Bulk annuity, longevity swap and superfund markets update – Q4 2020

Ian Aley, Head of Transactions

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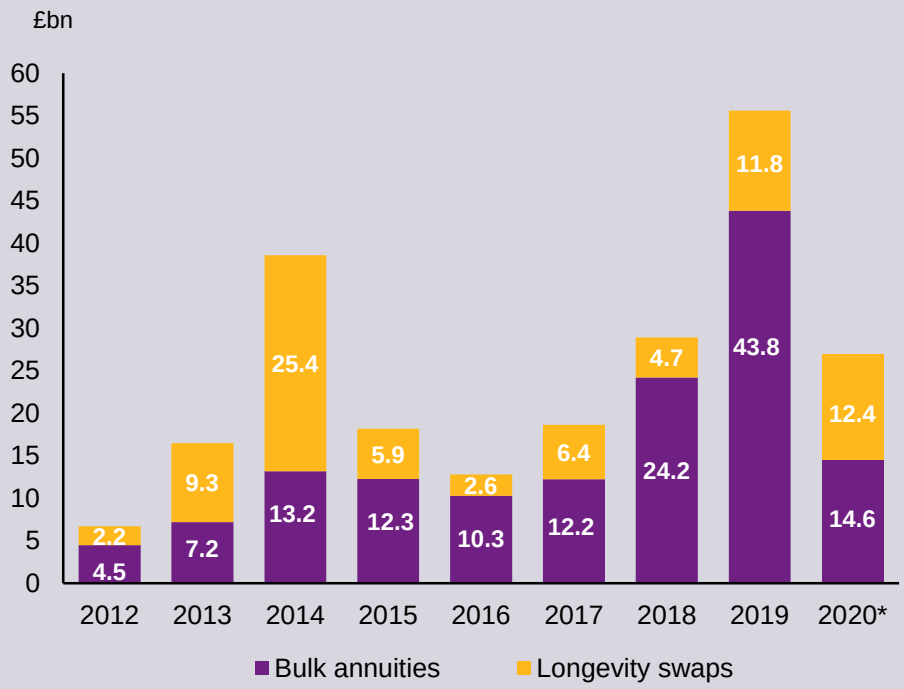
Willis Towers Watson

Bulk annuity, longevity swap and superfund markets update

Welcome to our market update. It's certainly been a busy year so far, as you can see from the chart below, with both insurers and pension schemes quickly settling into the 'new normal'. My team has been particularly active – leading 19 deals covering more than £14bn of liabilities – we've included some of our highlights on the next page. On page 4 we've reflected on recent buy-in pricing, and what the rest of the year may have in store, and on page 5, we've set out thoughts on how schemes looking to transact in 2021 should prepare. Finally on page 6, we've introduced superfunds and capital-backed journey planning. We hope you enjoy the update, please contact me or one of my colleagues if you have any questions.

Ian Aley
Head of Transactions



** Transactions led by Willis Towers Watson or publicly announced to date*
Source: Willis Towers Watson, September 2020

As we entered 2020, we predicted another incredibly busy year in the de-risking markets. This has been the case, although not quite to the extent expected, given COVID-19 and the associated falls in equity markets.

The longevity swap market has been very busy, and 2020 may well prove to be a record breaker, with more than £25bn of deals expected by the year-end.

Whilst hedging longevity risk during a global pandemic may seem counterintuitive at first, the reality is that the implications for life expectancy will not be known for many years – if not decades – and so many of our clients are choosing to manage this risk, where it is affordable to do so.

In the bulk annuity market, there have been 80 deals so far (compared to 150 in total in 2019) but there is still 3 months to go and the market is always very busy in Q4. Overall we expect the volumes of £25bn by the year-end – the second biggest year on record but significantly less than 2019.

We don't consider this reduction in volumes to be entirely a bad thing as it has allowed smaller schemes to gain traction in the market, which was challenging at certain points in 2019.

2020 in numbers – so far this year WTW has been lead adviser to:

19 completed transactions for **16** schemes

15 bulk annuities ranging in size from **£2m** to **£1.6bn**

Over **50%** of all liabilities hedged

Deals covering **£14bn** of liabilities

Deals with all **8** insurers (the only adviser to have done so)

8 bulk annuities larger than **£100m**

Over **25%** of bulk annuities in H1

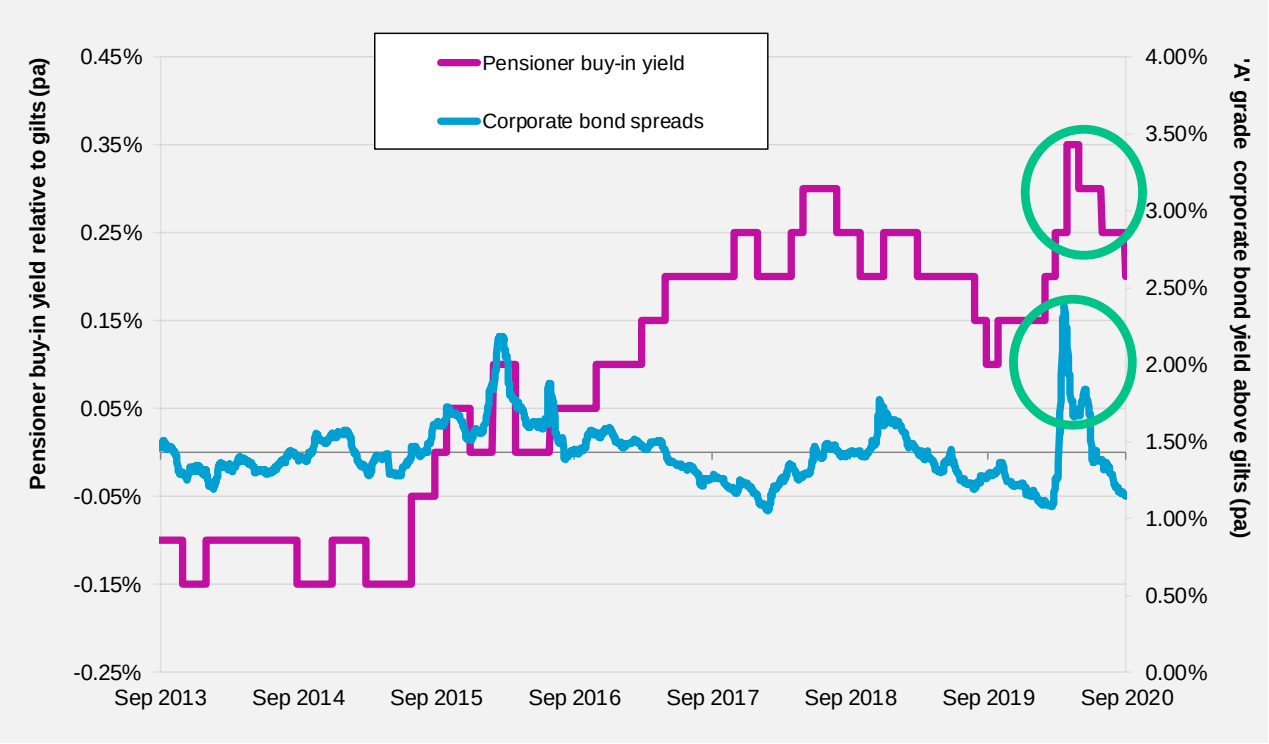
4 longevity swaps covering **£11bn** of liabilities

Based on transactions led by Willis Towers Watson , disclosed by insurers in their H1 reports or publicly announced to date
Source: Willis Towers Watson, October 2020

Current pensioner buy-in pricing

Pensioner buy-in pricing has been more attractive than gilt yields (ie if a scheme swaps their gilts / LDI for a buy-in, they can both increase the expected return on assets *and* transfer longevity risk) for nearly 5 years now. That said, some points over this period have proved better than others – driven either by insurer appetite or market conditions. We saw the latter in late March / April this year when the uncertainties surrounding COVID-19 led to particularly wide credit spreads and an associated improvement in pensioner buy-in pricing (the green circles on the chart below).

To put this in context, by transacting at the optimal time, a scheme transacting a £100m pensioner buy-in could have saved up to £5m relative to transacting a few months earlier. The schemes that were able to grab this opportunity were those that were in the latter stages of buy-in processes and those with existing insurer relationships who could mobilise quickly to achieve a repeat deal.



Looking forwards over the remainder of 2020, with continuing COVID-19 related uncertainty and the US election to come, we see potential for further market volatility and associated pricing opportunities.

Further, whilst several of the insurers have had very successful years, others are still looking to secure a few final deals to ensure they hit their annual new business target, reflecting the fact that 2020 has been a slightly quieter year in the market than predicted pre-COVID.

Source: Willis Towers Watson, September 2020

Preparing for 2021

Several of the insurers who have had a successful year to date are already turning their attention to 2021 – we expect the beginning of the year to be particularly busy. We expect that market to remain busy over the medium term also: a recent survey of clients revealed that 1-in-3 of our clients are expecting to undertake a buy-in within the next 3 years.

With that in mind, we've prepared some top tips for schemes that are thinking of approach the market next year:

Set clear objectives
Not only do clear objectives ensure a successful and smoothly run project, they also ensure value for money remains a key focus, and allows quick movement should a pricing opportunity arise.

Prepare your data and benefits
We can't say this enough. If an insurer has to choose between a scheme with cleansed data and benefits and one without, it will choose the former every time – not only because it makes their lives easier, but also because it demonstrates commitment to a transaction.

Be agile
It seems likely 2021 may be another volatile year in asset markets. But bad news for equity markets generally means good news for buy-in pricing. Ensure your governance structure allows for moving quickly if opportunities arise. Equally, be prepared to pause if pricing isn't at the targeted level.

Consider a longevity swap
Whilst longevity swaps aren't for everyone (eg those planning a buyout within a few years), their pricing is currently very attractive and favourable relative to historic prices and the concept of novating a longevity swap to a buy-in provider is now tried-and-tested.

Build relationships
The insurers value positive relationships with their clients. By building a relationship with key insurers in advance of approaching the market not only do you ensure you're prioritised when it comes to providing a quote, but it also means the senior management within the insurer – who sign off pricing – will have increased visibility of the deal.

Consider setting a price target
Insurers can't always quickly source a suitable portfolio of high yielding asset to match a scheme's cashflows. But time and clear guidance on where pricing needs to be for a scheme to transact focuses the minds of their asset sourcing team and often leads to the best possible pricing.

HELP! A buyout is out of reach

Enter stage left: Superfunds and capital-backed journey planning

Superfunds became a reality in 2020. They can offer a meaningful solution for schemes that would benefit from consolidation such as schemes:

- without scale;
- that are well-funded but have a weaker sponsor with an uncertain future; or
- with fewer options to take investment risk to meet benefit promises.

There are two superfunds in the public domain, Clara-Pensions and the Pension SuperFund. Both have healthy pipelines and are progressing through Stage 1 of the process to become authorised by the Pensions Regulator. We are expecting the first transactions to be announced by the end of the year, or in early 2021.

For schemes that have insufficient funding and no/limited contingent capital to make it into a superfund – capital-back journey planning can provide a solution. The capital-backer provides buffer capital to stabilise the journey to buyout or self-sufficiency, which allows the scheme to continue to take investment risk. The sponsor covenant stays in place.

Demand for alternative solutions that are well-run and well-priced is driving the availability of new options for schemes. It can be a complex area – but it is one that opens up potentially significantly improved member outcomes.

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The market for bulk annuities is not perfect. There are price influences that may not arise in a perfect market, such as capital/capacity constraints, sales targets, “indigestion” at providers from having recently accepted a large transaction, the opportunity for negotiation, and competitiveness amongst providers. Market terms are subject to considerable variability and at any one date a wide range of quotations could be obtained from different providers.

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