractive to multiple insurers?

- Yes → Consider open market process
- No → Does the scheme have a preference for exploring a transaction with a particular insurer?
  - Yes → Approach preferred insurer in the first instance
  - No → Approach all insurers that may be interested in the transaction - then consider if exclusive process beneficial



6. Innovating to achieve buyout – deferred premium to accommodate the sale of illiquid assets

Lucy Wilson

Pension schemes holding illiquid assets – those which cannot be quickly sold – is nothing new, and they are very effective investment for ongoing schemes with a longer-term time horizon. However, for schemes wanting to transfer their assets and liabilities to an insurer, illiquid assets can be seen as a barrier. While this can certainly pose challenges, Lucy Wilson considers the innovative solutions available in the context of a recent transaction that she advised on.

Case Study: Project Riverside

The Project Riverside pension scheme had a long-established objective of buyout and had completed a pensioner buy-in a few years ago as the first step on this path. The Scheme's residual investment portfolio was designed to achieve full buyout in a number of years and included investment in illiquid assets.

The Trustees monitored the Scheme's journey plan using WTW's Asset Liability Suite (ALS) software, incorporating automatic alerts to identify when a full Scheme buyout might be affordable. Rises in gilt yields, widening of credit spreads and falling costs of longevity reinsurance over the first part of 2022 meant that ALS identified that buyout was within reach – much sooner than anticipated. The Trustees then began the process of disinvesting from their illiquid asset holdings – not unusually for these investments, this would take up to six months to complete.

Continued favourable market movements meant that by the time the Scheme had provided data and the insurer had completed the quotation for the residual liabilities, full buyout was deemed to be affordable – but it would take several months for the illiquid asset to be sold and the insurer was, understandably, not willing to guarantee its price for that long.

Solutions such as those set out in Figure 9 overleaf were discussed that would enable the premium to be paid in full, as used on other transactions WTW has successfully completed. A number of solutions were not suitable in this circumstance and so it was agreed that WTW would negotiate a "deferred premium" structure with the insurer under which an agreed portion of the premium (in line with the value of the illiquid asset holdings) would not be required to be paid until the point at which the Trustees were expected to receive the monies from the illiquid assets.

We negotiated the details surrounding the mechanism with the insurer to manage the market risk the Trustees may otherwise be exposed to over the period of disinvestment if there were a mismatch in the movements of the illiquid asset holdings and the premium.

By using the agreed deferred premium structure, the Trustees were able to lock into attractive pricing with their desired counterparty to achieve their long-term aim of buyout well ahead of their expected journey plan.

Why are illiquid assets an issue?

Schemes may find themselves “fully funded” on a buyout basis – i.e. with assets of sufficient overall value to meet the required insurer premium – but without the ability to use illiquid assets in the short term, or to realise the assets for their full value. This could prevent schemes from taking advantage of attractive pricing and result in them missing out on opportunities to de-risk. This is often the case where schemes have reached full funding on buyout several years ahead of schedule, with the illiquid investment designed to reach maturity in line with the original timescales. Some investments can be realised by submitting a redemption notice to the provider – but this can take several months or in some cases years as well as mean a potential haircut to the asset value – whilst some investments cannot be redeemed ahead of schedule at all.

How do deferred premiums work?

Deferred premiums are agreements with an insurer to defer payment of an element of the premium for a specified period of time. The details around the structure are bespoke to each transaction and the terms would need to be negotiated depending on the circumstances – in particular the amount to be deferred, the period of deferral and whether the insurer increases its overall premium. Deferred premiums can give pension schemes the extra time needed to sell their illiquid assets or let the illiquid assets run off without having to sell at a significant loss or miss out on attractive bulk annuity market opportunities. The amount that needs to be paid is typically a specified monetary amount, increased with interest for the deferral period. If the deferred premium is not paid then the insurer has the right to scale back the benefits insured.

Figure 9: **Summary of options to prevent illiquid assets acting as a barrier to transaction**

	How does it work?	Downsides
Sell the assets on the secondary market	Exchanges the asset for cash, to enable payment of premium.	Lack of demand and excess supply (in part driven by pension schemes selling assets for liquidity) means haircuts on the value of the assets can be significant. Further, this process can still take longer than desirable or required.
Transfer of assets to buy-in provider	In-specie transfer of assets to the insurer as part of the premium payment.	Only likely to be viable if the assets are aligned with the insurer’s investment strategy or if the insurer is prepared to hold additional capital while it seeks to sell the asset. Not likely to be suitable for the majority of cases and haircuts likely to be applied to the valuation.
Sponsor loan or transfer	The sponsor provides the scheme with cash equal to the value of the illiquid assets. The loan is repaid as the illiquids run off, or the trustees transfer the illiquid investments to the sponsor.	Requires the sponsor to have available cash and the willingness to take on the risk in relation to the amount realised from the sale of illiquid assets, although the sponsor may be motivated to help in order to achieve buyout.
Transfer to another scheme	Similar to above, if there is another scheme with the same sponsor, an intra-scheme transfer may be possible.	Likely only possible in very specific circumstances, where there is both another scheme and the asset in question is attractive to this scheme.
Deferral of premium	Part of premium payment is delayed until the illiquid assets are realised. Interest is paid on the outstanding premium.	The Trustees must be certain that they will be able to pay the deferred premium when it falls due. Given the additional contracting complications and potential impact on their capital requirements, insurers are likely to prioritise deals with schemes who have divested their illiquid holdings ahead of transacting over those where a deferred premium structure may be required.

Source – WTW's experience of options available

Conclusions

With a number of schemes being further along their journey plans than anticipated due to increased gilt yields, widening corporate bond spreads and improved longevity pricing, more schemes may be looking to realise their illiquid assets earlier than expected. But, with a number of innovative solutions available, illiquid assets should not be a barrier to achieving buyout and we have experience of working with clients across a range of different approaches.

7. Embedding member experience in the insurer selection process

Greg Robertson

Kirsty Naylor

More and more pension schemes are in strong funding positions and an increasing proportion of the bulk annuity market relates to buyouts and full scheme buy-ins. When trustees are handing over the responsibility to pay members' benefits to the insurer, member experience after buyout is a very important area to explore.

Greg Robertson and Kirsty Naylor have outlined their experience on the areas that should be considered to ensure members will have a positive experience with the selected insurer.

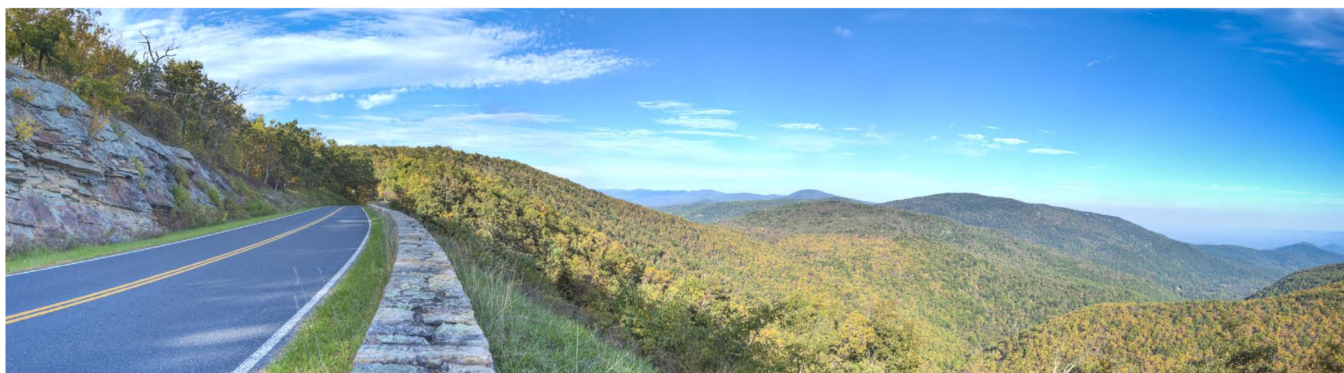
There are several ways trustees can obtain insights into the level and quality of service and support their members will experience post-buyout. For example, we have seen trustees take some or all of the following approaches:

- a high-level desk-top comparison between shortlisted insurers;
- high-level questions at insurer selection meetings;
- reviewing sample member communications;
- meeting members of the insurers' administration team;
- a standalone, more in-depth, discussion focused on member experience; and
- a deeper dive comparison involving a detailed questionnaire and site visits to each of the shortlisted insurers' administration centres.

Whichever approaches are taken, we recommend that trustees identify the aspects of member experience that matter to them early in the selection process. Figure 10 shows the areas that are most commonly considered by trustees.

Figure 10: **Example member experience checklist – key areas to consider when selecting an insurer**

- Member option factors
- Administration model
- Administration performance
- Member communications and support
- Buyout transition process and timescales



Member option factors

For deferred members, the benefits they receive after buyout will be determined by the factors that are used by the insurer for options such as commutation at retirement, transfers out and early / late retirement. Therefore, trustees pay close attention to the terms offered by each bidding insurer to understand the differences between them and the potential impacts on benefits.

Insurers' standard factors can be significantly different from those used by pension schemes. Whilst it is very scheme-specific, in our experience:

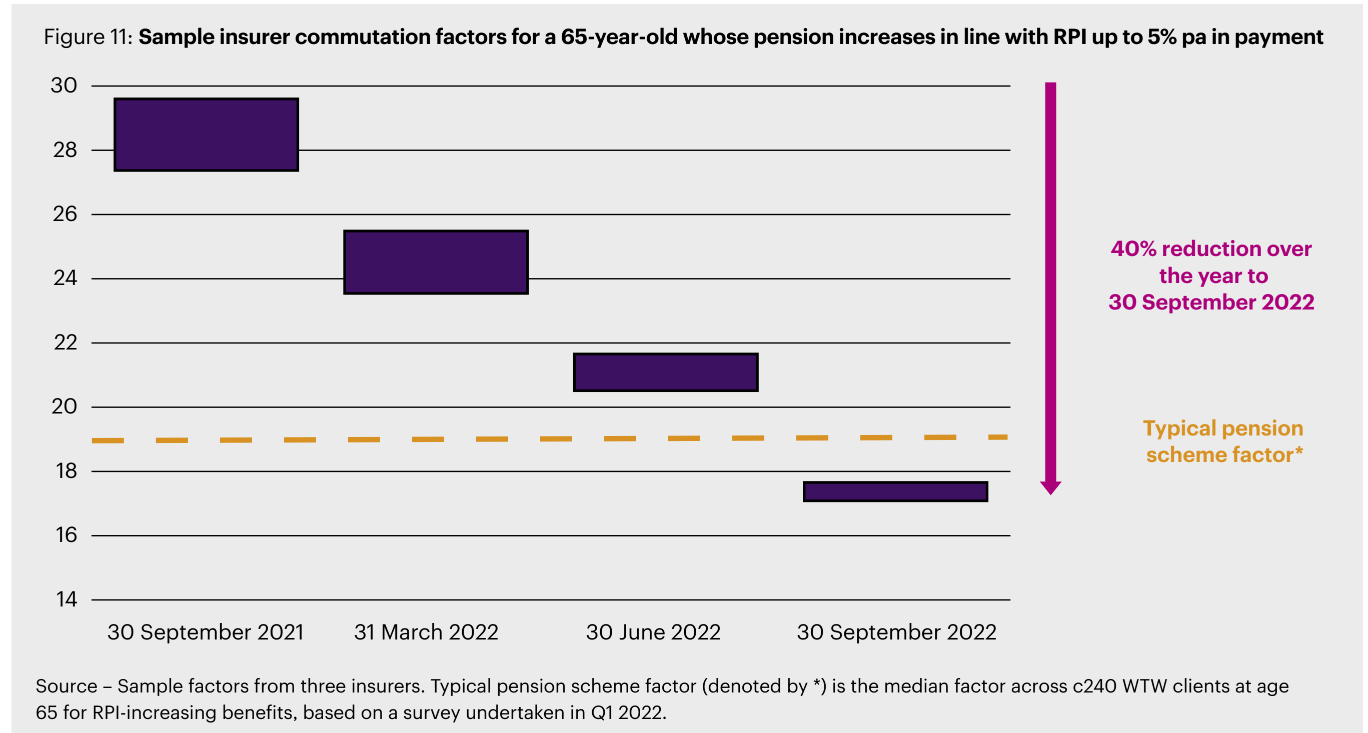
- Insurer commutation factors are often more generous;
- Insurer transfer value factors can be less generous; and
- Early and late retirement factors are typically similar.

Further, we typically see the greatest levels of variability between insurers for commutation and transfers out, with early and late retirement factors being generally more consistent. The level of commutation and transfer value factors can therefore be a differentiator between two insurers whose premium appears the same at face value but whose member option factors are materially different.

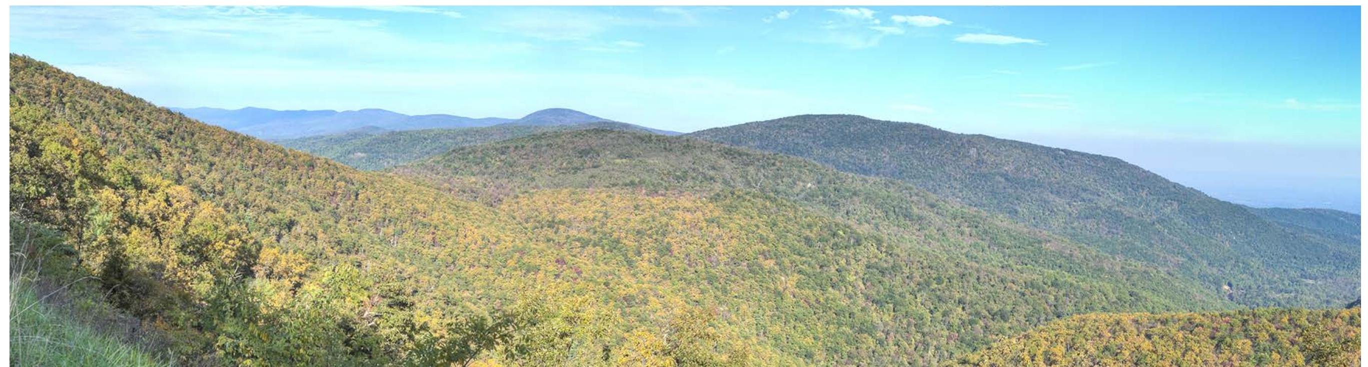
A key difference between insurers and most pension schemes is that insurer commutation factors are market-related, typically updating at least once per month, whereas pension scheme equivalents are often fixed between reviews. Insurers also tend to differentiate more between members when setting factors, allowing for an individual's life expectancy (based on pension amount and postcode) when setting the factors, whereas pension schemes typically use the same factors across the membership.

In relation to market conditions, the chart in figure 11, based on sample factors from three insurers, shows how dramatically insurer commutation factors have been impacted by market conditions over the last year. In 2021, there would typically have been a significant improvement for members by moving to insurer terms, but we would expect this gap to have narrowed more recently.

Figure 11: **Sample insurer commutation factors for a 65-year-old whose pension increases in line with RPI up to 5% pa in payment**



Source – Sample factors from three insurers. Typical pension scheme factor (denoted by *) is the median factor across c240 WTW clients at age 65 for RPI-increasing benefits, based on a survey undertaken in Q1 2022.



Whilst insurer commutation factors are often more generous than those of a typical pension scheme, this was not the case at 30 September 2022 due to a mismatch in the underlying market conditions. The typical pension scheme factor shown in Figure 11 was based on WTW's client survey undertaken in Q1 2022, following which gilt yields increased by over 2% pa, hence reducing the sample insurer factors considerably.

The issues to consider around factors are certainly nuanced, particularly as it's possible to insure a fixed percentage of the insurer's standard factors (eg 95% of their standard factors) with a corresponding impact on the premium. WTW conducts a quarterly survey of insurer factors to help our clients who have buyout as their likely long-term destination to consider the typical insurer approach when setting their own factors.

Administration model

Some insurers, such as Aviva and Legal & General, operate in-house administration teams, whereas others outsource to one or more third parties. Trustees often ask which model is preferable. In truth, there are pros and cons of both, and the answer lies in how the models are implemented rather than the models themselves.

Trustees can be concerned that the insurer loses control where administration is outsourced. In practice, insurers have negotiated much tighter administration agreements than most pension schemes. This reflects the bargaining power they have from the scale of their backbook and the prospect of significant future business for the administrator. The checks and balances in these agreements take differing forms, such as a commitment to provide ring-fenced administration teams, more regular and detailed reporting against service-level agreements (SLAs), financial penalties / incentives and review / break clauses in favour of the insurer.

On the other hand, trustees can be concerned that the administration systems of in-house insurers are less cutting edge than those of third-party providers. Whilst there are differences to understand, these insurers do have the advantage that they can more easily develop and tailor their systems to meet business needs.

We have first-hand experience of helping trustees get under the bonnet of insurers' offerings, such as the deep dive analysis Kirsty undertook for Project Samba (see case study).

Administration performance

Trustees are rightly keen to ensure that members receive the same level of service (or even an improvement) after buyout. This can be assessed by reviewing familiar metrics such as performance against SLAs or the number of complaints in a certain period, but there also insights to be gained from looking deeper, for example at:

- the number of individuals in the administration team;
- the level of experience amongst them;
- the rates of staff turnover;
- the average time to answer a phone call;
- the approach taken to dealing with bereaved relatives; and
- the training provided for new and existing administrators.

In our experience, insurers can typically demonstrate strong service levels and many trustees find that the insurers work to quicker SLAs than their incumbent administrator.

Case Study: Project Samba, a large full scheme buy-in expected to move to buyout in the next 2 years

How did the trustees build member experience into the selection process?

WTW was commissioned to carry out a deep dive on the administration capabilities and resulting member experience of the two shortlisted insurers before receiving second round quotations.

What did the deep dive comparison involve?

We firstly issued a detailed administration proposal questionnaire to both insurers covering 8 key areas and including over 40 questions. We also stressed the importance of this topic to the insurers, meaning that full detailed responses were provided alongside sample member communications.

We then facilitated a site visit for the trustees to each of the insurers' administration service centres, ensuring that senior individuals from the insurers' operations teams also attended. The visits allowed the trustees to further probe the questionnaire responses and to sit in on real time member calls.

Finally, client references were sought from existing clients of both insurers to fact check the information they had provided and understand other trustees' experience on a real-life case.

What was the outcome?

We prepared a detailed report for the administration sub-committee, providing a view on the strengths and weaknesses of each insurer's offering. The trustees then used the report as part of their final insurer selection considerations.

Member communications and support

Prior to buyout, members are accustomed to receiving communications from the trustees in a certain format and style. Following buyout, the insurer will be communicating with members directly. So how do insurer communications compare?

Insurers have shaped and refined their communications over many years, meaning they are generally high quality and easy to read for members. Some have even secured the Crystal Mark from the Plain English Campaign.

Where there is a greater differentiator is in relation to online tools. Some insurers have an established platform for members to access retirement and transfer quotations. Others currently have a more limited offering that only allows members to update their personal details or access payslips and P60s. For these insurers, there is an aspiration to provide greater functionality in coming years.

In addition, some insurers host member events or provide subsidised entry to festivals and exhibitions, whereas others prefer to focus all of their budget and effort on members' administration experience.

We also recommend trustees consider their own communication strategy when kicking off a project. Trustees have a key role to play in explaining to members the rationale for buyout and reassuring them that it will not impact their benefits. We often see trustees starting to introduce the concept in the run-up to a transaction, for example in the member newsletter.

Buyout transition and process

Securing a full scheme buy-in is typically a stepping stone to ultimate buyout. Whilst the policy is held as a buy-in, the incumbent administrators will remain in place and continue with business-as-usual activity. They will also need to embed the buy-in into day-to-day operations, including monthly reporting to the insurer, as well as completing any remaining data cleansing and working with the insurer to transition to buyout.

So, the demands on the administration team are high during this period. Trustees rightly want to know how the insurer will support this process. All insurers will put in place a dedicated transition manager, but the level of support does vary from insurer to insurer. Some will facilitate monthly progress calls and monitor an actions log, whereas others place more onus on the administration team to drive the project forwards and contact them when required. We have worked with all eight insurers over recent years and can share real-life experience of the implementation process with each one.

Conclusions

For schemes approaching buyout, member experience is rightly one of the key considerations for trustees. It is important for trustees to consider which aspects of member experience are most important for them and to factor in time to understand different insurers' offerings on this as part of the selection process.

8. What can we expect from the de-risking market in 2023?

Tom Ashworth

Tom Ashworth shares his predictions on what we might expect from the de-risking market over the next year.

Prediction 1

Full scheme buy-ins to dominate a busy market (by number of deals)

As Rhys Mellens mentioned earlier in the report, the story of 2022 was one of increased gilt yields, widening corporate bond spreads and improved longevity pricing. This has resulted in many pension schemes being further along their journey plan than anticipated and now close to, or in some cases at, a position where it is affordable to carry out a full scheme buy-in, which we expect will be the predominant type of transaction in 2023 and beyond.

The trend towards full scheme buy-ins has been further exacerbated by some schemes no longer having the liquidity to undertake partial buy-ins, as outlined in Louise's article, and some trustees now preferring to undertake a single full scheme transaction, rather than a series of partial buy-ins, given the absolute size of their scheme has now significantly reduced due to higher yields.

I have been purposefully careful with my wording, with full scheme buy-ins dominating the market by number of deals. This is because the market for pensioner buy-ins is still very much alive, forming a key part of the de-risking toolkit for the right scheme, albeit that pool of schemes will be smaller than previously. In addition, we expect more schemes than previously to consider use of longevity swaps as a way of managing longevity risks. These schemes are often those of scale and so we will continue to see significant liability transferred via pensioner buy-ins and longevity swaps.

Overall, despite gilt yields reducing the absolute value of liabilities, I expect a busy year with in excess of £40bn of bulk annuities transacted and £20bn of longevity swaps, meaning 2023 has the potential to be the biggest year ever in the de-risking markets.

Prediction 2

Schemes to accelerate transaction readiness

Preparation is key ahead of any de-risking transaction and, with the improved buyout position of many schemes increasing the demand for insurers' attention, this has never been truer than today. With this I expect to see schemes accelerate and ramp up their focus on transaction readiness in 2023.

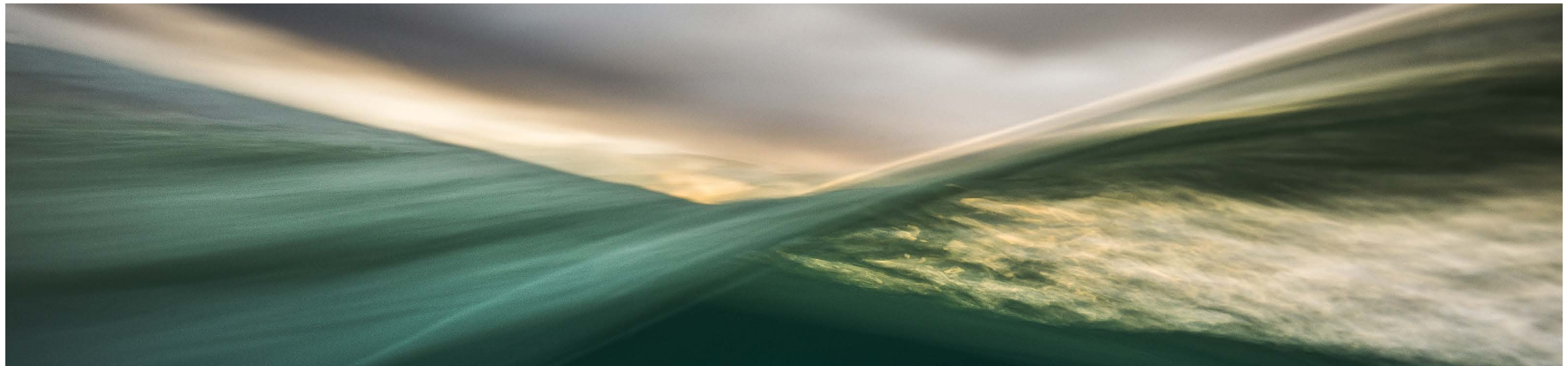
As described above, schemes may have experienced a rapid improvement in buyout funding levels, to the point of buyout being within reach, but they may not yet be transaction ready. Others, who cannot yet afford to buyout, will have seen how quickly affordability can change and will look to be in a position to move when the time is right for them.

Transaction readiness, in particular for a full scheme buy-in, covers a wide range of areas including considering the governance structure, reviewing the scheme's investment strategy, gathering and cleansing the necessary data, understanding the legal powers within the Trust Deed and Rules and considering the benefits to be insured. The specific tasks for each scheme should be discussed with your strategic adviser with a clear, accountable plan of action agreed with all stakeholders.

I see two strands of readiness – asset and data readiness - really coming under sharper focus in 2023.

One consequence of schemes reaching their buyout target ahead of plan is that they may still be holding illiquid assets which the trustees are unable to access, or to do so would incur a significant haircut. As Lucy Wilson mentioned earlier in the report, there are options to ensure that illiquid assets are not a barrier to a transaction, but I expect that many schemes will look to consider their options, and potentially take action, well in advance of any possible transaction.

The key to data readiness is agreeing a data journey plan with your administrator and strategic adviser. This will help balance the timing of approaching the market to maximise engagement and pricing opportunities whilst also understanding (a) the data work it's important to prioritise to optimise insurer pricing; and (b) the residual data risks. With administrators under significant resource constraints as they juggle the day-to-day running of schemes with GMP Equalisation and preparing for pension dashboards amongst other things, early and ongoing engagement with administrators throughout the process is imperative.



Prediction 3

Evolving insurer offerings

As we see an increase in the number of full scheme buy-ins, I'm pleased to see insurers continually striving to improve their propositions and I expect this to continue and possibly be accelerated in 2023, particularly in relation to some of the "extras" that come into focus with a full scheme buy-in.

Whilst I expect price will always feature heavily when selecting an insurer, with more schemes expected to approach the market with a surplus, I anticipate trustees placing a greater weight on non-price factors in the future. This will help to drive the pace of change in 2023, both as insurers newer to non-pensioner transactions look to enhance their credentials and as the more established providers look to push boundaries in order to stand out from the crowd.

This evolution could be in many areas. For example, it could be through providing a wider selection of investment vehicles for members' Additional Voluntary Contribution pots, enhancing their residual risk proposition (the cover they can provide to trustees to cover the risk that the incorrect benefits have been insured), improved member interface tools, or further standardised processes, both as part of the quote process itself but also as part of their ongoing interactions with schemes' administrators post transaction.

The continual challenge we have in a busy market place is that insurers are constrained by the human resources they have available. We've seen great strides in standardising quotations from the market recently, particularly for smaller schemes, which has helped to enable smaller schemes to access the market, but the challenge to insurers and pension professionals alike is always what more can be done to reduce the human capital required to produce quotations which will ultimately help service demand from pension schemes of all sizes.

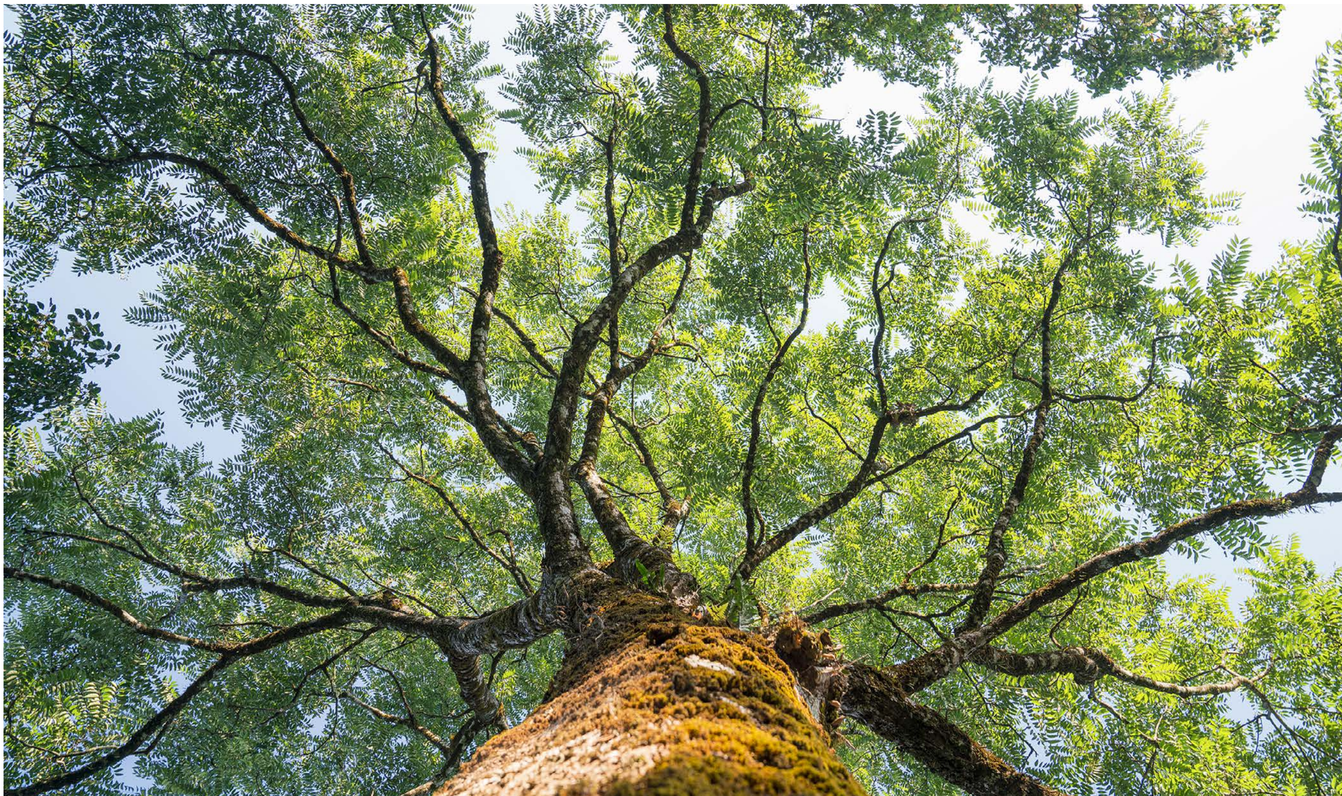
Prediction 4

A steady flow of deals, with unexpected opportunities for flexible schemes

The last couple of years in the risk transfer market have started slowly, with the vast majority of deals transacting in the second half of the year. With a strong pipeline of schemes looking to transact, the momentum built in the second half of 2022 will continue into the first half of 2023 which should result in a much more even spread of deals across the year.

If the pensions landscape in 2022 taught us anything, it is to prepare for the unexpected and so this steady flow of deals could be side-tracked by market volatility. As ever in volatile markets, it will be the well-prepared schemes, with robust, nimble governance structures in place who will be able to take advantage of any opportunities presented.

That said, even without market volatility, I expect opportunities to arise for schemes who are able to demonstrate flexibility - be that in their approach (for example by electing to work exclusively with an insurer) or in their timing (as individual insurers can have short-term pricing opportunities) - which could result in improved outcomes for their scheme and members.



As always, we will be watching markets closely to see if our predictions come true over 2023.

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