Our latest views and insights on pensions risk transfer in the UK

LCP pensions de-risking update

May 2021

2020 was a record year for longevity risk transfer despite the pandemic

Charlie Finch
Partner

2021 began with welcome news for many pension schemes in the form of a surge in gilt yields boosting funding levels and giving schemes extra capacity to de-risk. Combined with a strong desire from trustees and sponsors to lock down their risks, this is likely to lead to sustained appetite for longevity risk transfer over 2021.

Insurer pricing remains favourable with strong competition – last year four insurers vied for the most business written – and, where insurers target transactions, this is leading to some attractive opportunities.

We're also seeing innovation in the market and a number of non-traditional de-risking solutions are emerging. In this paper we provide an update on the traditional insurance market, as well as touching on the wider options available.

Imogen Cothay
Partner

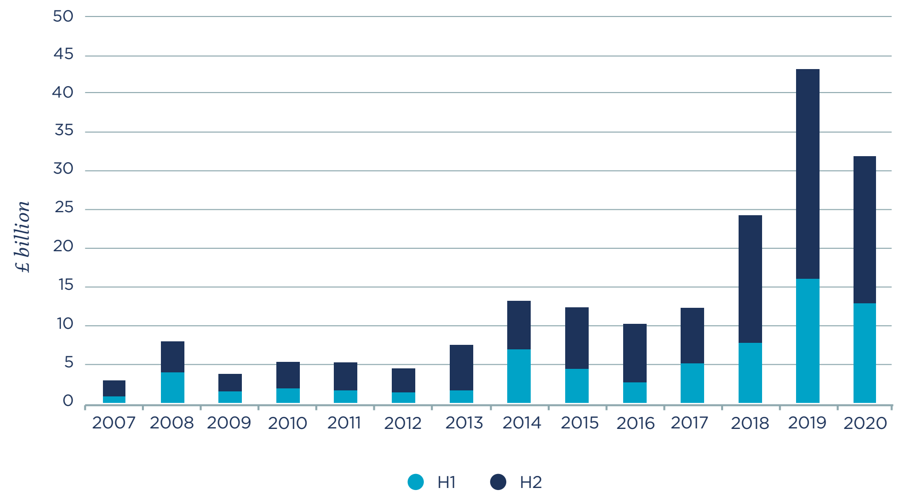
At the start of last year before the Covid-19 pandemic took hold we predicted that buy-in and buy-out volumes would top £25bn in 2020. It's a mark of the resilience of the pensions de-risking market that buy-ins and buy-outs surpassed our expectations reaching £31.7bn and with a record £24.1bn of longevity swaps.

The pandemic led to some exceptional pricing in spring 2020, fuelled by falls in the price of assets used by insurers to back their pricing. We helped schemes of all sizes assess their options during the spring, with many deciding to accelerate their transaction timetable or to complete opportunistic transactions. Schemes who were able to move quickly, particularly those who were established buyers with umbrella contracts, were best placed to take advantage of the price opportunities.

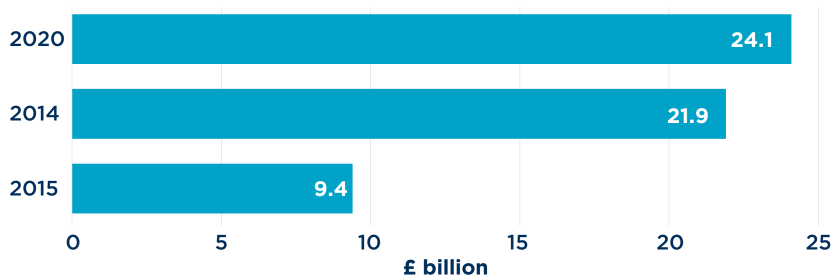
2020: Risk transfer fact and figures

Total longevity risk transfer reached a record level of £55.8bn, ahead of 2019 at £51.6bn. Buy-ins and buy-outs by UK pension plans totalled £31.7bn making it the second busiest year ever, behind 2019 at £43.8bn. Meanwhile, longevity swaps reached their highest total ever at £24.1bn.

Buy-in and buy-out volumes over time



Three largest years for longevity swap volumes



Largest transaction £3.3bn

Largest single transaction was an unnamed £3.3bn buy-in with Rothesay.

Increase in PPF+ transactions

The £2bn "PPF plus" buy-out for the Old British Steel Pension Scheme with PIC was the second largest buy-in/out of the year. In total there were 5 PPF+ transactions announced in 2020.

Surge in mid-sized transactions

Over 2020 60 buy-ins and buy-outs between £100m to £1bn were completed – a 67% increase on the 36 in 2019. In contrast, there were only two buy-ins/outs over £2bn (compared to six in 2019).

Six longevity swaps

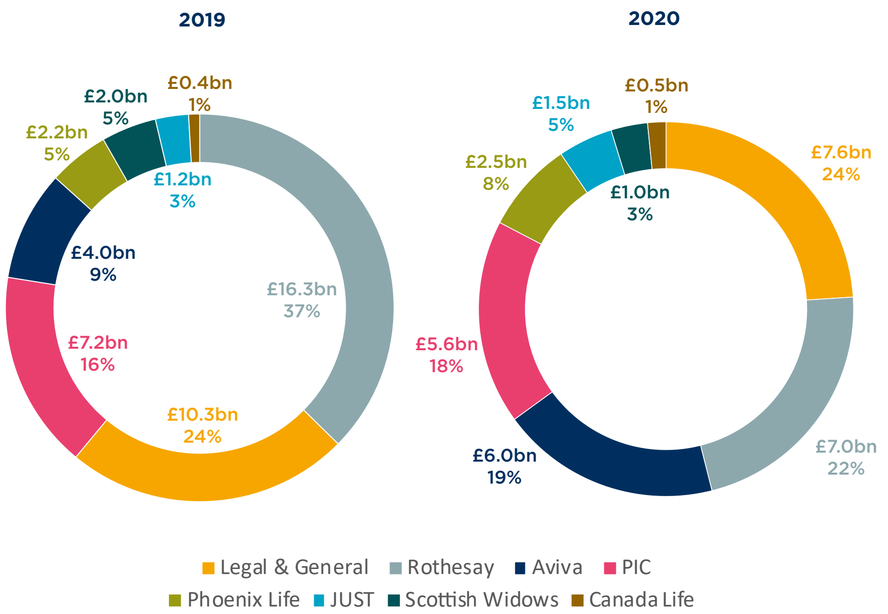
These were primarily by financial institutions such as Barclays, Lloyds Banking Group, Prudential and UBS, but also by household names such as the BBC.

Longevity swap conversions

Two longevity swaps were converted to buy-ins by MNOPF (£1.6bn) and LV= (£800m). This takes the total number of conversions to eight.

Buy-ins and buy-outs breakdown

Buy-in and buy-out volumes



Source: Insurance company data to end 2020 and public announcements

2020 was dominated by four insurers who between them wrote 83% of total volumes. In descending order these were Legal & General (L&G), Rothesay, Aviva and Pension Insurance Corporation (PIC). Whilst Rothesay's volumes were less than 50% of their record levels last year, Aviva's volumes increased by 50% to £6.0bn in 2020.

Largest buy-ins and buy-outs in H2 2020

Company	Size £m	Insurer	Type of transaction	Date	LCP lead adviser
Littlewoods	930	Rothesay	Full buy-in	Jul-20	✓
RockRose Energy	610	Rothesay	Full buy-in	Jul-20	✓
Hitachi UK	275	L&G	Full buy-in	Aug-20	
Siemens	530	L&G	Pensioner buy-in	Aug-20	
Ibstock Brick	340	Just	Pensioner buy-in	Aug-20	✓
M&S	390	Aviva	Pensioner buy-in	Sep-20	✓
M&S	360	Phoenix Life	Pensioner buy-in	Sep-20	✓
Smiths Group	140	Aviva	Pensioner buy-in	Sep-20	
Homestyle	100	Aviva	Full buyout	Sep-20	
British Steel	2,000	PIC	PPF+ buy-out	Oct-20	
Carillion	150	L&G	PPF+ buy-out	Oct-20	
Aviva	870	Aviva	Deferred and Pensioner buy-in	Oct-20	
Northern Gas	385	L&G	Pensioner buy-in	Oct-20	
Smiths Industries	150	Canada Life	Pensioner buy-in	Nov-20	
Deutsche Bank	570	L&G	Pensioner buy-in	Nov-20	✓
Lovell	110	Rothesay	Full buy-in	Nov-20	✓
Maersk	1,100	L&G	Full buy-in	Nov-20	
Aberdeen City Council ansport	240	Rothesay	Pensioner buy-in	Nov-20	
Phoenix Life	750	Phoenix Life	Deferred and pensioner buy-in	Nov-20	
Legal & General	400	L&G	APP covering deferred and pensioners	Dec-20	✓
National Grid	800	Rothesay	Pensioner buy-in	Dec-20	
Evonik	545	L&G	Full buy-in	Dec-20	✓
Aon Bain Hogg	510	Scottish Widows	Pensioner buy-in	Dec-20	
2021 announced to date					
West Ferry Printers (Reach plc)	120	Rothesay	Full buy-in	Feb-21	✓
Civil Aviation Authority	110	L&G	Pensioner buy-in	Feb-21	
Nortel	105	L&G	PPF+ buy-out	May-21	

Source: The table includes all named transactions above £100m in H2 2020 and H1 2021 using insurance company data and public announcements

Case study: £120m full buy-in in record time

How West Ferry Printers took advantage of attractive pricing and transacted within 3 months

Background

The West Ferry Printers Pension Scheme is a c£300m scheme with an existing £180m buy-in policy with Aviva covering the majority of current pensioners. The Scheme is sponsored by Reach plc, the largest national and regional news publisher in the UK with brands including the Mirror. Towards the end of 2020, Reach plc approached the Trustee about a potential restructuring of the sponsoring business and the possibility of insuring the Scheme in full. LCP has a longstanding relationship with the Scheme acting as scheme actuary, investment and de-risking adviser and supported the Trustee in these discussions.

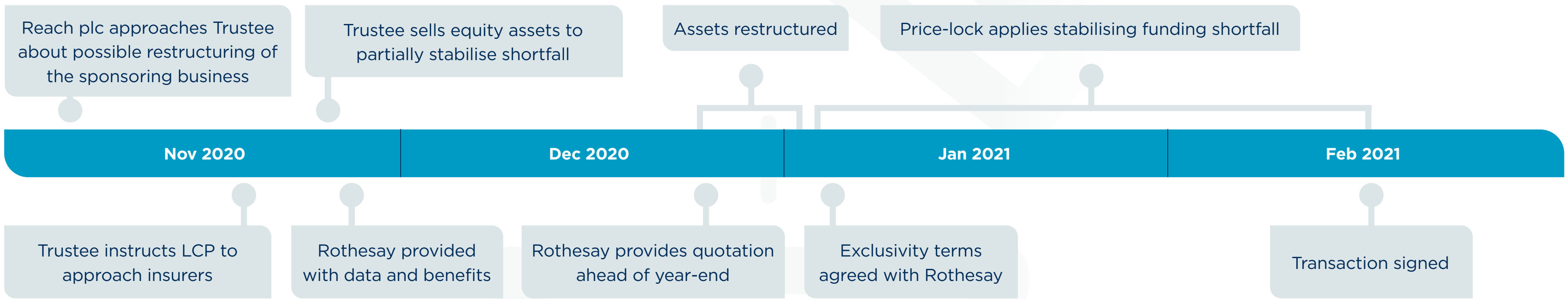
Approach

After considering initial price estimates, LCP approached insurers to seek firm quotations for the remaining uninsured liabilities - these were c90% deferred members. The Trustee moved quickly, working collaboratively, with the sponsor to seek price certainty ahead of the year-end as part of the wider business restructuring. The Trustee chose to sell its' equity holdings to partially stabilise the funding shortfall early. Rothesay agreed to provide a transactable price within four weeks – this was due to a clear process and Rothesay's experience of transacting with LCP. Pricing offered by Rothesay was very attractive for this liability profile and was within the sponsor's budget. With a clear recommendation from LCP, it was agreed to work towards exclusivity with Rothesay without delay.

Rothesay offered to lock their price to a transparent mechanism which gave certainty amidst potentially turbulent economic conditions over the year-end. The Trustee moved quickly to sell its remaining return-seeking assets and restructured its LDI portfolio over the Christmas period to align with Rothesay's price-lock. Once the funding shortfall was fixed, formal exclusivity was agreed with Rothesay in early January which gave time for contractual documentation to be agreed and signed in mid-February 2021.

Outcome

The £120m buy-in fully insured the Scheme providing long-term security for members and cost certainty for Reach plc so it could restructure the business.



We are delighted to have now secured the pension benefits for all members of our scheme, achieving our goal of providing members with long-term security. It is a testament to the expertise of our advisers and Rothesay's ability to move quickly that we were able to meet the ambitious timetable required to achieve this positive outcome.

John Pannett, Chair of the Trustee for West Ferry Printers Pension Scheme

Longevity swaps breakdown

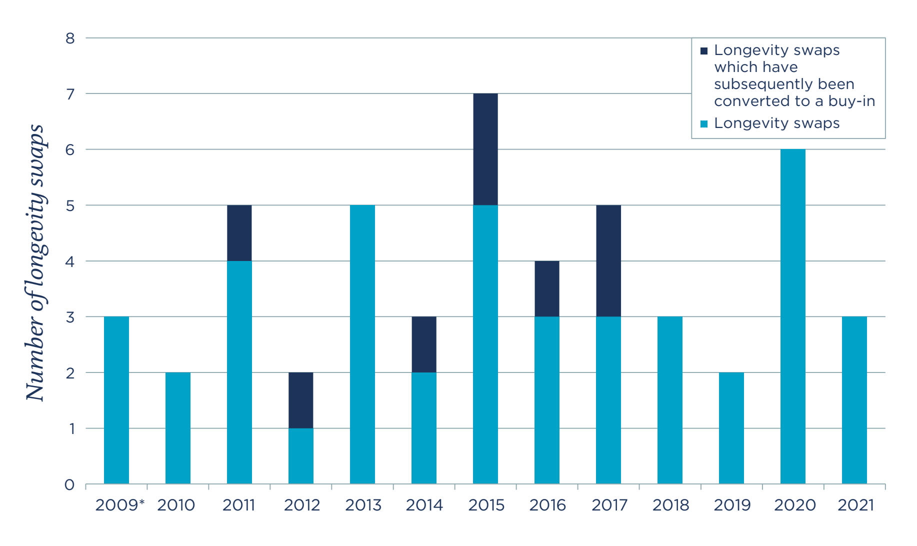
The longevity reinsurance market is continuing to provide significant and reasonably priced capacity to hedge longevity risk, even against a backdrop of increased uncertainty on mortality trends due to the lasting impacts of Covid-19. For schemes targeting full buy-out, longevity swaps can be used as part of the wider journey plan to lock down a component of future buy-in pricing, whilst retaining the flexibility to convert into buy-ins in the future. There is a growing trend for pension schemes that have entered into longevity swaps to convert these into buy-ins. Since the conversion of the British Airways longevity swap in 2018, others have followed suit, including the pension schemes of SSE, Allied Irish Bank and Rolls Royce.

Longevity swaps in 2020 and announced to date in 2021

Company/ Scheme	Liabilities covered £m	Structure	Intermediary	Reinsurer	Date
Lloyds Bank	10,000	Sponsor subsidiary	Scottish Widows	Pacific Life Re	Jan-20
Willis	1,000	Captive Insurer	Captive	Munich Re	Jun-20
UBS	1,400	Pass-through intermediary	Zurich Assurance	Canada Life Re	Jul-20
Prudential	3,700	Captive Insurer	Captive	Pacific Life Re	Nov-20
Barclays Bank	5,000	Unknown	Unknown	Reinsurance Group of America	Dec-20
BBC	3,000	Pass-through intermediary	Zurich Assurance	Canada Life Re	Dec-20
Axa UK	3,000	Unknown	Unknown	Hannover Re	Feb-21
Undisclosed	6,000	Pass-through intermediary	Zurich Assurance	PICA	Apr-21
Fujitsu	3,700	Captive Insurer	Captive	Swiss Re	May-21

Source: Public announcements

Longevity swaps which have subsequently been converted to a buy-in

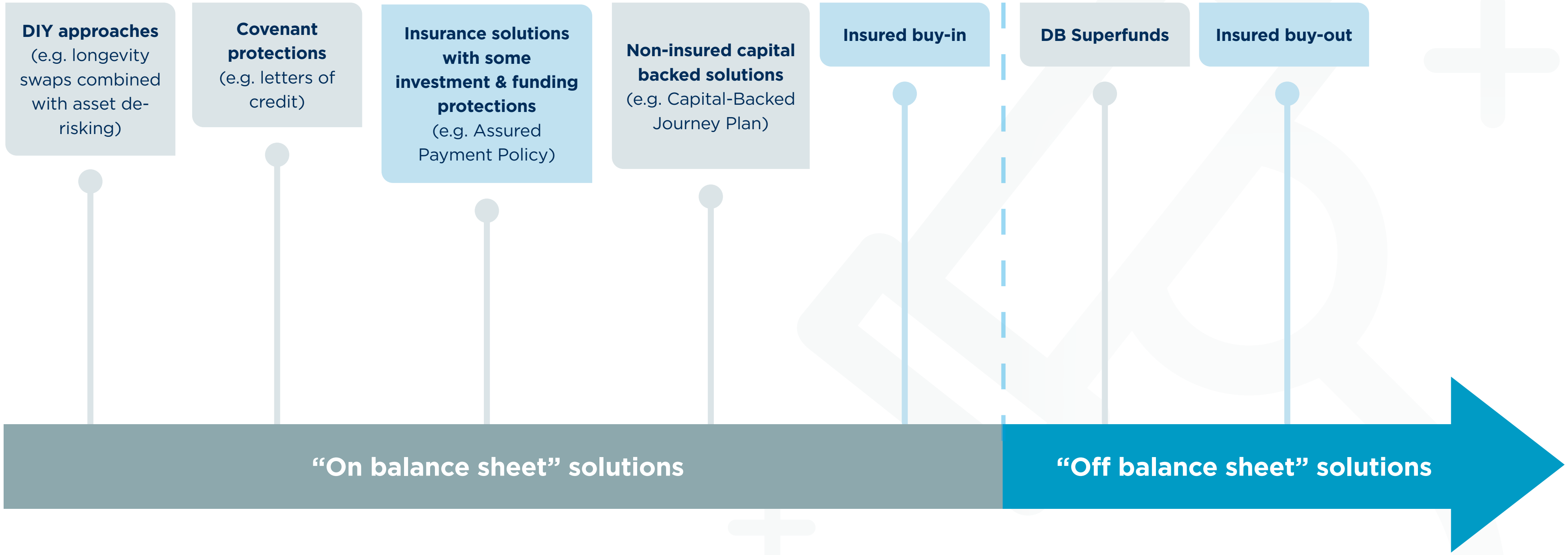


* Three longevity swaps were completed in 2009 for the same pension plan - we have grouped these as one transaction

LCP recently advised the sponsor of an unnamed scheme on a c£6bn longevity swap with PICA – the fourth largest ever completed in the UK. LCP provided detailed advice on structuring and other areas including value for money in the context of the pension scheme's long-term journey plan, and against the backdrop of a global pandemic, which was of particular importance to the sponsor.

A full spectrum of de-risking options

In the last couple of years, there has been a rapid evolution in non-traditional de-risking solutions, providing schemes with alternative options to a buy-in and buy-out. The diagram below shows the spectrum of options that is emerging. The insured solutions are shown in blue.



What's the latest with DB superfunds?

For the past year, the Pensions Regulator has been working closely with Clara Pensions and the Pension SuperFund to conclude its due diligence assessment of the two DB superfunds. If this process successfully completes by the autumn – which the two superfunds are hopeful for - it will pave the way for the first transactions by the end of the year.

Schemes seeking to be early movers in the DB superfund market can take reassurance from the level of due diligence the Pensions Regulator is undertaking. Once complete, this will offer an alternative de-risking option for potentially improving member outcomes.

A full spectrum of de-risking options *continued*

Spotlight on Legal & General's ("L&G") Assured Payment Policy ("APP")

At the end of 2020 LCP advised the Legal & General Group UK Senior Pension Scheme as they executed a £400m APP covering their uninsured pensioners and deferred members, the largest APP transaction to date.

What is it?

L&G launched APP which was developed to help schemes on their journey to buy-out. Under APP a pension scheme receives a pre-agreed series of cashflows from L&G, in exchange for an upfront premium. The payments received by the scheme:

✓ reflect actual inflation experience, including any caps or floors.

✗ do not reflect demographic experience eg mortality experience or when members retire.

It can therefore be thought of in two different ways:

1. **Buy-in without longevity protection:** pension schemes lock into bulk annuity pricing, other than the cost of insuring longevity and other demographic risk. Investment risk is removed and the demographic risk can be insured as and when it becomes affordable to the scheme (ie converted to a "vanilla" buy-in with L&G).
2. **Super-LDI:** APP is a tailored bond that perfectly matches the scheme's pension increases, both in deferment and retirement, with a return in excess of gilts. The APP can cover all the expected benefits under a scheme, or a subset. Similar to LDI, the payments from L&G can to be rebalanced periodically if they diverge from payments to members, and there is also the flexibility to surrender part of the policy for liquidity if needed (for example for transfers out and other member options).

Might an APP be appropriate for my scheme?

Because an APP does not include longevity protection the price is lower than a buy-in, particularly for non-pensioners. In addition, under an APP, the scheme continues to make a gain relative to buy-out pricing as members retire and/or take up member options. APP suits schemes that:

✓ Are targeting buy-out, but are some way off being fully funded – an APP costs less than a buy-in and can be converted into a buy-in with L&G in the future by adding the demographic protection.

✓ Have hard-to-hedge pension increases – one of the big benefits of APP is that it hedges pension increases perfectly.

✓ Wish to target non-pensioners (eg because they already have a pensioner buy-in) – the cost of an APP is broadly the cost of a buy-in without the cost of insuring longevity risk. This longevity protection is much higher for younger members and so, compared to a buy-in, the cost of an APP is particularly attractive for younger members.

Interested in finding out more?

If you think an APP might be of interest for your scheme then please contact us. We would be happy to have a conversation to explore whether it might be appropriate for your scheme and what would be involved if you wished to explore it further.

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Our latest de-risking content

Longevity report 2021

Our latest longevity report aims to help you understand a key risk to your pension scheme: how long members of the scheme are going to live. We summarise recent trends in mortality and take a look at what might happen in the future.

+ Discover more

Solvency II Review

19 February marked the close of HM Treasury's Call for Evidence on Solvency II. In response, LCP calls for a detailed look at the rules governing buy-ins and buy-outs so that insurers can better meet the requirements of DB pension schemes and their members.

+ Discover more

Our investment thinking

LCP Vista Spring 2021: Decisions, questions, expectations

Our latest edition of Vista contains short, hand-picked articles from our investment experts designed to provide food for thought for investors pondering tough decisions.

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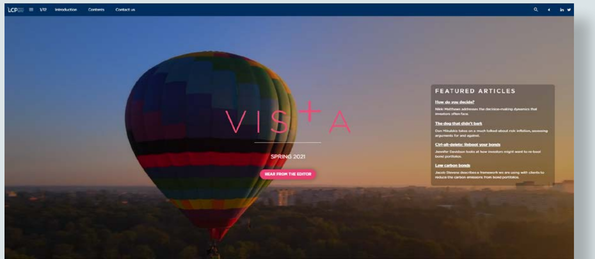

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In case you missed it:

Pension buy-ins/outs - Predictions for 2021 and beyond

Watch our webinar on-demand where we share our predictions for the pensions de-risking market in 2021 and beyond. We also cover what this means for you and your scheme and our top tips on making you stand out from the crowd.

+ Watch now

Our latest transactions

+ £570m pensioner buy-in by Deutsche Bank

+ Largest ever Assured Payment Policy (APP) to date

+ £544m full buy-in of Evonik's UK pension schemes

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We've been lead adviser on 40% of all buy-ins and buy-outs over £500m since 2014.

LCP is a firm of financial, actuarial and business consultants, specialising in the areas of pensions, investment, insurance and business analytics.

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