UK Risk Settlement Bulletin

Q2 2021

The Q2 bulletin looks at the importance of accurate marital information for transactions, the latest mortality projections and long term journey planning.

To have and to hold – the importance of marital data for risk settlement

Pension schemes typically pay survivor pensions to the spouses (or qualifying partners) of pensioners after they have died, so marital characteristics (e.g. data on existence and age of qualifying partners) are key to valuing liabilities. Our research has revealed significant variation, with affluent pensioners up to 30% more likely to be married than less affluent pensioners.

For schemes considering risk settlement, marital data is very important. It ensures the scheme has a realistic picture of its own liabilities, for assessing affordability and value for money of the protection being purchased.

We have seen cases where actual experience can be very different to the marital assumptions made – up to 5% of liabilities in some cases. This has the potential to derail transactions if schemes are unprepared.

Marital survey collection

There are two main ways of collecting data:

- Write out – the scheme writes to members asking for their marital details. This provides accurate data but is relatively expensive and time-consuming. And results may not be representative of the whole scheme, as married members are often more likely to respond.
- Electronic tracing – tracing services use proprietary data to predict marital status. This can be quick, non-invasive and relatively cheap. However, the results are only predictions and the trace codes need interpreting for a scheme's eligibility definition.

What do insurers prefer?

A recent Aon survey of insurers showed that almost all providers require up-to-date marital data to achieve the most competitive pricing.

There were differing views on the exact data preferred and on the relative merits of particular tracing services. A common theme, however, was that schemes should collect data at outset and, for write outs, design the questionnaire and processing of responses carefully to ensure results were meaningful.

A spectrum of approaches is acceptable to providers as illustrated below.

These findings reinforce the message that marital data is crucial for risk settlement, with careful preparation needed to ensure that the information collected is fit for purpose.

Methods to collect marital data

Source: Aon's Demographic Horizons© team

CMI 2020 – modelling in a pandemic

2021 began against a background of rapidly increasing COVID-19 infections and subsequent deaths, which had started in the weeks running up to the end of 2020. A major reason for the rapid increase is likely to have been the spread of a more infectious variant of the disease.

In the first 10 weeks of 2021, almost 40,000 more deaths were registered in England & Wales than in the equivalent period in 2019. Unlike in the pandemic's first wave, as set out in the below charts, deaths from causes other than COVID-19 were significantly lower than they had been in previous years. This is partly due to frailty (some individuals who died in the first wave of the pandemic would otherwise have since passed away due to other medical conditions, so the remaining population is on average slightly healthier). It is also partly because lockdown meant that diseases like flu were circulating at much lower levels than is typical in winter.

In the most recent weeks, deaths from COVID-19 have fallen significantly, with deaths from other causes remaining low. Both the UK's impressive vaccination program and its continued lockdown have contributed to this fall.

As a result of the pandemic, most pension schemes will have experienced significantly more deaths in 2020 and the first part of 2021 than in previous years – by itself, we expect this to reduce liabilities by less than 1% for a typical scheme. From a funding point of view, the key concern will be the forward-looking impact of COVID-19 on mortality.

CMI 2020 – mortality projections

When pension schemes and insurers need to estimate future life expectancy, they use the Mortality Projections Model which is published annually by the Continuous Mortality Investigation (CMI) – the latest version, CMI 2020, was published in March 2021.

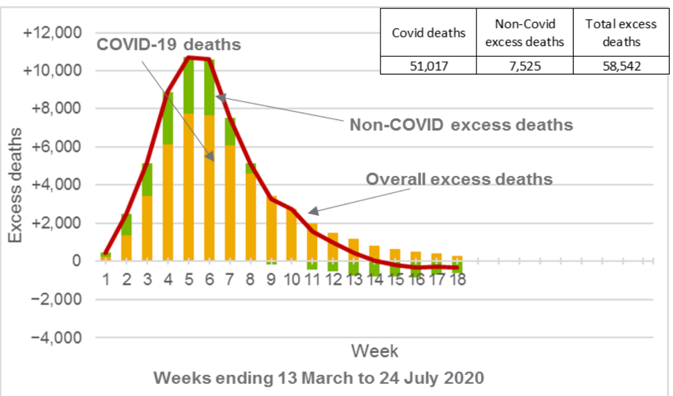
If mortality experience over 2020 in the model had been included, this would have led to a 4% reduction in life expectancies – this was widely regarded as unrealistic, including by the CMI itself. In the latest version of the model, the CMI have therefore placed zero weight on the 2020 data, which means that liabilities for a typical pension scheme will be slightly lower using CMI 2020 compared to using the 2019 version of the model. This aligns with current market consensus, that best estimate long-term mortality has not changed significantly despite the pandemic.

This does not mean that longevity risk has gone away – if anything it has increased as the longer-term impact of COVID-19 remains highly uncertain.

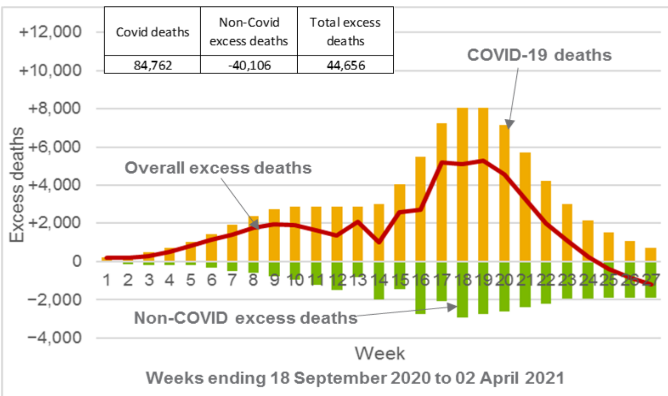
However, whilst COVID-19 has the potential to lead to outcomes with high mortality, the real-world effectiveness of the vaccines seem to be likely to mitigate against the worst of these – remaining uncertainties are around new variants, long COVID and the impact of an economic downturn on longevity (which may not always be negative). And some consequences may be more clearly positive for longevity – for example, better attitudes to hygiene and social distancing (particularly in future flu seasons), possible increased support for higher healthcare spending, and future applications for mRNA vaccines.

Deaths from all causes over the 'first' and 'second' COVID-19 waves

Excess deaths* (first wave)



Excess deaths* (second wave)



Source: CMI data

What is your Scheme’s end game?

UK pension schemes are increasingly focused on their ultimate destination, or ‘end game’. That end game could be self-sufficiency, consolidation or an insurance buyout.

As part of the Pension Schemes Act 2021 the Chair of Trustees is required to sign off a "statement of strategy" for ensuring benefits can be provided over the long term.

Many schemes now have an idea of their ultimate long term goal, but relatively few have a detailed plan of how they will get there and the actions that will be taken along the journey.

Journey planning

An approach where schemes focus on their journey to the ultimate end-game and plan out the timing and scope any PIE exercises, Enhanced Transfer Value exercises and investment strategy decisions along the way is the most effective.

This type of approach means that all decisions on the journey are taken with the end target in mind, increasing efficiency, reducing costs and spreading workloads smoothly over the journey period. This also ensures that strategic opportunities aren’t missed due to any lack of governance, preparation and planning.

Ultimately, every step along the journey should help you reach your destination.

How to plan the journey

Once a scheme has planned what it’s long term target will be, it is important to consider the key steps along the journey.

A typical plan, no matter what the ultimate end game target, should consider a number of key areas:

End-game considerations and governance:

- Has a suitable target been set for the end-game?
- Are the key stakeholders sufficiently educated on the end-game and aware of what is required for a successful journey?

Member experience:

- Is the scheme aware of how the support offered to members will change – for example if the scheme is transferred to an insurer or consolidator?

Asset preparation:

- Is the current investment strategy still appropriate as the focus turns increasingly towards an end game target?
- Have de-risking triggers been considered as the scheme matures and moves along its journey?

Data:

- Does the scheme hold clean and complete data (for example, marital data), and can this be efficiently cleansed for all projects that are part of the journey?

Benefits:

- Does the scheme have a full understanding of the benefits to be secured, including discretions? Any benefit uncertainties could delay the end-game target.
- Is a comprehensive and legally-reviewed benefit specification available?

Examining all workstreams holistically allows prioritisation of projects based on their interdependency with other items along the overall journey. This process enables the scheme to identify the barriers and opportunities to achieving its end-game target.

Each scheme's route to its end-game will be different allowing for scheme specific circumstances, Trustee and Sponsor objectives and the interaction between these over time.

If you would like to learn more about how to plan your scheme’s journey to its long-term goal, please contact your usual Aon settlement contact.

Aon Survey

Aon has surveyed over 120 schemes in 2021 to explore where schemes are placed along their journey to their end-game – the results of this survey will be published shortly.

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Bulk annuity market outlook

The chart below indicates the expected range of best pensioner pricing available, relative to gilt yields, in the bulk annuity market for a typical scheme.

Current pricing levels

On this measure, pricing remained relatively stable, and at an attractive level in the first few months of 2021. This attractive pricing was despite credits spreads, which have remained narrow relative to historic levels.

Credit spreads measure the return available on corporate bonds above the 'risk-free rate'. This is a proxy for the additional return that insurers can achieve.

Market experience

Despite the challenges presented by low credit spreads in the current environment, we have seen a number of transactions achieve particularly attractive pricing so far in 2021.

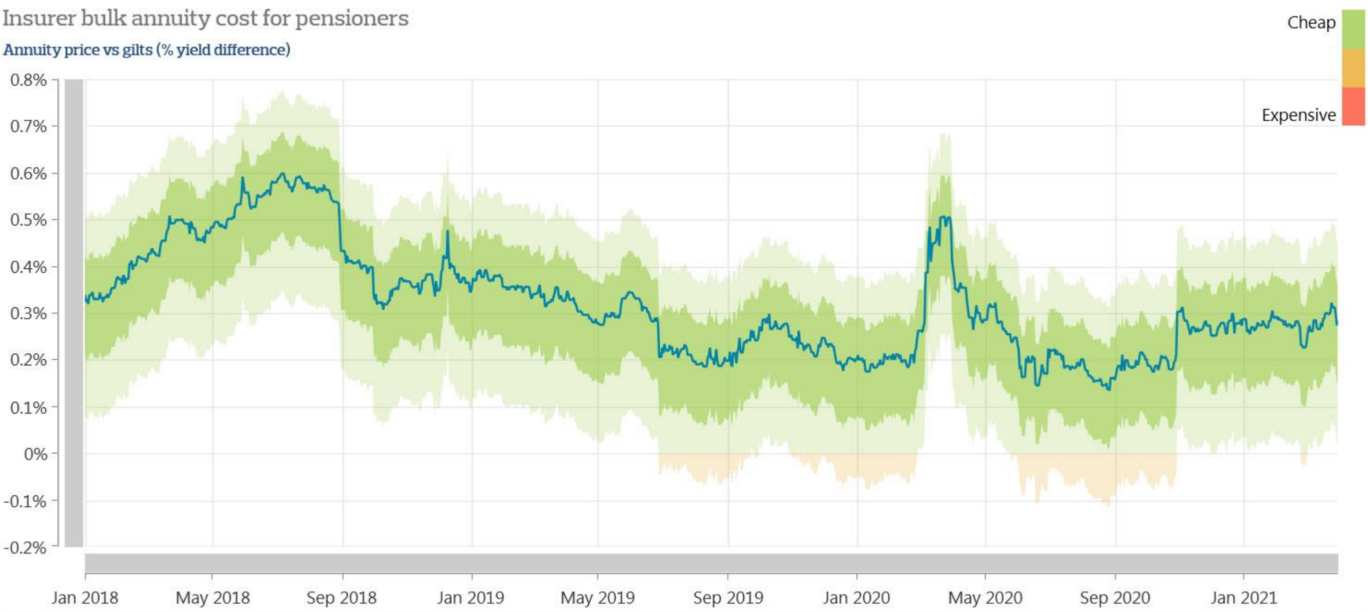
Insurers are often now using other assets, rather than predominantly bonds, to back new business. For example, we have seen insurers source assets such as infrastructure, property and mortgages to back their annuities, and this has enabled them to achieve stronger pricing in the first quarter of the year.

This suggests that the schemes that are well prepared and give insurers transaction certainty can still achieve good outcomes for all stakeholders involved.

Insurer appetite in 2021

As is often the case at the beginning of a new year, as insurers reset targets and capital availability renews, insurers have been keen to write new business.

At present, it appears that insurer appetite has been stronger than the number of transactions completing over the first quarter of 2021. This suggests there are significant opportunities for schemes who are ‘transaction ready’ to approach the market in 2021.



How to read this chart

- This shows the return from a bulk annuity for pensioners, relative to the yield on a comparable gilt portfolio, assuming insurer-type assumptions beyond the discount rate.
- A higher position represents a better price.
- This comparison ignores the material value from annuities giving a better hedge than gilts, including longevity cover.
- Expected pricing for a typical scheme is shown by the blue line.
- Prices typically fall in the darker shading, and some auctions fall in the lighter shading. Pricing outside the shading typically represents an unusual liability profile.

Chart sourced from Aon's Risk Analyzer

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