

UK Risk Settlement Bulletin

Q2 2024

For Professional Clients Only



Differentiating Insurer ESG Approaches

Sustainability Principles Charter

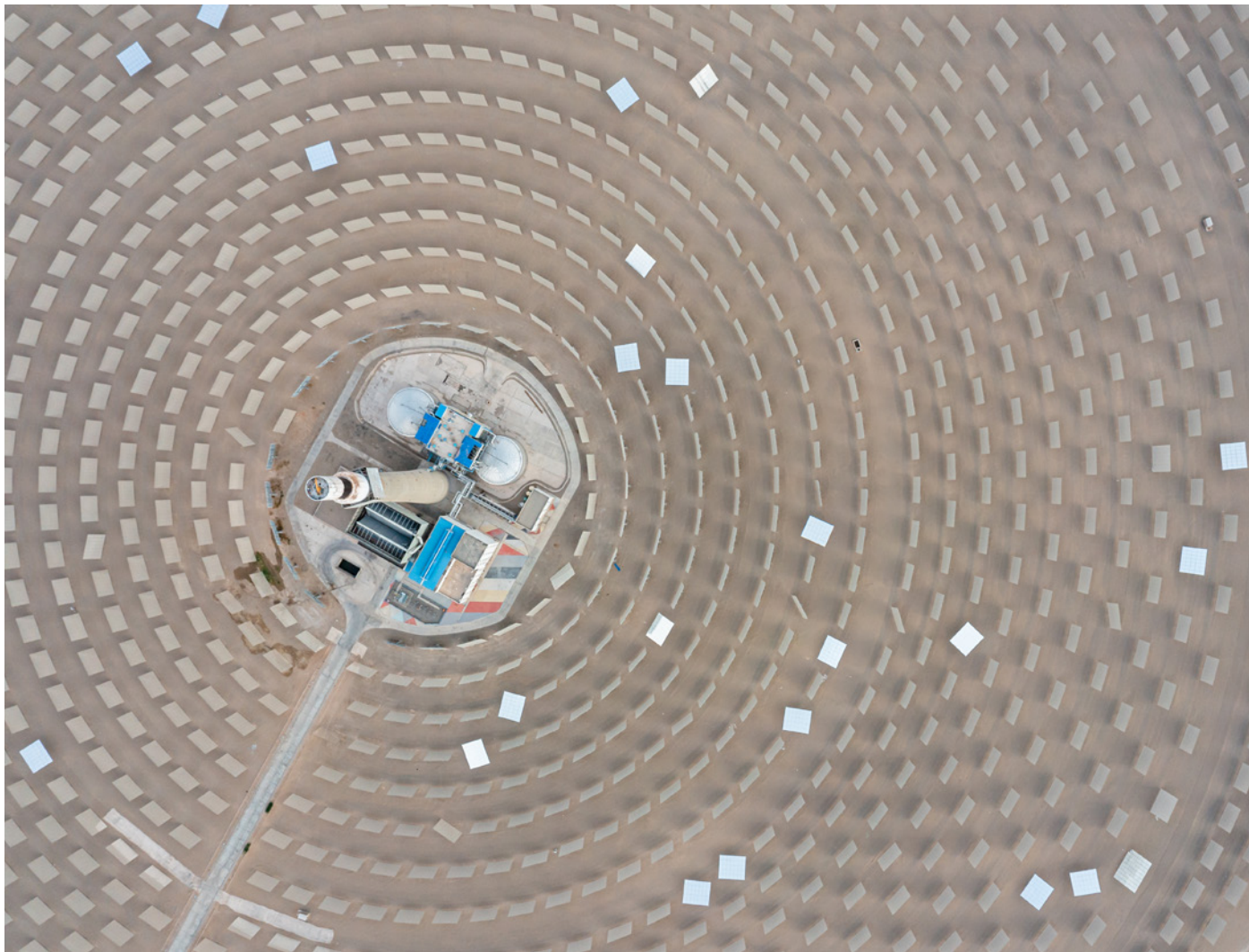
Aon was a founding signatory to the [Sustainability Principles Charter](#), alongside six UK bulk annuity providers, a number of pension funds, independent trustees, and other advisory firms, when it launched in January 2024. The Charter seeks to align expectations around sustainability for UK pension schemes within the bulk annuity process, a topic which we have been fervent supporters of for a number of years.

The six most active bulk annuity providers have already signed up to the Charter and we expect others will follow over time.

Signatories pledge to adhering to the principles of the Charter and helping to shape it over time. Specifically, the Charter asks for a commitment to transparency on matters of sustainability, embedding sustainability into decision-making, ongoing reporting to beneficiaries and trustees, and engagement across the sector as best practice evolves.

The launch of the Charter follows several years of increasing recognition of the importance of sustainability in the pensions industry. Vitally, trustees and sponsors want to know that members' benefits, spanning multiple decades into the future, are safeguarded and 'future-proofed' in a fast-changing economy.

We believe that increased transparency, engagement, and collaboration can only be a positive thing for UK pension schemes looking to secure their members' retirements.



The Bigger Picture

An insurer being a signatory to the Charter, or other relevant networks and initiatives, is a good high-level indicator that an insurer is working to address sustainability in their investments or wider business practice. However, we maintain that there are wide-ranging elements to consider when selecting or monitoring a bulk annuity provider, the importance of which will be unique to each trustee group and sponsor.

Most trustees and sponsors have their own Environmental, Social, and Governance (ESG) targets and requirements, and we are increasingly seeing trustee boards wanting to hold their bulk annuity provider to the same standards as their other investments.

When choosing an annuity provider, ESG can be a significant differentiating factor alongside policy price, insurer financial strength, and administrative capabilities.

Aon's annual ESG survey of bulk annuity providers goes beyond the headlines, including interrogating insurers' investment policies, resilience to future climate events, workforce and community policies, and influence on the wider economy. With sustainability being a key industry theme, we look beyond documented policies to seek specific examples of where ESG

has meaningfully influenced their business behaviours and investment decisions. Insurers' individual progress and strengths can vary widely across different assessment criteria, and progress year-on-year. Our analysis enables trustees to evaluate their potential or existing insurer's credentials against their own objectives.

Ultimately, ESG assessments are not simply a 'pass' or 'fail' exercise – the picture is continually evolving, with new initiatives and advancements emerging year-on-year, and each trustee board will have their own expectations and priorities which are likely to develop and change over time. The Sustainability Principles Charter commits signatories to transparency and driving best practice, but stakeholders may still seek an independent review, bespoke to their ESG objectives.

Aon's Insurer Due Diligence service monitors the ESG credentials of UK bulk annuity providers. Please contact your usual Aon settlement contact for more information.



Insurer Cyber Resilience

Over recent years, cyber risks have become an increasing focus for pension schemes with a number of high-profile cyber incidents hitting the headlines, including the attack on pension scheme administrator Capita in 2023.

In December 2023 The Pensions Regulator issued updated guidance to pension schemes on how to manage cyber risk. A key part of that guidance related to managing pension scheme providers, who often handle data, assets and technology on behalf of schemes.

Under the new guidance trustees are expected to seek assurances from any providers they rely on. This is now increasingly extending to bulk annuity providers. These checks are happening both at the time of a transaction and then on a periodic basis thereafter where a scheme is holding a long-term buy-in.

Pre-Transaction Assessment

Ahead of securing a buy-in transaction, trustees will often carry out due diligence on the insurer(s) they are considering in order to support a selection decision on the preferred provider amongst other factors such as price. This due diligence has in the past often focussed on financial strength, administration capabilities, and the ESG policies of insurers.

We are now seeing schemes start to consider cyber due diligence of potential insurers ahead of a transaction given that the chosen buy-in provider will become a key service provider to the scheme, including holding member data.

Post-Transaction Reviews

Following the completion of a buy-in, it can be easy to think that all risk exposures have been tied down and member benefits are fully secure. However, during the period of the buy-in, until the scheme moves to buyout and is wound up, the trustees' obligations to effectively manage the scheme remain.

Where schemes do hold a buy-in with an insurer we are starting to see schemes conduct ongoing monitoring of the insurer. This will include monitoring factors such as financial strength, but also cyber risk and the controls insurers have in place.

Cyber risk is an ever-evolving area and controls in place today are unlikely to remain sufficient in the future as cyber risks change. Methods of attack change, and defence capabilities need to adapt. As Artificial Intelligence (AI) is adopted by cyber criminals, it also needs to be adopted by businesses looking to establish real-time responses. The Pensions Regulator stresses the importance of reassessing providers periodically, to maintain management of what is a rapidly evolving risk.

Whilst most trustees don't typically have the power to terminate a contract with a bulk annuity insurer as they might be able to do with other providers, they can still have influence over their annuity provider. If there were material concerns then the collective voice of existing clients, potential future clients, and the consulting industry would be difficult to ignore.



Reviewing Cyber Risks in Practice

Aon has carried out cyber reviews across insurers in the bulk annuity market and the overall picture is that strong cyber policies and controls are generally consistent across the industry. However, there are still differences that trustees need to be aware of, and periodic checks that should take place.

The reviews we conduct include assessing insurers across a number of areas and is in line with the framework set out by National Institute of Standards and Technology.

Governance	Does the insurer have strategy, leadership and policies in place to consider and manage cyber risks?
Identify	What is the insurer exposed to, including critical functions and threats to data, systems and assets?
Protect	Does the insurer have measures in place to contain and limit a cyber security event?
Detect	Is infrastructure in place to discover cyber security events in a timely manner?
Respond	How does the insurer take action following detection of an incident?
Recover	What processes are in place to return to normal business operations following an event?

Summary

Whilst cyber resilience is generally strong across the insurance industry, some providers have more developed approaches than others. Some have more legacy systems, some are self-sufficient in cyber resilience, while others depend on third parties.

The decision whether to run administration in-house or outsourced to a third party is a significant decision that has an impact on how cyber risks are managed, but even amongst those that outsource there are different models with varying implications.

The good news for schemes is that, while this is yet another item to add to the list of tasks, you're not alone. Many Aon clients have bulk annuities, and have the same questions of the same providers. Our specialist cyber team, Aon Cyber Solutions, have undertaken cyber reviews of insurers across the market. Whether you're just embarking on the search for an insurer, or have a bulk annuity provider whose controls you would like to understand better, please get in touch with your usual Aon Risk Settlement consultant.

Shifting Market Dynamics

M&G and Royal London Enter the UK Bulk Annuity Market

In March 2024, insurer Royal London formally announced their entry into the bulk annuity market and disclosed that they had completed two bulk annuity transactions for their own pension schemes over 2023/24.

The two transactions completed reflected a £246 million full-scheme buyout and a £348 million partial pensioner buy-in. Royal London are currently in price testing to plan towards their first external transaction.

This news followed the re-entry of M&G into the market in September 2023, after a 7-year hiatus since it last traded under its Prudential brand. M&G recently completed their third transaction in March 2024, bringing new business since re-entry to £900 million following two deals in 2023. M&G have publicly stated an intention to write £1 billion - £1.5 billion of new bulk annuity business in 2024.

Given the continued growth of the bulk annuity market, following a record year in 2023 with £49.1 billion of new business completed, other insurers are currently considering the viability of launching their own new bulk annuity proposition.

The presence of M&G and Royal London, and any further new entrants, in the market is expected to bolster competition over time as these providers become established. This gives greater choice for schemes looking to approach the market and more capacity.



Sale of Scottish Widows Annuity Book

On 13 March 2024, Scottish Widows announced that they had entered into an agreement to sell their c.£6 billion bulk annuity portfolio (covering approximately 42,000 policyholders) to Rothesay, another existing bulk annuity insurer.

Lloyds Banking Group haven't publicly commented on the reasons behind the sale. We understand that whilst bulk annuities have remained a profitable business line in recent years, the Group has focussed on other strategic priorities and operations. As the bulk market annuity has grown materially since 2016, Scottish Widows had continued to write selectively, but had developed their individual annuity offering.

The transaction will be structured initially as a reinsurance arrangement between Scottish Widows and Rothesay and is expected to lead to a transfer of the underlying assets and policy liabilities to Rothesay in 2025, subject to regulatory and court approval.

This follows past cases of bulk annuity providers withdrawing from the market and their portfolio successfully transferring to another provider's annuity fund. Any such transfers are scrutinised carefully and subject to rigorous checks to safeguard policyholders' benefits. This is known as the 'Part VII process', a regulatory process set out in Part VII of the Financial Services and Markets Act 2000.

Given the rigorous approvals process, and the high solvency coverage of Rothesay's annuity fund, we wouldn't expect this transfer to have any notable impact on security for policyholders with either Scottish Widows or Rothesay. However, those who hold a bulk annuity policy with Scottish Widows should consider carrying out due diligence on Rothesay to understand the insurer that will ultimately be responsible for members' benefits.

Please get in touch with us if you would like further information on the new entrants in the market or the sale of the Scottish Widows bulk annuity book.



Bulk Annuity Pricing

The chart below indicates the expected range of best deferred and pensioner pricing available, relative to gilt yields, in the bulk annuity market for a typical large scheme, traditionally defined as a scheme with over £100 million in liabilities. On this measure, pricing remained relatively stable over the first quarter of 2024, with movements in the relevant markets underlying this pricing measure (gilt, swap and credit markets) largely offsetting each other.

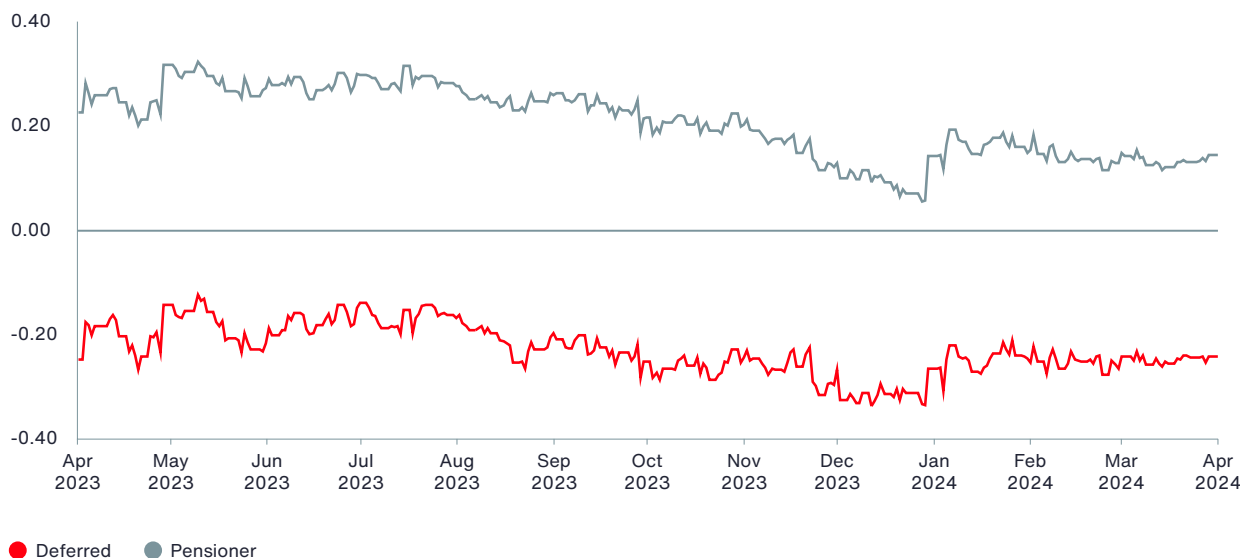
The market remains very busy for transactions of all sizes, and it is important that all schemes can demonstrate they are sufficiently prepared to transact and have governance structures in place to facilitate effective decision making to capitalise on a firm annuity price when offered.

Recently, in light of the significant growth in the £ billion+ segment of the market, we have developed a new iteration of the model to reflect pricing available for schemes that fall into this ‘jumbo’ size category. Alongside our existing ‘large scheme’ and ‘small scheme’ models, this means we now have three separate modellers to reflect the distinct segments of the market.

For more information on pricing for your own scheme, please contact us.

Bulk Annuity Pricing Relative to Gilts

Return relative to gilts % p.a.



Source: Aon's Risk Analyzer

How to Read this Chart

The graph compares the estimated annuity cost with a value on a gilts basis, where the other elements of the gilt basis beyond discount rate are assumed to be exactly the same as those under the solvency basis, and the discount rate relative to gilts is derived to give the same value as the annuity cost.

In practice most comparator gilt bases use different assumptions, in particular for determining inflation-linked pension increases, and this can mean that the discount rate on a comparator basis is materially lower relative to gilts than the level shown here.

This graph should not be used for direct comparison with scheme funding bases without scheme specific modelling.

There is variability in solvency pricing beyond market conditions that isn't picked up in this model. At times of high market volatility this uncertainty is likely to increase. Accurate pricing can only be achieved by going to market.



About

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Compliance code: A4-310724

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