THE JOURNEY CONTINUES...

Rothesay

THE JOURNEY TO BUY-OUT 2021

MORE FOCUSED

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INTRODUCTION

Last year we published "The journey to buy-out", which was a collection of articles that explored in depth the issues and processes associated with reaching buy-out and the many avenues a scheme can take to get there.

A year on, these articles are still as relevant to the market as they were then. Endgame planning remains high on the agenda for an increasing number of schemes and their sponsoring employers, as what was once a distant spot on the horizon continues to come into focus.

This update has been designed to complement last year's publication and builds upon the insights we shared with you. The articles have been written by a host of industry experts and we hope that you find them interesting and helpful.

The publication last year also presented the results of a survey we completed with our friends at mallowstreet. We carried out the survey again this year and have shared with you the results of this on page 54 as well as throughout this update.

MORE FOCUSED

Boris Johnson announced the first national lockdown on 23 March 2020. It was supposed to last two weeks, however, we all knew we were entering unprecedented times and what lay ahead was hard to predict.

The financial markets started to react earlier than most to the pending pandemic. We saw the biggest movements in gilt yields and credit spreads since the financial crisis and sterling fell to its lowest level in 35 years. In the short term, many sponsoring employers shifted their focus to stabilising their businesses, whether that was because they were an essential service or a service that had suffered devastating effects overnight. Some schemes were able to take advantage of the market volatility and through early preparation and quick decision-making they were able to secure bulk annuities.

In these times, the insurance industry demonstrated why it is entrusted with the pension benefits of millions of people: solvency levels remained strong, service levels were maintained and the market continued to function. As a business, the commitment we make to trustees and our policyholders is our number one priority, and ensuring their benefits remain safe and secure comes first above all else. The market volatility experienced in 2020 is testament to how the insurance market and its regulatory regime provides extremely high security for trustees and policyholders.

The long-term effects of COVID-19 on longevity are still unknown, but what is clear is that the future direction for longevity is less certain today than it was 18 months ago, increasing the risk pension schemes hold. As such there is a greater desire today for pension schemes to de-risk where they can.

UNDERSTANDING THE JARGON

For those of you new to this market, there can be a bewildering amount of jargon and we have again included (and updated) a glossary of terms at the back of this update.

ROTHESAY'S "HOW TO" GUIDES

Over the course of the last year, we have released several guidance papers to the market that are designed to give our insights into the data processes run for most schemes that come to market. At the back of this update you will find our "how to" guides on marital write-out exercises, cashflow pricing requests, query logs and experience data. Whilst these guides are aimed at pension scheme consultants, they also make interesting reading to any trustee who wants to really understand the details.

CONTACT US

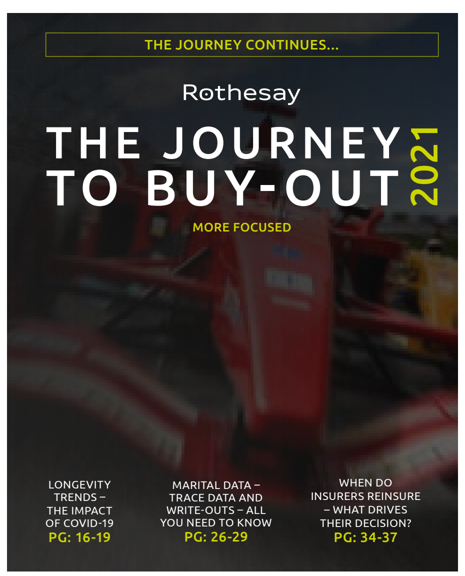
We have missed meeting with you and discussing these topics in person over the last year, however, we really hope to meet again face to face very soon. In the meantime, we hope you enjoy the contents of this update and please don't hesitate to reach out to discuss your scheme further with us. Our contact details can be found on page 72.

TOP 20

Transactions in the bulk annuity market

Name	Size (£m)	Insurer	Date	Type
GEC 1972 Plan (telent)	4,700	Rothesay	Sep 2019	Full buy-in to buy-out
Rolls-Royce	4,600	Legal & General	Jun 2019	Pensioner buy-out
British Airways	4,400	Legal & General	Sep 2018	Pensioner buy-in
Allied Domecq (Pernod Ricard)	3,800	Rothesay	Sep 2019	Buy-in
Asda	3,800	Rothesay	Oct 2019	Full buy-in
British American Tobacco	3,400	Pension Insurance Corporation	Aug 2019	Buy-in
Undisclosed	3,300	Rothesay	Dec 2020	Pensioner buy-in
ICI	3,000	Legal & General	Mar 2014	Pensioner buy-in
National Grid	2,800	Rothesay	Oct 2019	Pensioner buy-in
TRW	2,500	Legal & General	Nov 2014	Pensioner buy-out
Nortel Networks	2,400	Legal & General	Oct 2018	PPF+ buy-out
Philips	2,400	Pension Insurance Corporation	Nov 2015	Full buy-out
British Steel	2,000	Pension Insurance Corporation	Oct 2020	PPF+ buy-in
Aviva	1,700	Aviva	Oct 2019	Pensioner buy-in
Civil Aviation Authority	1,600	Rothesay	Jul 2015	Pensioner buy-in
MNOPF	1,600	Pension Insurance Corporation	Feb 2020	Pensioner buy-in
National Grid	1,600	Legal & General	Nov 2019	Pensioner buy-in
Total	1,600	Pension Insurance Corporation	Jun 2014	Pensioner buy-in
EMI	1,500	Pension Insurance Corporation	Jul 2013	Full buy-out
Rentokil Initial	1,500	Pension Insurance Corporation	Dec 2018	Full buy-in to buy-out

INTRODUCTION



MALLOWSTREET
IN PARTNERSHIP WITH ROTHESAY
Pension Risk Transfer Report

2/5
pension schemes targeting buy-out

27%
of schemes with assets under £200m think they are too small for insurance companies

Market discussions 2021*

15%
of the total pension liability transferred to insurers in 2020 was deferred liability

£3.3bn
pensioner buy-in with Rothesay: largest transaction of 2020

£31bn
of pension liability transferred to insurers in 2020 (second largest year on record)

MARKET DISCUSSIONS 2021

*

SMALL SCHEMES

In 2020

17

schemes under £200m publicly announced transactions

DAVID STEWART
Lane Clark & Peacock LLP

David Stewart is a Partner within LCP's specialist longevity de-risking team. He advises trustees and sponsors on their strategic journey to buy-out together with implementation of phased buy-ins and full buy-outs. He has advised on over 60 transactions from as small as £5m to some of the largest buy-ins and buy-outs including recent transactions for QinetiQ and Littlewoods. He has a particular interest in helping smaller schemes and pioneered the use of pre-negotiated contracts for smaller schemes through LCP's streamlined buy-in and buy-out service.

The insurance market is currently busy, and it's only expected to get busier over the coming years (as many schemes are heading towards buy-out over a similar timeframe). There are currently attractive opportunities for smaller schemes, but as the market gets busier, there is a risk that some insurers will focus their resources on medium-sized and larger schemes. Therefore, it will become increasingly important for smaller schemes to ensure they maximise insurer engagement and present themselves attractively to the insurers.

The key things for smaller schemes to consider are:

1. You might be closer to buy-out than you realise – markets have improved significantly over recent months, which has seen many schemes' buy-out funding levels improve.

2. Beat the rush – either via advanced contributions from the sponsor or completing partial buy-ins whilst on the journey to buy-out (this is not just the domain of large schemes).

3. Be 'buy-out ready' to maximise insurer engagement – ensure the benefits are well documented, the data is clean and accurate, a clear decision-making process is in place (where decisions can be made quickly, if needed) and the investments are liquid and broadly match insurance pricing.

4. Use a streamlined service to increase insurer appetite – LCP's streamlined service, with pre-agreed insurer contracts, ensures an efficient, structured process, whilst having the benefit of achieving pricing and terms similar to larger schemes. In fact, insurers are increasingly demanding that smaller schemes use a streamlined service.

*

DEFERRED MEMBERS

In 2020

£4.8bn

of deferred liabilities transferred to insurers out of the £30bn total market volume

BEN STONE
Mercer

Ben is a Partner within Mercer's Risk Transfer team. He has 20 years of industry experience, including over 10 years focussed on pension risk transfer with Mercer and previously with PwC and WTW. Over the last decade, Ben has led advice to both trustees and scheme sponsors, specialising in bespoke and innovative large transactions, including some of the largest that have taken place (e.g. the £1.7bn British Airways captive longevity swaps in 2017, the £4.5bn British Airways pensioner buy-in in 2018 and the £3.8bn ASDA buy-out in 2019).

One interesting feature which we have seen in the bulk annuity market over the last two to three years is the increasing proportion of deferred pensioners covered by transactions. A number of schemes have entered a buy-out sooner than anticipated under their journey plan – in many cases driven by the scheme sponsor wanting to secure members' benefits with an insurer to remove defined benefit pension liabilities from their balance sheet. Research carried out by Mercer in 2020 showed that in the majority of publicly announced buy-outs in the last ten years, a scheme sponsor's share price has improved after announcing the transaction. For this reason, we often see pension scheme buy-outs taking place alongside wider corporate transactions – e.g. M&A activity.

Buy-out insurers have become more accustomed to taking on deferred pensioner liabilities. The increase in supply of longevity reinsurance for younger lives has helped to increase market capacity; and long-dated asset opportunities for insurers help to create a competitive pricing environment for these buy-outs, which include significant numbers of deferred pensioners. Going forward, we expect this feature to continue – particularly as schemes who are following a strategy to do a series of partial buy-ins have a deferred-pensioner heavy population remaining to insure in order to reach buy-out.

The long-standing perception that deferred pensioners are "unwanted by insurers" or "hard to insure" is now yesterday's news;

the 2020s bulk annuity market is open for schemes of all shapes and sizes.

MARKET DISCUSSIONS 2021

FUNDED REINSURANCE

Funded reinsurance

Reinsurers take on asset and longevity risk for bulk pension annuity transactions

PHILL BEACH
Pacific Life Re

Phill heads up Pacific Life Re's Global Funded Solutions (GFS) proposition, providing funded reinsurance solutions and further supporting their clients on asset intensive business. Phill joined Pacific Life Re in 2017 as Head of Pricing for their Europe business unit and has extensive experience in leading teams in the bulk annuities, retail annuities and retail protection markets.

Pacific Life Re has recently launched its funded solutions proposition, GFS.

Insurers support the pension risk transfer market as they take on pension liabilities, often enhancing the security to underlying pension scheme members. Quite often the insurers themselves enact their own insurance by entering into longevity reinsurance agreements with their panel of reinsurers. This allows them to diversify the risk across more providers and manage their capital.

Until recently the reinsurance market has been dominated by longevity only risk transfer deals, but now a number of funded reinsurance transactions have taken place…

…where reinsurers take on some assets with the longevity risk. This helps insurers in a number of ways, from further diversification and capital management, to adding an additional pricing lever which may sometimes improve the price to the pension scheme. GFS was created to further support Pacific Life Re's clients to write asset intensive business where it is required. The initial focus was to support the UK pension risk transfer market, but the team is also looking to expand into other geographies and product lines where there is a demand for this form of reinsurance support.

It's an exciting new venture for Pacific Life Re, where we are adding additional reinsurance support to our market-leading longevity proposition. Overall, we believe this adds more capacity to the market and will help insurers de-risk members' pensions.

SO WHAT'S HAPPENING WITH THESE SUPERFUNDS?

No scheme in our survey
>90%
funded is considering consolidation

KIERAN MISTRY
Hymans Robertson LLP

Kieran is a risk transfer specialist at Hymans Robertson. He has advised on a large number of buy-ins and buy-outs including the Allied Domecq Pension Fund's £3.8bn buy-in with Rothesay, and he leads Hymans' Non-Traditional Risk Transfer team which advises on superfunds and other emerging risk transfer options.

Great question!

It feels like the superfunds have been rumbling on in fits and starts for years, without any transactions getting over the line! Since The Pensions Regulator (TPR) came out with its guidance last year setting out its expectations of superfunds themselves as well as scheme sponsors and trustees considering consolidation, everyone's been waiting with bated breath for the first transactions to be announced. But things then went pretty quiet, at least publicly.

Behind the scenes there's been loads of activity and progress. Superfunds have been busy preparing rafts of supporting evidence to allow TPR to assess them against the guidance. At the same time the first candidate schemes, many of which have a real urgency to quickly transfer to a superfund, have been preparing to submit their cases for clearance. I believe it's now a when, not if, we see the first schemes transfer to the superfunds.

This will be a welcome development for the pensions industry, as many scheme sponsors emerge scarred from the COVID-19 pandemic, less able to support their pensions obligations.

The sad truth is that there will be more corporate insolvencies to come, particularly in the sectors hardest hit by the economic downturn, lockdowns and shifts in social behaviour. So while buy-out with an insurer will remain the gold standard the vast majority of trustees and sponsors aspire to attain for their members, for schemes with a struggling sponsor which can't afford to buy-out in the short to medium term and may never make it there, superfunds may offer a valuable option to improve the security of their members' benefits.

SUPPLY V DEMAND

SIMON BRAMWELL
Barnett Waddingham LLP

Simon is Head of Longevity Risk Transactions at Barnett Waddingham, acting as lead adviser on regulated transactions to manage longevity risk. He's worked with trustees and sponsors on numerous buy-ins, buy-outs and longevity swaps over the course of the last ten years.

As in any dynamic market, the bulk annuity market is subject to supply and demand factors that influence pricing.

In the bulk annuity market, demand is driven by maturing pension schemes eager to de-risk: after years of deficit reduction contributions, investment de-risking and slowing trends in future mortality improvements, pension scheme funding levels have improved significantly. The next logical step for many of these schemes is to pay to transfer their risk to an insurance company. This demand has been enabled by a pensions consulting industry that has developed significant expertise and resource to help these schemes. This may be from initial preparation many years in advance of going to market, through to helping them determine when and how to approach insurers, before ultimately helping to negotiate the terms of the bulk annuity contract and its implementation. Innovation has been necessary to manage this demand, with the development of streamlined processes and pre-negotiated contracts for smaller cases, a greater understanding in the drivers of (and hence the ability to monitor) bulk annuity pricing and a market-wide working practice to ensure schemes are well prepared and insurer pipelines well understood. An interesting factor that may shape demand soon is the emergence of consolidator options. Whilst distinct from the insurers (in most cases those considering a bulk annuity will not be in a position to consider a consolidator – and vice versa), it seems likely that it'll be the same pool of bulk annuity specialists advising pension schemes on consolidator options. This may only be a short-term effect as consultancies adapt and the size and relevance of the consolidator market becomes clear.

There are
8
insurers operating in the bulk annuity market

The supply side has been remarkably resilient in meeting this huge increase in demand for bulk annuities, with the combined value of bulk annuities written in 2019 and 2020 broadly equalling the value written in the five years prior to that. This despite an extremely challenging 2020, where an entire industry had to adapt very quickly to new working environments (with understandable impacts on operational processes), disruption in the financial markets and pension schemes (and, occasionally, their sponsors) pausing for thought as they grappled with the impact of the pandemic. It certainly helps that the factors influencing the insurers' ability to meet this demand are currently favourable: years of investing in development and growth means they have large teams of specialists across business development, pricing, asset sourcing and longevity; improvements in technology and its use have helped to speed up pricing and the implementation of new contracts; a supporting reinsurance market that has also innovated and grown in size and capacity alongside the insurers; and sourcing capital to support their business has not been a problem – with investors eager to find opportunities to earn decent returns in an ultra low-yield environment. Concerns about the insurers' ability to source higher-yielding assets to support competitive pricing have been largely unfounded, although it probably remains the biggest supply-side risk.

It should also be noted that there have been no recent new entrants in (or exits from) the bulk annuity market to meet this demand. Recent discussions with insurers suggest no scaling back in their ambitions – indications are those with the greatest market share want to maintain that position; those with lower market share are expanding their teams, capacity and offerings (e.g. increased appetite for non-pensioner liabilities). Finally, there are certain aspects of detail within the insurance regulatory environment that are widely acknowledged as being ripe for adjustment – more so now the UK has left the EU. The drivers for change are likely to positively impact insurer supply, but it's early days and it may be some time before change is enacted.

In short, the demand and supply dynamics of the bulk annuity market currently seem well-balanced, with the majority of those looking to de-risk having managed to do so when they wanted to and at a price they were anticipating. It's not immune to imperfections: spikes in financial markets have driven some short-term pricing volatility (both good and bad); competitive pressure towards year end can influence insurer appetite; a concentration of "jumbo" transactions can significantly impact the ability for smaller cases to get insurer interest; and some processes across the industry remain inefficient, despite great progress. However, the market has come through a very tough 12-15 months relatively unscathed and with the prospect of a very busy year ahead as life returns to normal.

SOLVENCY II REFORM

"We see significant scope for reform. In particular, the risk margin is too sensitive to interest rates. And under current interest rate conditions it is too high."

Anna Sweeney of BoE on SII reform, 15 June 2021

OLIVER DIXON
Rothesay

Oliver Dixon is the Head of the Capital Actuaries at Rothesay. He joined Rothesay in 2013 and is responsible for the continuous monitoring of the firm's solvency position as well as its economic and accounting valuation measures. Oliver's role involves the assessment of the capital implications of new asset and liability transactions, including the impact of any changes to the regulatory capital rules. Prior to joining Rothesay, Oliver worked for Willis Towers Watson as a consultant in their life insurance practice.

The future direction of the prudential regulatory regime for UK insurers post-Brexit is currently a hot topic of discussion, particularly in light of HM Treasury's review of Solvency II.

There has been much speculation that the end result of this will be materially lower capital requirements for annuity writers and that this will lead to cheaper pricing for pension schemes. However, there has been enough mood music from regulators suggesting they consider that the level of capital held by insurers is presently broadly at the right level, to conclude that this is probably slightly wishful thinking.

There are many areas covered by the Solvency II review, but the two which get most focus and discussion are the risk margin and the matching adjustment – both of these introduced new requirements into the solvency framework when Solvency II became the biting capital standard at the start of 2016.

What is clear, is that whilst the risk margin is meant to provide greater security for policyholders, its design and extreme sensitivity to interest rates has made balance sheet management harder and more costly for insurers. It is ironic that a calculation which considers interest rate risk as hedgeable, makes the task of doing so significantly more difficult. The present calibration of the risk margin has incentivised the transfer of large amounts of longevity risk offshore, to jurisdictions which sit outside of the Solvency II regime – indeed, on some transactions, it is not commercially viable for UK insurers to retain longevity risk, given the present levels of risk margin. Therefore, we would expect a significant reduction in the volatility of the risk margin to come out of this review, as well as a non-trivial reduction to its size, given it has grown disproportionately since it was designed.

On the whole, the matching adjustment rules in their current form work well and incentivise sensible cashflow matching and asset allocation. The language of the rules is very binary, however, which can prevent insurers from offering some policy terms, which they would otherwise be willing to. But, the punitive incremental capital for holding liabilities outside of the matching adjustment framework means there are a relatively clearly defined set of terms which Rothesay can and cannot accommodate. We are hopeful that some of the binary regulatory language will be softened as part of the HM Treasury review process, but, in general, we don't expect to see great changes here, as most commentators agree that the matching adjustment framework is working.

So, the indications so far are that the net result of this review is likely to be relatively modest changes to the overall quantum of capital held, but potentially less volatility associated with the regulatory balance sheet for UK insurers and a system which places less reliance on the reinsurance market.

The challenges of... ESG

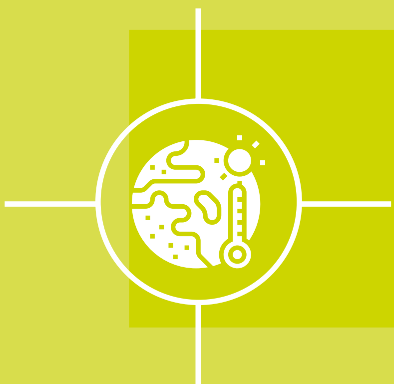
There has been a clear step change in the last 12 months in the amount of conversation around Environmental, Social and Governance (ESG). Many pension schemes, asset managers and insurers are working on formulating clear policies, clear disclosures and clear commitments, many of which have now been announced.

This is great to see.

Introduction

I thought it might be interesting to talk about some of the challenges of actually formulating and implementing an ESG policy in practice. Below I've discussed some of these challenges. I have deliberately chosen not to try and explain to the reader what to do. I have also not described Rothesay's positions and policies, but you can find these in our ESG report if you are interested.

My intention is instead to give a first-hand account of what this looks like to a relative novice and maybe to be of slight help to anyone who is coming to this new. If anyone would like to discuss their own experience or ask any questions after reading this, please do get in touch!



Context

Some context first, whilst what is now called ESG – in particular climate change – has always been important to me on a personal level, I've only relatively recently become involved in how this could/should be managed from an organisation perspective when I asked to attend the meetings of Rothesay's Climate Change Working Group last November. I am not an investment expert and have never had the job of investing other people's money.

Over the last nine months it has been really interesting to see up close the work involved in preparing to issue Rothesay's first ESG report, which we were very pleased to publish in July. It has also been really interesting to compare and contrast the work I see Rothesay doing internally with the conversations I have had with consultants and pension schemes as they try to meet the same challenges.

1. IT STARTS WITH RISK CONTROL

As an absolute minimum, building ESG into an investment framework is about risk control. As an insurer we have to make specific disclosures to the PRA to evidence that we have considered these risks. The Task Force on Climate-related Financial Disclosures (TCFD) is also a good example of building a framework for risk assessment, and the hope is this will then lead to better and more sustainable decisions on capital allocation.

I recently heard a trustee say; "We've always done this; we just didn't know it was called ESG". The world is changing and companies which aren't going to perform well as a result of those changes are not a good investment. ESG brings a specific framework to consider some specific risks (e.g. are they slow or in denial about climate change, are they poorly managed due to a lack of diversity or poor governance, etc.).

2. QUANTIFICATION

Measurement is clearly important but is not without its challenges. Unlike most pension schemes, at Rothesay we do all our investment in-house. This means we don't need to worry about different managers using different approaches but the flip side is we have to work out the methodology ourselves.

Most of the focus at present is on measurement of Carbon Intensity (CI), which is certainly easier to measure than Social and Governance factors, but even so it's not always clear which carbon should be measured to avoid double counting (e.g. Scope 1, 2, 3 emissions etc.) or what the methodology should be. In addition, there are whole sectors where information is patchy and there can be major differences in disclosure between different jurisdictions around the world. The good news is there are specialist third parties offering this service and I expect much more consistency (and coverage) will be achieved over time. In the meantime, close attention needs to be paid.

3. SETTING THE RIGHT POLICY/TARGET

Once you've controlled your downside risks and measured your existing exposure, if you're serious about ESG you need to decide what your overall targets should be. There is a lot of jargon to get up to speed with but this effectively boils down to a few key questions:

- What peer group will you benchmark against?
- Will you aim for net zero and when?
- What about being "Paris-aligned" to an overall level of warming?
- Will you achieve this by simply disinvesting from companies/sectors with a high Carbon Intensity today, or is it better to understand each company's transition plan and reward those who are trying the hardest?
- Do you want to go further and proactively seek to invest in green initiatives? How can you do this in a risk controlled way?

4. DO YOU WISH TO BE PART OF ANY INITIATIVES/ ALLIANCES?

There are many initiatives/alliances out there that can help you demonstrate your level of commitment (by becoming a signatory or member of these groups you are also signing up to certain obligations) and also provide you with guidance. Some examples are set out below, but there are many others:

- TCFD – aims to improve and increase reporting of climate-related financial information.
- UNPRI – an aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice.
- NZAOA – a global alliance of asset owners setting and reporting on ambitious interim targets for net zero emissions by 2050.

5. IMPLEMENTATION/ GOVERNANCE

As a company which lends significant sums to other companies/governments, we want to know what their ESG policies are but we also want to know their words will be followed by action. We also know that our clients and prospects will expect the same of us.

It becomes important then to consider how you should build ESG commitments into your governance and performance appraisal structures. This clearly needs to cover how you will hold your investment managers and companies you invest in to account, but also how you will hold yourselves to account.

6. GETTING YOUR OWN HOUSE IN ORDER

It would be a shame to miss the easy opportunities to build ESG into how you run your own company or trustee board. What are your policies on business travel and remote working? What about printing or mailings to customers/members? Do you still require signatures to be on printed documents? Have you investigated the use of carbon offsets? There is a lot of variety here and care needs to be taken to ensure any contributions are being spent in a way that actually makes a difference.

7. STAKEHOLDER COMMUNICATION

Once your policies are all in place you will probably find you want to tell everyone. Especially if you've been very ambitious and wish to influence peers as a leader on ESG. How will you communicate your position? How much transparency do you wish to commit to? Will you be open about the challenges you still face?

More importantly, will you seek input directly from your stakeholders? Are you brave enough to ask if they are as happy with your ESG stance as you are? After all, looking after all stakeholders is what ESG is all about.

TOM SEECHARAN
Rothesay

Tom joined Rothesay's Business Development team in October 2019 and has 20 years' experience as a pensions actuary helping schemes and sponsors manage pensions risk. Previously, Tom led KPMG's UK Pensions Risk Settlement team since 2011.

COVID-19 IMP-ACT

100,000+

excess deaths in the United Kingdom[1],
a 9.0% fall in GDP (from Feb 2020 to Jan 2021)[2],
8+ months of lockdowns

Longevity trends – the impact of COVID-19

COVID-19 has had a profound impact across all aspects of life. Its direct impacts have been visible and felt by us all on an individual level. And the collective impacts on us as a society – through behavioural changes, excess deaths, NHS strains and economic strains – have been monitored, analysed, publicised and discussed over the last 12+ months.

1 CMI mortality monitor – Week 13 of 2021.
2 ONS analysis of coronavirus and the impact on output in the UK economy: January 2021.

ANDREW GACHES
Hymans Robertson LLP

Andrew leads Hymans Robertson's Longevity Services to insurance and financial services clients and has many years' experience advising major players in the longevity market. His expertise was central to the establishment of Club Vita and he now focuses on guiding clients through the process of recognising, quantifying and managing the longevity risk they face, both in the context of pricing products and regulatory requirements under Solvency II. Andrew is a regular speaker at conferences, has written articles and authored papers on longevity, and is a long-standing member of industry working parties and committees.

The huge uncertainty that faced us early last year has been replaced by the reality of the impacts that have emerged: 100,000+ excess deaths in the United Kingdom[1], a 9.0% fall in GDP (from Feb 2020 to Jan 2021)[2], 8+ months of lockdowns.

Yet great uncertainties still remain.

How will the economy respond as we emerge from lockdown?

What impact will unwinding the additional public debt have?

What knock-on impact will there be on future longevity?

COVID-19 IMP-ACT

IMPACT TO DATE OF COVID-19 ON LONGEVITY

The immediate impact of COVID-19 on longevity is well known, with excess deaths seen across the UK population, particularly in Q2 of 2020 and Q1 of 2021. Pension schemes have seen qualitatively similar impacts (albeit perhaps slightly smaller, with a lower exposure to the hardest hit parts of society). Individual schemes will know or can quantify the impact they have seen from their own data.

ASSESSING FUTURE CHANGE IN LONGEVITY

It is more challenging to assess how COVID-19 will impact the future evolution of longevity. The CMI Mortality Projections Model is a tool used by many pension schemes to express their view on future longevity changes (and in many cases to help form it). It provides a method of extrapolating recent past trends into the future (combined with users' views on longer-term evolution).

This is great if the recent past is our best guide to the near future, but that approach breaks down when a shock event (such as a pandemic) fundamentally changes longevity in a way that is not part of a sustained trend. The CMI recognise this, and so their latest edition allows users to specify the weight to be given to the 2020 data (with a default weighting of nil). That avoids the issue of extrapolating 2020 into the future and provides users with the flexibility to set their own view.

This is a workable framework for expressing a view but does not help answer the question of what impact COVID-19 will have on future longevity. One approach to do this would be to look at the real-world drivers of longevity and assess the potential impacts that COVID-19 may have on these.

1 CMI mortality monitor – Week 13 of 2021.
2 ONS analysis of coronavirus and the impact on output in the UK economy: January 2021.
3 Club Vita COVID-19 longevity scenarios.

POTENTIAL COVID-19 DRIVERS OF LONGEVITY

NEGATIVE	POSITIVE
Direct short-term risk of COVID-19	Survivorship bias
Direct long-term risk of COVID-19	Changes to health and social care
Global recession	Reduced circulation of influenza
Disruption to non-COVID-19 medical care	Reduction in smoking
Long-term health of COVID-19 survivors	Changes in air pollution

DRIVERS FOR FUTURE CHANGES IN LONGEVITY

There are multiple drivers, all stemming from COVID-19 (directly or indirectly), which change the outlook for longevity in future (see table above). The difficulty in assessing these is compounded by the fact that while many are negative (e.g. the lasting effect of disruption to non-COVID-19 medical care, or the impact of a global recession on healthcare spending), there are also some positive impacts (e.g. the potential catalyst for beneficial changes in health and care systems, and medical innovation).

POTENTIAL IMPACT AND UNCERTAINTY OF FUTURE LONGEVITY

To date, most pension schemes have made no explicit change to their longevity assumptions to reflect COVID-19. They may take the view that the negative drivers outweigh the positives, and so maintaining current assumptions until they have a clearer view is a prudent approach to take.

Amongst insurers and reinsurers there has been a move to more sophisticated assessments, focusing in on the drivers which they view to be most significant, but as yet there is (perhaps unsurprisingly) no clear, documented consensus on the most likely impact.

The range of plausible outcomes are well illustrated by Club Vita's COVID-19 longevity scenarios[3], which take account of several of the drivers discussed above (as well as the impact of excess deaths to date). These include scenarios showing moderate decreases in liabilities (-0.9% to -2.5% for typical schemes) through to more optimistic outcomes (a moderate increase in liability driven by COVID-19 becoming a catalyst for improvements in health and social care, particularly amongst the most deprived) and pessimistic possibilities (with much greater decrease in liabilities, driven by mutation-driven additional waves, prolonged economic recession and a downward spiral in healthcare provision).

What is clear from this analysis, is that while COVID-19 may act as a headwind to future improvements in longevity, it also compounds the uncertainty in relation to future longevity.

IMPLICATIONS FOR SCHEMES CONSIDERING BUY-IN AND BUY-OUT

Most pension schemes are on a de-risking journey, with buy-in and buy-out being key tools they can call upon to help achieve that journey. So a natural question is what impact COVID-19, and its effects on future mortality, should play in execution of that strategy?

Should schemes delay transacting if they believe longevity improvements will be lower in future? There are a number of reasons not to:

i) competition in the insurance and reinsurance market drives insurers (and the reinsurers who take on most of the longevity risk) to update their own longevity assumptions as evidence emerges, so it is to their detriment to not reflect updated expectations; and
ii) the financial impacts of COVID-19 are typically greater than the longevity impacts, so it is the financial impact on pricing that is likely to be the real driver in any decision. Many pension schemes might also find themselves left with a financially weaker sponsor due to COVID-19 challenges, which may increase appetite for short-term risk reduction.

More fundamentally, as risk increases so do the potential benefits of risk reduction. To the extent that COVID-19 has ramped up uncertainty in future longevity, the value of a buy-in or buy-out to a scheme will also increase. In contrast, reinsurers (who will typically become the ultimate holder of most of the longevity risk) will be able to at least partially offset that risk against their mortality books, so are (from an economic perspective) less impacted by increased uncertainty.

SWAP NOVATION – WHAT'S CHANGING

Many pension schemes use swaps to gain duration and meet their target for liability hedge ratios. Specifically, interest rate swaps and inflation swaps are used in conjunction with invested assets to match or reduce the interest rate and inflation exposures in the long-term pension promises to members. Some schemes enter these swaps directly whilst others use pooled schemes to gain an indirect exposure to swaps.

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Rothesay

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When securing a bulk annuity, swaps held directly are often transferred to the insurer as part of the payment of the insurer's premium. The bulk annuity insurer will also want to hedge the interest rate and inflation risks inherent in the pension liabilities that it is securing for the pension scheme trustees. Taking on the swaps as well as some assets for the premium payment can help the insurer quickly achieve a match for the interest rate and inflation exposures in the new bulk annuity contract. This process of transferring swaps is called novation, as the insurer replaces the trustee in a swap contract with the counterparty bank staying in place. Transferring the swaps in this way can reduce the transaction costs for the pension scheme and therefore make a bulk annuity marginally more affordable.

As of 1 September 2021, the way swaps are collateralised is due to change for a large number of long-term investors, including insurers like Rothesay and the very largest of pension schemes. Certain swaps that are put in place after this date will be subject to a requirement for initial margin. Initial margin is additional collateral that both parties will need to exchange with the other party with the aim of reducing counterparty default risks further. There is no netting in the exchange, however, and it will therefore require additional assets and create additional costs for both sides.

Existing swaps agreed prior to the September date are not subject to these requirements as there are grandfathering provisions. Crucially, however, the grandfathering is lost if existing swaps are novated and this loss occurs even if the novation is between two parties that benefit from grandfathering provisions.

Trustees that are planning to complete a bulk annuity should therefore explore whether swaps are likely to be transferred as part of the premium payment and investigate whether additional costs will be incurred. For trustees that hold swaps within a collective/mutual scheme this is unlikely to be an issue as swaps are rarely novated.

Trustees that do hold swaps directly, however, will need to plan the most suitable approach to premium payment in the light of these new costs. This basically means choosing between novation to the insurer or unwinding the swaps ahead of premium payment (and instead purchasing duration matched gilts).

As part of this it will be necessary to explore whether the counterparty banks are willing to accommodate a novation given that they will also have some extra costs which they may seek to pass on to the pension scheme. A bank is likely to view an incoming UK insurer as being more secure than a pension scheme however. It should therefore see a reduction in its costs for counterparty risks and this cost reduction might go some way to offset the bank's extra costs from the initial margin.

It seems unlikely that banks will automatically accept novation and there will need to be some kind of discussion or negotiation about costs before a bank agrees to change its counterparty from the trustees to an insurer (which is not too dissimilar to how things currently work). If the costs to novate are too large then unwinding the swaps might prove the optimal route.

If unwinding the swaps is the right approach for a pension scheme then care will be needed to match the insurer's premium requirements in the period up to premium delivery. Unwinding swaps too early could introduce significant mismatches versus the insurer's premium and jeopardise the successful completion of a transaction if falls in interest rates create a shortfall. Perhaps consideration could be given as to whether investing in duration matched gilts upon unwind of the swaps is a sensible strategy. Transactions proceed smoothly when the behaviour of the pension scheme's portfolio closely or perfectly matches the behaviour of the insurer's premium over the period of awarding exclusivity through signing of the bulk annuity contract all the way up to delivery of the premium in full. If the movement of the pension scheme portfolio does not closely match the insurer's premium requirement then a value gap can emerge and a transaction can suddenly become unaffordable, wasting the time, effort and fees spent on execution. As always, planning ahead is the key to successful execution.

BUYING OUT *WITH CONFIDENCE

Lots of schemes are now on a journey and planning towards eventual buy-out – with a focus quite rightly on data and benefit cleansing, perhaps years ahead of a buy-out transaction or as part of a series of buy-in transactions.

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The advantages of carrying out this preparation work for bulk annuity transactions are well documented and include an increased likelihood of insurer engagement, improvements to underlying pricing and providing trustees with ***CONFIDENCE*** that they are securing the correct benefit entitlements.

IS A BUY-OUT AFFORDABLE?

For full scheme buy-outs, thorough preparation is critical; not just for the insurance transaction itself but for what happens next. During a buy-out transaction, most (if not all) of the scheme assets will be committed to fund the insurer premium, perhaps with a small contingency for expenses and GMP equalisation "top-ups".

This is what makes data preparation critical for buy-outs. Unlike a pensioner buy-in, new data or benefit issues emerging are more difficult to "fix" (e.g. by allowing residual liabilities to mature for longer or by seeking additional returns from scheme assets) and schemes will only typically have limited residual assets to make good any unexpected shortfalls.

Therefore, should more material liabilities emerge, the only way to insure them post transaction is via a contribution from the sponsor, which is likely to be unhappy at being asked to write what could be a substantial cheque, with difficult questions being asked about transacting too soon. In some cases, uncertainty around underlying issues in the scheme may also result in missed market opportunities due to uncertainties on overall affordability.

It is therefore critical that robust planning and detailed preparation work is carried out well in advance of a buy-out transaction, where it is more important that stakeholders have the confidence they need to enter into a transaction at the right time – as the margin for error is much smaller.

CONSIDERATIONS FOR BUY-OUT TRANSACTIONS

As part of their journey to buy-out, schemes should be assessing the risk of known and unknown data and benefit issues emerging as well as wider issues around buy-out and wind-up to make sure these are allowed for when assessing affordability. This will help mitigate the risk of insuring too early and will help with the key decision around transacting with an insurer at the right time.

WILL THE DATA AND BENEFIT CLEANSE WORK STAND UP TO EXTERNAL SCRUTINY?

Insurers and reinsurers may want to carry out their own due diligence on member data and benefits during, or even after, a transaction takes place. As schemes approach buy-out and prepare for the issuance of individual policy documents, members may also raise questions as communications increase in frequency – so it is important that trustees and sponsors are confident that their scheme data and benefits are correct.

For example, an area of data preparation that is often overlooked is mortality experience data. It is important that this is up to date and reconciled against current pensioner and non-pensioner data as it is crucial for pricing and an area of focus for reinsurers who are increasingly keen on carrying out their own due diligence. However, this is often neglected by schemes and can sometimes need significant rectification work ahead of an insurance transaction to help increase the chances of competitive pricing being achieved.

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ADDITIONAL FACTORS TO CONSIDER

If residual risk cover is required, then further due diligence will be carried out and schemes can expect this to be an intensive process with detailed reviews of legal documents and recalculation of member benefits from first principles undertaken.

GMP equalisation, accurate calculation of contingent spouse pensions and issues around fixed protection also need to be planned for and costed as part of buy-out affordability assessment.

BENEFITS IN THINKING ABOUT THE BUY-OUT EARLY

Considering the ultimate end-goal is important for schemes and understanding the likely issues ahead of an insurance transaction is becoming increasingly important.

Carrying out the right preparation and planning for the issues that could be likely to arise towards the end of the process of buy-out is key, with multiple benefits in doing so:

- Facilitates certainty around final insurance transactions.
- Avoids the risk of insuring too early.
- Allows for a more efficient path for insuring residual risk cover, mitigating the risk of issues emerging during the transaction phase or post-transaction.
- Paves the way for an efficient and cost-effective buy-out and wind-up process.

STEPHEN PURVES
Aon

Stephen is a Partner in Aon's Risk Settlement Group. He has 20 years' experience advising both trustee and corporate clients on buy-ins, buy-outs and pension scheme wind-ups. Stephen has led and advised on more than £25bn of bulk annuity transactions including several large, high-profile and complex transactions for a number of FTSE 100 clients and more recently on the Co-op's buy-in transactions during 2020. He has been involved in developing several innovations and transaction features which are now prominent in the wider market today and also brings insurer-side experience from his time at Aviva, where he was head of new business for bulk annuities between 2017-2019.

MALLOWSTREET
IN PARTNERSHIP WITH ROTHESAY
Pension Risk Transfer Report

50%+
of schemes are prioritising getting member data in check

Marital data is just one piece of the data jigsaw required for a buy-in/out quotation. Other information is equally important, but this piece is often the one missing from the box when the decision is made to approach the insurance market. That is because it isn't something schemes routinely collect or maintain (except perhaps at life events).

Marital data means information on marital status at a point in time, including spouses' dates of birth (if applicable).

DATA JIGSAW

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Marital data –

trace data and write-outs – all you need to know

DATA JIGSAW

WHY IS MARITAL DATA IMPORTANT?

When insurers derive a premium to charge, they have to make assumptions on how long people will live and how likely it is that a spousal benefit will be payable on their death. Current marital status information is the best predictor for marital status at death. Therefore having accurate, up-to-date marital data is important to processes:

- It avoids unnecessary prudence in assumptions and more accurately reflects the scheme's data. There have been some cases where the scheme is much less married than the average population which has been verified as a result of collecting the marital status data. In the absence of such data, insurers tend to rely on their own assumptions which include some prudence margins.
- In certain cases, for example very high value members or where no young spouse reduction applies in the scheme rules, insurers may be unwilling to provide a quotation without receiving up-to-date marital information.
- Reinsurers rely on marital status information for pricing and they too will build in prudence margins where the data is not available. Certain reinsurers will increase the fee payable where this information is not available, which in turn impacts the premium.

HOW TO GATHER MARITAL DATA

There are two main ways to gather marital data: electronic tracing (by a third party agency), or simply writing to your members and asking them. Each has its own pros and cons.

There is also a third source of marital data – that which is gathered from members in business-as-usual administration (often upon retirement). Any data of this form held by administrators must be disclosed early in a process as Trustees are usually required to warrant that they have shared all such information and insurers may wish to reflect it in their pricing. However, this data is often not a good substitute for tracing and up-to-date write-outs as it will usually be out of date and members' circumstances may have changed.

ELECTRONIC TRACING

To carry out a trace, an agency is provided with basic member data (typically name, address, gender and date of birth). The agency cross-checks against its databases of public data, credit agency data and private data sources (e.g. phone directories) to establish its best guess of the member's situation.

Tracing is independent and relatively cheap. It is quick – a matter of days, compared to weeks or months for a member write-out exercise. However, it won't find all members (especially overseas ones), and objectively is not 100% reliable. Certain responses are ambiguous and will still force insurers to make assumptions.

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Oliver is a pensions actuary on Rothesay's Pricing and Reinsurance team. Oliver joined Rothesay in 2016 and is focused on the underwriting and execution of new liability transactions. Prior to joining Rothesay, Oliver was at LCP and advised clients on buy-ins/buy-outs.

WRITE-OUTS

A write-out involves sending your members a form (or the digital equivalent) and asking them to return it with details of their marital status.

The advantages of write-outs are many of the failings of tracing. Responses are black and white, and a well-run exercise can achieve a high response rate across the population. They are also a great opportunity for wider data validation.

Write-outs do have their own pitfalls though: response bias (where married members are more likely to reply), and basic mistakes (which you don't get from a fully electronic system) – whether by the member filling in the form incorrectly or the administrator miskeying the response. In fact, we have seen error rates of 5% to 10%, muddying the water and risking an insurer wanting to re-price down the line when the truth emerges.

The key with a write-out is to do it well, and this will help avoid many of their drawbacks. In particular:

- Encourage responses from all members, including deferreds. Focus the form on data verification rather than spouse information, follow up non-responders and consider if there is an incentive you can offer for responses.
- Make sure you provide an opportunity for members to disclose relationships of dependency (partners at the same address, say) as well as simply marriage.
- Record responses carefully, accurately and in full.
- Present the data in a clear, sensible manner.

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Remember insurers will be relying on the write-out results and may wish to review the forms as part of due diligence so images should be retained and indexed appropriately.

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WHAT TO DO NEXT

Taken together, write-outs and tracing complement each other and provide the most robust information to support a firm price with no undue margins. It won't always be possible to have both, and insurers can of course quote if only one or the other is available (using our experience of regularly working with these data sets). Our objective would always be to provide our sharpest pricing in all circumstances – but the more data that is available, the more certain we can be of our assumptions.

We are always happy to provide guidance on the running of write-out exercises so please get in touch with us if you would like further information on this or any other aspect of data preparation prior to formal approach to market.

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INSURER CASHFLOW PRICING – WHEN & WHY?

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Prior to approaching the market, many schemes will work with their advisers to assess affordability. Most advisers closely monitor the bulk annuity market, and will likely be in the process of completing transactions with other schemes at the same time. Advisers can use this market knowledge to formulate a view on the pricing levels they expect schemes may achieve. So when and why would you also need to approach insurers for an indication of affordability via cashflow pricing?

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WHY?

We often see advisers tracking market pricing accurately for pensioner liabilities. However, in certain circumstances, typically where there is less market information available, market knowledge alone may not be sufficient to provide an accurate indication of insurer pricing. These circumstances may include:

- A very large scheme: as transaction size increases – say beyond £2bn – it may be more difficult to predict insurer pricing, possibly due to variability in insurer appetite and ability to source the necessary assets on this scale.
- A heavily deferred transaction: longer duration liabilities may be riskier for an insurer to underwrite, due in part to the increased optionality for deferred members and reinsurance appetite for deferred liabilities, making it more difficult to predict insurer pricing for a given scheme.
- A scheme with non-standard benefits: non-standard pension increases or the existence of an underpin may be priced differently across insurers and relative to advisers' models.

In addition, insurer appetite changes through time, possibly in response to favourable reinsurance pricing or available asset opportunities. Sourcing cashflow pricing directly from insurers will be the best way to gauge these dynamics.

WHAT DOES THE PROCESS INVOLVE?

Cashflow pricing is a relatively straightforward process for most insurers, and pricing can often be provided over the course of a few weeks. In addition, insurer ability to work with cashflows that the scheme has readily available makes this an efficient process for schemes and their advisers.

Alongside the cashflows themselves, insurers will require details of the assumptions used in the projection of these cashflows. Insurers will typically make adjustments to allow for differences in inflation and mortality improvement assumptions. However, at this stage it is difficult to adjust for any of the other assumptions due to the lack of detailed membership data. Clients should therefore bear in mind that full insurer pricing may differ from cashflow pricing to the extent that there are differences in assumptions or modelling of the benefits.

For this reason, a cashflow price from an insurer will not be a guaranteed, transactable price. For that you will need to go through a full quotation process and provide insurers with full scheme data, including any experience data and marital data you may have.

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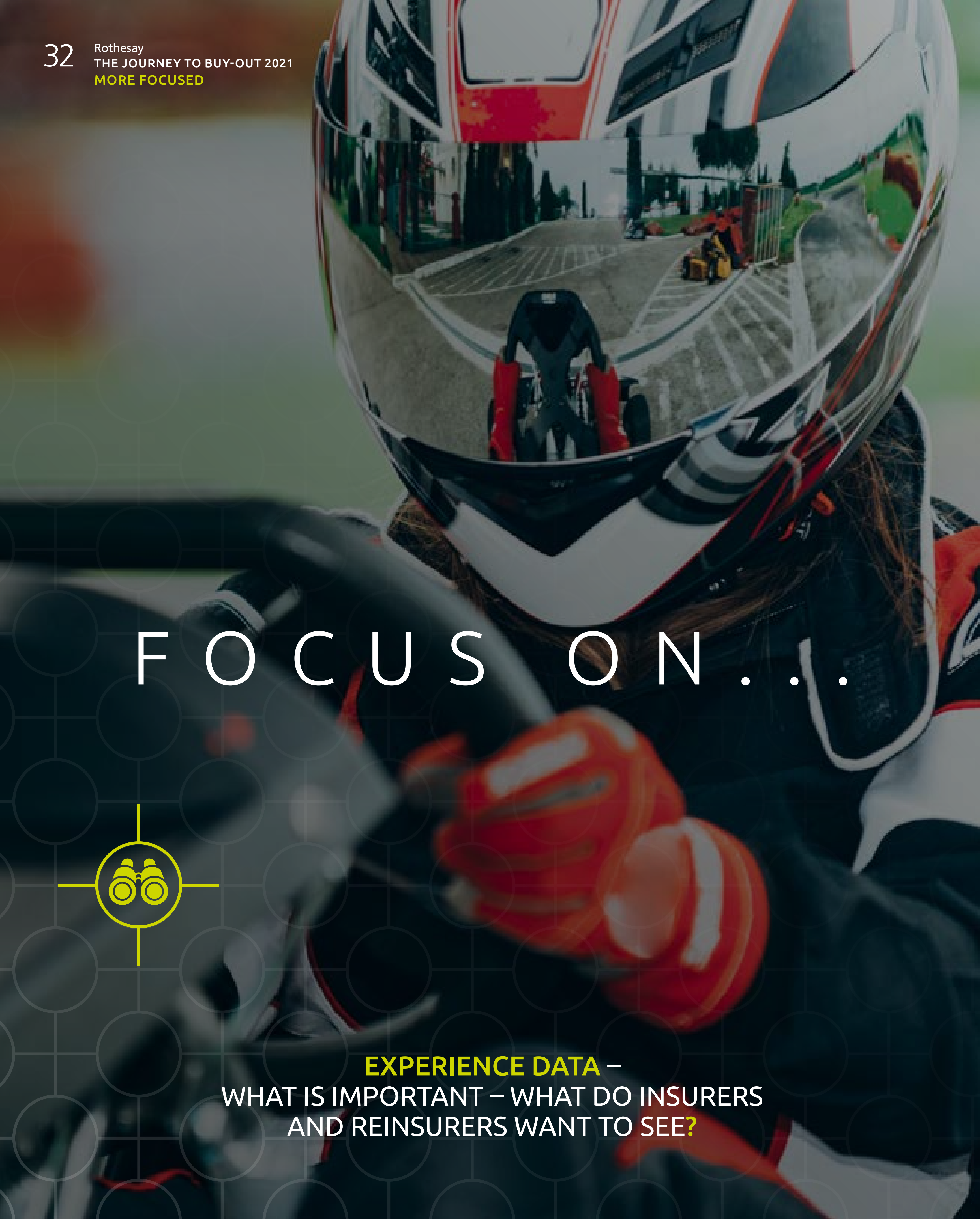
We always encourage schemes to come and speak with us if they are considering approaching the market. For further details, please refer to our guidance paper on cashflow pricing at the back of this update.



FOCUS ON...

EXPERIENCE DATA – WHAT IS IMPORTANT – WHAT DO INSURERS AND REINSURERS WANT TO SEE?

Pension buy-in/buy-out is often the final step in the de-risking journey plan for many scheme trustees.

The entire journey is rewarding yet full of new challenges that need to be overcome along the way. Trustees can maximise affordability by having the right data available at the start of the process that can be used by the insurers and reinsurers to evaluate the future longevity expectations of the pensioners and dependants. This can be a less stressful process when trustees are well prepared. Much of the necessary data is readily available, as it is used by the scheme actuary. Furthermore, simple steps taken at the right times can improve data quality. Summarised below are best practices from a reinsurer's perspective regarding data that can drive better pricing outcomes.

Simply put, improving the credibility and robustness of data could result in less insurer margin for adverse deviation, which improves pricing and affordability through both lower capital requirements and increased pricing tension driven by increased reinsurer participation.

DAVID LANG
Prudential Retirement

David is a Vice President and Actuary within the International Reinsurance team for Prudential Financial Inc. David is responsible for overall transaction leadership and governance for longevity reinsurance transactions. He has 11 years of experience in the reinsurance field and has led or participated in three of the four largest UK pension longevity swaps.

FOCUS ON...
Experience data

While reinsurers often focus on the most recent five years of longevity experience, providing up to ten years is best practice. In particular, 2020 and, so far, 2021 have resulted in unprecedented levels of mortality. The data periods impacted by COVID-19 may be of little use to reinsurers depending on their internal standards on predicting future expectations.

When gathering data, trustees should keep in mind the importance of providing as much accurate data as possible. In the case of schemes with multiple sections, we encourage sharing as much data as is available in respect of affiliated sections to allow the reinsurers to analyse that data and determine if it can add credibility to the section in focus for the buy-in/buy-out.

Beyond basic data such as benefit amounts, demographic details, date of retirement, and date and cause of exit, reinsurers, seek additional detail when available such as length of service and job codes. In certain industries, information in respect of early and or ill-health retirements is also a meaningful addition to the data pack, which could impact longevity outcomes. For schemes that undertake liability management exercises or offer other types of benefit augmentations, reinsurers prefer a full history of policy information and benefit amounts.

Significant advancements have been made in recent years in respect of predictive modelling and data mining. Accurate postcodes and broad coverage in both the current retiree data and experience data is increasingly important. As reinsurers have made material advancements in modelling UK longevity using affluence indicators, postcodes are of particular significance. This is especially true for smaller schemes or younger schemes with modest amounts of scheme experience. Additionally, ensuring that up-to-date records are kept will have the extra benefit of increasing the effectiveness of death tracing and other scheme write-out procedures.

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FOCUS ON...
Marital data

While not the key focus of this article, marital data and the quality of that data influences the longevity assumptions provided by the reinsurer. Obtaining marital information for as many individuals as possible, which is contingent on accuracy of the name and address information, will result in lower overall margins added by the reinsurers. Reinsurers prefer it when data is obtained as close to the buy-in/buy-out date as possible, while still being available in the initial Request For Quotation (RFQ) to insurers, and through a broad or targeted direct survey.

FOCUS ON...
Full scheme buy-outs

For trustees seeking to transfer both pensioners and deferred beneficiaries, there are extra considerations for the data in respect of the deferred lives. As companies may see changes to workforce demographics and job functions over time, so may the types of employees who worked for the company. As actual death experience of deferred populations is often minimal, other factors must be considered to estimate longevity. This may include extrapolating the experience using current retiree data, but that can only be done if the underwriters believe the groups divided by time share common traits. To allow for proper underwriting of deferred populations, items such as job codes and length of service are necessary. It is also advisable to ensure postcodes are accurate for this population by including them in write-outs and/or utilising an online portal where former employees are asked to keep information updated.

IN SUMMARY

- Trustees are encouraged to provide additional data, allowing the reinsurer to determine significance.
- Gathering and maintaining records in respect of job codes and benefit changes is advisable.
- Be forward looking in your use of beneficiary websites and write-outs, maintaining current address and marital data on all beneficiaries regardless of payment status.

When do insurers reinsure – what drives their decision?

WHY DO INSURERS REINSURE?

Here at Rothesay we have used longevity reinsurance since day one as we believe it is good risk management practice. However, it wasn't always common practice in the marketplace, and therefore in order to understand why insurers might choose to reinsure bulk annuity business at a certain time, the underlying motivations behind using longevity reinsurance should be considered:

- Primarily, UK insurers transfer longevity risk in order to **optimise their solvency position**: Solvency II longevity capital (SCR) and risk margin is reduced (and is partly replaced by counterparty risk capital).
- Insurers typically target a certain overall risk profile, i.e. some combination of asset risk, longevity risk, credit risk, etc. longevity reinsurance is one of levers insurers can use to **rebalance their overall book risk profile**.
- By entering a longevity swap, the insurer is exchanging variable (i.e. longevity-linked) cashflows with fixed cashflows. As such, longevity reinsurance will directionally **stabilise key financial metrics** (including earnings and capital coverage), therefore increasing security for both policyholders and shareholders.
- Where longevity reinsurance is placed concurrently with the annuity purchase transaction, insurers may be able to access the considerable underwriting expertise of the reinsurers.

What drives their decision?

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Rothesay

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WHAT TRANSACTION PROCESSES ARE USED?

The execution timing of longevity reinsurance treaties will depend in large upon the type of transaction process being used – these generally fall into three buckets:

1. TREATY REINSURANCE:

Often referred to as "flow treaties", these are ongoing arrangements between an insurer and a reinsurer, under which bulk annuity deals will become automatically reinsured on pre-agreed pricing terms, provided they meet the acceptance criteria. Generally, only smaller annuity deals are eligible (e.g. less than £300m premium size), and any non-standard features (e.g. a high proportion of deferred lives, overseas lives, or high value lives) would render the deal ineligible.

Insurers may run a periodic tender process to select a particular reinsurer (or reinsurers) with whom to partner.

Under such a flow treaty, the reinsurance is generally incepted automatically, on the same day as the bulk annuity contract (between the insurer and trustee) is signed. As such, the capital position of the insurer does not suffer as much of a "step jump" on the transaction date. Transaction terms are generally agreed in advance and highly standardised, and therefore minimal resource should be required on the part of either the insurer or reinsurer. Where insurers utilise these contracts it may limit the flexibility they have to agree bespoke terms with a pension scheme.

2. BESPOKE/UPFRONT REINSURANCE

In contrast with treaty reinsurance, this transaction process is "facultative", meaning that the reinsurer will individually underwrite the specific profile of the pension scheme under consideration. More recently, such processes have been occurring in tandem with the annuity quotation process itself.

Under such a bespoke process, the longevity reinsurance could be entered on the same day as the bulk annuity contract – with the same benefits of capital position continuity as mentioned above. However, the contractual negotiations on such transactions can be more involved (particularly for larger deals, e.g. over £1bn, and for insurers/reinsurers who do not have prior agreements in place), so it is not unusual for the reinsurance to sign after the bulk annuity transaction is signed.

Where an insurer requires the reinsurance to be in place on the same day as the bulk annuity contract (e.g. where they do not have sufficient capital to support the risk without the reinsurance), the execution timeline for the bulk annuity becomes exposed to the timing of the reinsurer(s). Consultants will typically ask bidding insurers if their pricing offer is dependent on reinsurance, because this added jeopardy in the timeline may be a risk that the trustees are not prepared to take.

3. BACK-BOOK TRANSACTIONS

Sometimes insurers will retain the longevity risk for a period of time. At a later date they may decide to bundle several unreinsured pension schemes together, and bring them to the reinsurance market for tender. This may comprise ten or more individual pension schemes, and £1bn+ of liability.

A larger total deal size will attract more reinsurers to quote in a busy market, and the increased diversification of multiple pension schemes may also lead to attractive pricing. In particular, pricing for such a block should be better than the sum of the individual prices associated with a flow treaty (left), but the insurer will need to hold additional capital in the intervening period. Under a flow treaty, reinsurers have less control over the deals they end up with, and will build in some margins for this uncertainty in pricing. Such uncertainty does not exist where there is a known pool of schemes.

A back-book transaction can take several months to run, given the complexity and number of underlying schemes. Insurers will typically only tender such a block every couple of years. However, all of this work is done behind the scenes to manage insurers' longevity risk exposures in line with their risk appetite. There is no impact on the underlying pension schemes, because they have already secured their cover in the years prior.

TIMING CONSIDERATIONS

Having detailed both the underlying motivations behind longevity reinsurance, and the broad categories of reinsurance process used in the market, some specific timing considerations are outlined below:

- **SIZE OF DEAL** – for larger transactions, the insurer may be required to execute the reinsurance concurrently with the front, as sufficient capital may not be available to "warehouse" the underlying liability even temporarily on an unreinsured basis.
- **YEAR-END REPORTING** – longevity reinsurance impacts various internal and externally reported financial metrics; notably earnings and capital coverage. Insurers may therefore be motivated to align reinsurance execution around wider reporting targets.
- **COMPETITION IN THE MARKETPLACE (DIRECT SWAPS)** – UK insurers are in competition with other demands for longevity reinsurance, e.g. from other jurisdictions (USA, Canada, Netherlands), as well as from UK direct longevity swaps (i.e. transactions between pension schemes and reinsurers directly, generally facilitated by a captive intermediary cell). Deal timing may therefore also be driven by reinsurance capacity; both in terms of financial capital, as well as human capital!
- **ALTERNATIVE DEMANDS FOR CAPITAL** – at any given time, an insurer may be considering various alternative uses for the free capital it has available. For example, there might be a profitable asset investment opportunity which requires significant capital, in which case the insurer might be motivated to reduce longevity capital requirement via entering into reinsurance transactions.
- **PROFILE/CHARACTERISTICS OF THE UNDERLYING LIABILITY** – certain features of the bulk annuity treaty might dictate the timing of the longevity reinsurance. For example, the scheme might be running a large transfer-out or winding up lump sum exercise, or might be reshaping benefits in the initial period of a buy-out transaction. In such cases, the insurer may choose to delay incepting the reinsurance. It is also possible that for a pension scheme with a very high proportion of deferred lives, the insurer might have to wait several years until the block has matured sufficiently.

UMBRELLA CONTRACTS

HOW TO GET THE MOST OUT OF THEM

Since the first transaction in 2014, umbrella contracts have become a popular approach to de-risking for trustees who plan to undertake multiple buy-in transactions on their route to buy-out. Here we look at what an umbrella contract is, and how trustees can get the most out of them.

UMBRELLA CONTRACTS: WHAT AND WHY?

WHAT?

An umbrella bulk annuity contract is one which provides the legal framework for entry into multiple transactions combining a common basis with transaction-specific elements. As such, entering into an umbrella contract with an insurer offers flexibility to cover further tranches of liabilities on the same legal terms as the original transaction. Important commercial terms (e.g. price and inception date) or other transaction-specific elements are recorded in a transaction-specific confirmation. Once put in place, the umbrella contract stands ready to cover new tranches of liabilities with the only step being agreement of a transaction confirmation setting out the "tranche-specific" terms. In this way, transaction-specific items can be tailored to individual tranches of liabilities while the broader legal terms, negotiated up front, are preserved.

WHY?

For trustees who anticipate undertaking multiple rounds of de-risking on the road to buy-out, the umbrella structure provides transaction efficiency and rapid market access. Rather than negotiating a new contract for each tranche of liabilities that a trustee wishes to insure, the trustee and the insurer will continue to use the contractual documents agreed for the original transaction with transaction-specific negotiations confined to a small number of key commercial terms.

With the legal detail largely agreed up front, the provider and the trustee's advisers and board can focus on pricing and other critical commercial elements, and new transactions can be executed in a fraction of the time taken to negotiate a new bulk annuity contract. Efficient transactions allow trustees and insurers to be nimble in taking advantage of market movements, so that when conditions are right, deals can be done rapidly to crystallise a pricing advantage.

Some umbrella structures additionally provide for operational efficiencies by amalgamating reporting and other operational activities required of trustees across tranches.

HOW TO GET THE MOST OUT OF AN UMBRELLA CONTRACT

Experience shows that an appropriately structured umbrella contract can be a useful tool to smooth the journey to buy-out.

Here are a couple of key pointers for trustees to bear in mind when considering implementing an umbrella contract:

- **Have a strategy:** those trustees who use an umbrella structure successfully have a clear strategy for approaching the market with new transactions. They may have a predictable annual process for seeking pricing in relation to new beneficiaries, and they may have an umbrella contract with more than one insurer so that all the insurers they approach are "transaction ready".
- **Identify the flexibility that is needed up front:** different schemes may require different levels of flexibility within the umbrella contract, meaning the transaction-specific content of the contract may vary. If there are heterogeneous benefits within the scheme, the umbrella contract should allow the specificities of the benefits of a particular tranche to be addressed in the transaction-specific content. Likewise, trustees who have more than one administrator should ensure that the terms of the umbrella contract leave scope for the variation in services provided by different administrators. It is best to have an understanding of salient differences in the universe of benefits and beneficiaries that might be insured under the umbrella contract up front so that the necessary flexibility can be built in from the start.
- **But keep variations to a minimum:** though transaction-specific contractual terms are sometimes needed, the aim is not to dilute the benefit of the umbrella contract by introducing unnecessary variation. Experienced legal and actuarial advisers are able to guide trustees on how to incorporate necessary flexibility while preserving the transaction efficiency afforded by the umbrella bulk annuity model.
- **If an umbrella contract, with successive tranches of buy-in, will be part of your buy-out strategy, then start with a purpose-built contract:** it is best if terms are built to cater for the umbrella structure from the start, since reverse engineering a contract to cater for multiple tranches can be time-consuming and costly.

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Kate is a partner in Allen & Overy's insurance team. She advises trustees, insurers and reinsurers on pension scheme de-risking transactions, covering both buy-ins and longevity swaps. Kate has worked on some of the largest de-risking transactions completed to date and has played a leading role in a number of market "firsts", including advising:

- The Trustees of the Airways Pension Scheme on a £4.4bn buy-in with Legal & General;
- Rothesay on a £2.8bn buy-in deal with the National Grid UK Pension Scheme;
- The Trustees of the BT pension scheme on a £16bn longevity swap with the Prudential Insurance Corporation of America; and
- Asda on the full insurance buy-in and proposed buy-out of its £3.8bn pension scheme.

RUN-OFF COVER

TRUSTEE PROTECTIONS AT BUY-OUT

Part of a lawyer's job is planning for things that might go wrong. It is not a positive outlook, but it is one that becomes valuable for pension scheme trustees looking to buy-out and wind-up a pension scheme.

While a scheme is ongoing, trustees know that should something go wrong, they are underwritten by the assets of the scheme. The scheme will usually pay advisers' fees, meet the Pensions Ombudsman or Information Commissioner Office fine or, ultimately, put the aggrieved member right if they aren't receiving the correct benefit. If there is a solvent scheme employer standing behind the scheme, so much the better. Things can look somewhat less comfortable at the point of wind-up. As the scheme's bank account is emptied, trustees often light upon difficult questions.

What if a member we never knew about comes out of the woodwork?

What if our decisions on GMP equalisation are challenged in ten years' time?

What if someone notices that the trust deed was never properly executed?

The sad truth is that pensions lawyers think about these questions all the time.

Run-off cover is a type of insurance designed for trustees with these concerns. It may seem counter-intuitive. The scheme has entered into a bulk annuity, so why is it the scheme (or the company) are being asked to pay for yet another costly insurance policy? In fact, the policies serve different purposes. In entering into a bulk annuity, the trustee is agreeing to secure a defined set of benefits: the focus is securing the member rather than the trustee. There will therefore always be trustee risks that are not covered. Examples might arise from insuring incorrect data in the bulk annuity, but other risks for the trustee include complaints relating to their conduct or a member claiming special terms which were never properly documented. In practice, the risk of these claims should be very remote, particularly if a thorough job is done in cleansing the scheme data and preparing high quality specifications. That said, the trustee is not just looking at the substance of a complaint, they must also consider the costs of responding, even if that complaint has little or no merit. There could be substantial professional fees associated with defending even a very poorly conceived, baseless claim.

The intention is that run-off cover will provide broad indemnity cover for trustees against the risk of any claim relating to the trustees' role, including expenses. Run-off cover may be part of the sponsor company's directors and officers insurance or a stand-alone policy, but it will not be written by the same insurer providing the bulk annuity. This means the run-off cover needs to be brokered as part of a separate exercise. It is important to be aware that trustees may need the sponsor to secure run-off cover on their behalf. The trustee may not have sufficient funds or may not have power under scheme rules to purchase its own insurance. In any event, there are limits on what risks can lawfully be secured from scheme assets (particularly in relation to fines and penalties).

Unfortunately, recent experience is that run-off cover has become much harder to obtain. An already small market has tightened and quotes are not always readily provided, and where provided the premiums appear to have increased sharply.

It has always been important to look at run-off cover in the context of the trustees' other protections. Now that run-off cover has become more problematic, focus has naturally shifted to those other protections with renewed interest. This is a complex area, but some of the main considerations are listed below.

- The key risk for trustees will always be insuring the wrong member benefits. Bulk annuity policies are structured to minimise this risk through the data cleanse process. The hope is that if the right members have the right benefits, they should have little reason to pursue an action against the trustee. Thorough preparation for buy-out should be the trustees' first protection from the risk of future complaint.
- The scope of a bulk annuity policy can sometimes be expanded to cover some residual or data risks, particularly for larger transactions. This can be very valuable additional cover but it is never "all risks" although this term is sometimes misleadingly used.
- If possible, we often recommend that trustees negotiate indemnity cover from the scheme sponsor. As run-off cover is typically time limited and capped in value, having a company indemnity as fall back can provide real comfort at no up-front cost to the sponsor. If a company has a sufficiently robust covenant, trustees may be comfortable forgoing run-off cover altogether in reliance on the company's protection.
- The trustee should also have the benefit of a discharge at the point of wind-up, whether statutory or in the wind-up documents or both. In practice the value of this protection may be limited in circumstances where an incorrect benefit has been secured.
- Trustees established as corporate vehicles are also, as individual directors, protected by the corporate vehicle. Not only is the trustee company usually wound up, making it harder to join that company to proceedings, but it is also usually difficult to look past a corporate vehicle to claim against individual directors (to "pierce the corporate veil" to use the legal jargon).

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There is real value for trustees in considering trustee protections early on and ideally before they commit to an endgame plan. The trustee may need company support in the form of an indemnity or in brokering and paying for run-off cover. A trustee looking to enter into a bulk annuity, particularly one driven by a sponsor, is therefore well advised to seek written agreement on the protections it will require early on and before its negotiation position diminishes.

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What is a deed poll & why would you use one?

Once trustees have acquired a Bulk Purchase Annuity (BPA) contract, they will typically hold it as a scheme investment until winding up. That's the scenario considered below.

Trustees typically use provisions in a BPA (every modern BPA has them) to request that the insurer issues individual policies (IPs) to the insured beneficiaries. The IPs replace the benefit promise under the BPA, which terminates.

If the IP terms satisfy prescribed requirements, their issuance will confer upon trustees a statutory discharge in respect of the liability to provide the covered benefits; that's a good thing.

Some insurers are prepared to adopt a different process. This involves an interim step between the issuance of IPs to beneficiaries and the termination of the BPA. The BPA is terminated on the execution by the insurer of a deed poll.

So, what is a deed poll and when might it be helpful to use one?

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What is a deed poll?

It's nothing more than a deed to which the insurer is the sole party. Under the deed poll, the insurer promises the beneficiaries it will pay them the insured benefits.

The deed poll is structured so that the promises made constitute a series of IPs, but the insurer doesn't have to compile and issue policy documentation for the individual policies to take effect.

Are there additional legal considerations?

In most respects, the legal considerations are those which apply when adopting the more typical route.

The deed poll must create IPs on terms which satisfy the prescribed requirements, so deed poll execution confers a statutory discharge. That isn't difficult, but it's an important point of detail.

It's also important to ensure that the deed poll satisfies the relevant legal requirements so the IPs created constitute valid policies of insurance. Again, this is generally not complicated. For example, the identity of the beneficiaries and their benefit entitlements can be included in schedules or incorporated by reference to data files.

An area for consideration (where relevant) is the treatment of missing beneficiaries. One English law requirement for a valid contract of insurance concerns the need to be able to identify the person(s) intended to benefit from the contract. This must be stated in the policy with sufficient particularity to make it possible to establish the identity of all persons who at any given time are entitled to benefit.

A question arises as to whether it is possible to describe the class of "missing beneficiaries" in a deed poll with sufficient certainty for there to be no doubt that this requirement is satisfied. A follow-on question is whether, if it were established that the requirement had not been satisfied, the deed poll would fail in its entirety.

We're satisfied it is possible to identify the class of missing beneficiaries with sufficient particularity. This will typically involve replicating within the deed poll the definition of missing beneficiaries (and potentially some of the associated provisions) from the BPA.

Even if the second question arose, the promise to each individual named beneficiary is encapsulated within a single IP under the deed poll. We would argue, therefore, that no such IP should be affected by the invalidity of a separate policy (or policies) purported to be created by the same deed poll for missing beneficiaries.

If trustees and their advisers are concerned, there are some mitigating steps. The missing beneficiary promise can be placed in a separate deed poll. This removes any risk that the missing beneficiary provisions could invalidate the deed poll as it applied to known beneficiaries.

Another option is to omit missing beneficiaries from the deed poll, ensure the insurer's obligations under the missing beneficiary provisions in the BPA survive termination on execution of a deed poll and confer upon missing beneficiaries the right to enforce those provisions.

When should trustees use a deed poll?

There is often a commercial driver for the sponsor of a pension scheme quickly to remove the scheme as a balance sheet item. This can be challenging using the typical IP approach.

There is usually a lot of information being passed from a scheme's trustees/administrator to the insurer in anticipation of the transition to individual policies. The insurer needs to ensure it has all necessary information in order to be able to administer the IPs, as well as actually compiling the IP documentation and ensuring that the statement of benefits in each IP is correct.

If the whole transaction has been expedited, these tasks might have to start before data cleansing has finished. That can be logistically challenging (if not impossible) and increases the risk of mistakes due to the pace of the work and the cross-over between particular elements.

The deed poll route allows the insurer to focus first on ensuring that it understands the correct benefits and has all information required to administer them. The process of producing the IP documentation can be implemented later. The deed poll route "buys time" for the parties and reduces the risk of errors arising by allowing balance sheet settlement without the insurer having to produce the IP documentation.

Are there downsides when using a deed poll?

Beneficiary experience
Under the typical IP approach, beneficiaries receive their policy documentation at the same time as their welcome letter from the insurer. This is reassuring for some people; they can "touch" the benefit promise, so it's real.

Beneficiaries typically receive a welcome letter from the insurer that coincides with execution of a deed poll, but they won't receive their policy documentation until later. Beneficiary experience is an important consideration; potential adverse experience shouldn't be taken lightly. That said, our experience is that any concerns can be addressed though sensitive communication with beneficiaries.

Flexibility to address other issues
The industry currently faces uncertainty relating to two potentially significant issues.

The first is that some pensioners can potentially suffer adverse tax consequences as a result of the issuance of an IP to them. The second is that, depending upon where they are domiciled at the date of issuance, some overseas beneficiaries might be ineligible for FSCS protection if an IP is issued to them and the insurer subsequently fails.

At present, a common measure to mitigate both of these risks is for trustees to request that an insurer issues IPs to the trustees, who then assign the benefit of the IPs to the relevant beneficiaries.

A question arises as to whether the same risk mitigation measure is available under the deed poll route. Our view is that it is. Given that a deed poll constitutes a series of individual policies, there is nothing to prevent the insurer from issuing IPs under a deed poll to a scheme's trustees, rather than its beneficiaries.

Execution of the deed poll would be followed by an assignment of the benefit of the constituent IPs, as would be the case if the more typical IP route were adopted.

Conclusion

Using a deed poll is likely to be preferable for trustees (and sponsors) where there is a need to expedite scheme wind-up.

The deed poll route should not, however, be regarded as the panacea for delivering expedited buy-out transactions. That is not the case. A deed poll is a helpful tool to reduce the timeframe from BPA inception to buy-out, but it doesn't remove the need for the often significant amounts of work required in the intervening period.

Guidance papers*

1. MARITAL WRITE-OUTS
2. CASHFLOW PRICING
3. QUERY LOGS
4. EXPERIENCE DATA

1. MARITAL WRITE-OUTS

Best practice

At Rothesay, we have seen a number of recent processes in the market, from different consultants, where issues identified in the marital write-out have led to quotes being revised, in some cases materially.

This note pulls together some common issues we encounter and some suggestions to consider as part of running a marital status write-out which would likely improve the efficiency and certainty of a de-risking transaction.

1. Form contents

- The options available on the form for members to respond to should correspond with the benefit provided by the scheme, e.g. if an adult dependant benefit is available (discretionary or otherwise) a response providing the opportunity for a member to indicate a dependant should be included on the form.
- If your scheme has other eligibility criteria (such as marriage date) for entitlement to a contingent benefit, this data should also be gathered.
- You may wish to include marriage date in any case for data verification – see below.
- If you are gathering other data simultaneously (e.g. child details) then make sure this is captured in a separate distinct section of the form so that members don't enter this information in place of a spouse (and make it clear that details of children are not sought in the spouse section).
- Asking members to verify non-spouse information on the form (such as their own sex and date of birth, and potentially pension details) is a good way to ensure single members also respond. Any data pre-populated on the form should be spot checked against the source data to avoid merging errors.

2. Recording responses

- It is critical that data is recorded separately to data held from previous exercises/legacy data on the admin system – even if the response received is confirmatory with respect to data already held. When data is aggregated it makes accurate underwriting difficult or impossible and we may need to disregard the entire exercise.
- You should record who was sent a form, who responded, and the details of their response if one was received.
- Colour coding should not be used for recording responses as it makes manipulation of the data for underwriting very difficult.
- The response should not be interpreted or translated in any way. For example, if there are five check boxes for marital status these should be literally recorded in the results, not collapsed or a different description used. Insurers and reinsurers will have differing views on how to interpret the data, so providing unadjusted data is important. If a member makes any annotation, this should be disclosed.
- Data typed in should have normal do/check processes applied if practical to do so. In larger exercises where this is not possible at least the larger value cases and/or cases with large age differences should be checked (see below).
- Late responses are inevitable. Ideally, run the exercise sufficiently far in advance of any approach to market so that these have all been received, but otherwise make sure they are logged and actively disclosed at an appropriate time before the transaction.
- Responses should be in a single file, not split into supplementary files unless absolutely necessary. Our preference is for marital data not to be merged into the data extracted from the admin system as this can lead to issues identifying the new data (see above) but instead contained in its own file which only contains the gathered data and no legacy data.
- If non-spouse data has been gathered (e.g. member date of birth) then this should be updated on the admin system if required and reflected in the pricing data extract.
- If the exercise has been run in phases (e.g. with forms being sent out at different times for different groups), then responses to each phase should be readily identifiable. You should tell insurers the dates on which each exercise was run.

3. Checking

It would pre-empt insurer queries and catch easy issues early if basic checks could be carried out:

- Where a write-out contradicts other data being disclosed (such as a marital trace, if conducted) – confirm that the data reflects what is on the form (we wouldn't necessarily look for schemes to chase down any differences – but if a difference exists it should be verified that it accurately reflects the contents of the form).
- Spot check large/implausible age differences (in either direction).
- Check implausible spouse age as compared to the date of marriage (if collected).
- Check other data that doesn't "make sense", e.g. a spouse date of birth provided alongside a status of divorced or widowed.
- Check cases where the spouse date of birth supplied appears the same as the member date of birth.

Insurers may want to carry out due diligence on the write-out exercise – so you should keep all forms in digital format, readily available.

When the Request For Quotation (RFQ) is issued, schemes should supply all marital data held, even if considered by the trustee to be out of date/superseded.

This often includes legacy admin system data, or data collected at the point of retirement as well as write-out data – please describe the source of any such data in as much detail as possible (e.g. "collected in retirement processing").

2. CASHFLOW PRICING

How to get optimum results

Cashflow pricing accuracy can be limited depending on the assumptions/format used so this note aims to set out what Rothesay looks for when reviewing cashflows and how consultants can provide information in a manner likely to lead to the most accurate cashflow-based price.

The requests below are fairly prescriptive – if any are more difficult to achieve then we would still provide a price, but it is unlikely to be as accurate.

In addition to cashflows, you should confirm the dates you would like to be used for the quotation. We prefer that only future cashflows are included in a price rather than trying to capture retrospective cashflows.

1. Cashflow layout

- Cashflows for deferreds should be "2D" i.e. split by assumed retirement year and payment year. "1D" cashflows for pensioners (by payment year only) is sufficient. This allows appropriate adjustments for differing increases pre and post-vesting.
- Annual cashflows are sufficient (as opposed to monthly – though these would also be acceptable), but please clearly state the period covered by each cashflow.
- A separate set of cashflows should be provided for each inflation-linked pension increase (pensioners) or each combination of inflation-linked deferred revaluation and pension increase (deferreds). Fixed increases (pre or post-vesting) can be grouped as treated as the same type of increase.

2. Assumptions

- No allowance should be made for member options (transfers or commutation). Where appropriate, Rothesay will make allowances for the impact of options when generating the quotation.
- No allowance should be made for expenses or other external liabilities.
- The inflation assumption used should be a single rate (for simplicity), and should be set at a recent date. It is important not to use a "nil inflation" assumption and to use up-to-date levels as this minimises the errors otherwise introduced when Rothesay substitutes its own inflation assumption. Please specify for each tranche the assumption you have used for pension increases and revaluation.
- The central mortality assumption should use the same experience factor for all males and all females (i.e. please don't make different assumptions for contingent lives or for different groups of membership, although a different experience factor for males versus females would be acceptable). Taken in aggregate, the mortality assumption should give a value consistent with the scheme's best estimate view of mortality.
    - Please provide sensitivities in the form of change in PV (percent) for +/- 10% qx to the assumption adopted.
- Any specified standard set of CMI longevity improvements can be used, but please avoid making non-standard adjustments/using non-standard versions or combinations. This simplifies the adjustments Rothesay needs to make when comparing to our own views of longevity improvements.
- Contingent spouse assumptions should be the scheme's best estimate. We would not generally review these for a cashflow-based price.
- Members should be assumed to retire at the age which maximises their liability (i.e. the youngest age at which no early retirement factor applies. Where a member has multiple tranches with different retirement ages, each tranche should be retired independently at the youngest unreduced age).

3. Other information

- Please provide details of any incentive exercises carried out by the scheme (i.e. PIEs, ETVs and/or FROs). Please confirm the dates, scope, nature and take-up of each exercise.
- Please confirm the PV-weighted male/female proportion by status and present value.
- Also split by status, please provide the PV-weighted average age and (for deferreds) normal retirement age.
- Please give some background to the industry and to the nature of members' roles.
- We can carry out a light-touch model-based demographic assessment and allow for this approximately in our pricing if you are able to provide skeleton information for each member: status, date of birth, gender, postcode, service dates and total pension amount (please specify the "as at" date). If you have carried out a mortality experience analysis, then please also provide the results of this analysis.
- Please confirm the pension increase date, reference month for inflation, and which the first increase applied in the cashflows is.
- If there are any unusual features, benefits or underpins in the scheme, please provide details of these.
- Please provide details of any other de-risking/insurance transactions carried out by the scheme.

GUIDANCE PAPERS

3. QUERY LOGS

The key to process efficiency

This note aims to improve the process of compiling query logs and provide pointers on how best to answer questions from insurers in a productive manner.

Insurers inevitably have questions when an RFQ is issued. But how those questions are answered can impact:

- Deadlines – with long lists of queries to triage, insurers can miss pricing deadlines, with follow-on impacts on processes.
- Engagement – insurers might not give as much focus to processes that have long query logs as the investment of time/opportunity cost is too great. This can impact price, in turn.
- Comparability of prices – as queries can be misinterpreted/not all allowed for by all insurers (especially if responses are being provided right up to submission).

It is therefore important that query logs receive appropriate focus during the broking process.

By far the best way to achieve this is a short query log. Our view is that on most deals 20-40 queries is acceptable, but more than this number is typically a symptom of a query log that is failing. We have seen processes with 100+ queries – spread over the market of quoting insurers, with investment of time by brokers and other advisers this is an enormous waste of time and resource.

Before approaching the market – the gold standard
The best time to deal with queries is before they are even raised. Ideally, brokers would ask someone independent to the client team to value the materials planned to be included with the RFQ – or at the very least read them and review the data and consider what questions they might have. These can then either be directly addressed in the benefit specification or RFQ, or a revised cut of data can be sought. It is much more efficient for an insurer to have the answers at the start of the process than it is to revisit the benefit modelling for each query log revision.

Brokers should also consider investing time in identifying common queries across deals. Many insurers ask the same questions on every process and if these can be answered up front (again, either in the RFQ or an opening cut of the query log) having the information at the beginning makes a real difference to efficiency.

One person on the broking team should be appointed to manage the log throughout – they will become familiar with all the questions on the log and best placed to triage queries (see below). If multiple individuals are involved then duplication, or worse contradiction, can occur. Insurers will have pricers working very closely with the log – it is appropriate that consultants give it the same priority/focus.

When a query arrives
The first step is triage:

- Has the query raised already been answered in the benefit specification or RFQ? If it has then there is no need to include the query on the log – this just creates overhead for all parties and obscures new information that is actually relevant/important. It can also create the risk of contradictory answers. The consultant should point the insurer directly to where the question is answered and confirm that is sufficient.
- Is the query already on the query log? Again it is sufficient to point the person raising the query at the answer – do not fill the log up with lots of signposts of the same question.

When answering a query, keep in mind the following principles:

- Do not, under almost all circumstances, make ad hoc changes to data from a query log. This creates a disproportionate amount of work and adds no value to a process. Data can be fixed in the post-transaction data cleanse or, if necessary, with a single insurer in exclusivity. If data is ambiguous then an instruction on interpretation is sufficient, but don't change the data itself.
- Is the question being asked about benefit modelling or underwriting (or sometimes both)?
  - If the question is for underwriting the answer should be factual and you should not give instructions. Some things insurers simply need to make their own minds up on. For example, there could be two conflicting postcode sources and an insurer asks which they should use for their underwriting – it is not appropriate or desirable for a consultant to provide a steer. You can factually answer in this example that one set is newer but it is up to the insurer as to how to use that information.
  - If the question relates to benefit modelling you should give a clear instruction on how to model it – see below for more information.
  - It is harder if a question spans both categories and in such cases you may need to give two answers to the same question. For example, if the total does not add up to the tranches as a tranche of pension has been omitted you will need to answer that for modelling/pricing purposes insurers should use the tranches provided but (for underwriting) the total provided factually reflects the full pension in payment to that individual (and it is helpful to add the background detail that a tranche has been omitted from the extract).

- Query answers should be complete but succinct and to the point.
- Responses must be clear above all else. This is more important than accuracy. It may, for example, not be possible to establish admin practice on a particular minor point or individual so instruct whatever is most clear. If it turns out not to be right then it can usually be fixed in the cleanse. This principle is less applicable to underwriting questions but these are generally easier to answer (factually) in the first place.
  - In the interests of clarity, instructing the simplest route is usually best. For example, if there is GMP that hasn't been put into payment at GMP age (for pensioners), you should not come up with a complicated formula of applying late retirement factors, rebalancing current pension etc. – which all insurers may interpret differently. You can just instruct to disregard the GMP age information, which is clearer and simpler.
- Responses should not change – they should ideally be accurate too. Little drags efficiency as much as changing a response at a later date, which happens too often. If you subsequently discover an inaccurate answer has been given consider retaining the old answer and fixing in exclusivity, noting the above principle that clarity is more important than accuracy during a tender.
- Answer the question that is asked, considering what you would need to know if you were pricing the benefit. Incomplete responses or responses that do not go to the key point of a question lead to follow-ups and inefficiency.
- Don't be a postbox. Brokers add real value to a query process – especially if the above principles are followed. Administrators rarely give answers of the nature required by insurers, and brokers need to interpret and reword before playing back to insurers.
- Finally, if the response can be "price the data provided", it should be.

Managing the log

- The log should ideally be in Excel rather than PDF format. This enables sorting, annotating and sharing digitally most easily.
- The log should be circulated regularly, with responses provided in a timely manner. If it is very difficult to establish the "right" answer it is unlikely to be material, and an instruction can usually be given more quickly (see above principles). This allows an insurer to get on with pricing work without waiting for a more "right" response which may not affect the outcome.
- Functionally identical queries should be grouped (perhaps into the same query number). For example, ten queries along the lines of "service does not align with tranches" do not need ten identical responses (to price the data provided – see above). One larger query is easier to digest.
- It should be clear when questions have been responded to on the log. Colour is not suitable for this as it is harder to filter on and doesn't carry over from one version to the next (so if an insurer misses an interim version queries can be missed). The best way is a column with a "last edited" date – this also means if a query response has to be amended it can be readily flagged.
- Having a separate "round 2" query log can be helpful to draw a line under "round 1" – depending on query volumes. If you have succeeded in running a short, well managed, log it will be unnecessary, but if query volumes are large it can be helpful.
- Query categorisation (e.g. benefits, data, experience etc.) can be helpful – but again generally it is better still if the query log can be sufficiently succinct/short as to make this unnecessary.
- Every follow-up query you receive to an answer usually shows a query that has not been fully answered first time round, so do revisit and consider what could have been done better (applying the principles set out in this section).

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4. EXPERIENCE DATA

Requirements and common issues

This note aims to provide guidance to consultants when preparing experience data to accompany a quotation request.

Insurers and reinsurers will want to see experience data to inform their underwriting even if there are only a minimal count of deaths. However, experience data is not something maintained day to day by administrators and often is infrequently reviewed by consultants which means it is more prone to errors than in-force data.

High-quality experience data may be given more weighting by insurers and reinsurers which may support more competitive premiums than assumptions underwritten on postcode models alone.

The economic consequence of errors in experience data can be significant. If errors are identified during due diligence by an insurer it is possible trustees may face an unexpected change to the premium. Trustees will be asked to warrant experience data, with possible consequences should errors subsequently be identified. Therefore, care should be taken in its preparation and presentation to insurers to make sure that all parties can have confidence in the data.

Basic experience data requirements

The following are essential to any experience extract. There are no circumstances in which any of these items can be omitted without compromising the credibility of the data. Any additional data that can be provided is also helpful.

- Unique ID number. Required to check data consistency and to support due diligence of the data.
- Date of birth – day, month and year.
- Sex – male or female.
- If applicable, scheme section. If the transaction is for a section of a scheme, then this is essential.
- If applicable, whether the member has been included in a member option exercise e.g. PIE, WULS and whether they accepted or rejected.
- Status at exit – active, deferred, pensioner, dependant or child.
- Date of entry – date of joining for actives, date of leaving for deferreds, date of retirement for pensioners and associated member's death for dependants.
- Date of exit.
- Mode of exit – typically death, transfer, commutation or (for children/temporary benefits) cessation. If "death with dependant" and "death with no contingent liability" can be distinguished this is helpful. Decodes may need to be provided.
- Pension amount. You should clearly specify the effective date – usually death for in-payment pensions. It should include all tranches at that time.
- Postcode at death.

If available, linked member IDs for dependants and children should be supplied so that they can be associated with their original member.

Other key information

You should specify the date range covered by the experience extract (which should ideally be back to the oldest records held) and also the date the extract was run (to enable assessment of unreported deaths).

You should supply an in-force file that is consistent with, and extracted at the same time as, the experience data. Taken together the experience data and in-force data should ideally constitute all members who have ever been in the scheme, however:

- You may need to exclude particular sections – in which case they must be excluded from both lives and deaths. However, it is preferable for all data for all sections to be provided.
- If you are providing movements for a limited window (say the last 10 years) then all lives who have ever been in the scheme during the window concerned, regardless of exit reason, should be included across the data.
- Ideally experience data should include non-pensioners, but if this isn't the case then the data sets should together encompass anyone who has ever been a pensioner/dependant.

It follows from this that non-death exits must be included (labelled appropriately), and non-pensioner movements as well (the history of transfer experience is relevant for underwriting).

Even where a transaction is excluding groups of members (e.g. executives or groups with complex benefits), experience data will need to include (flagged) records of these lives.

If a PIE exercise has been run, then we will need sufficient data for both in force and exits to reconstruct pre-PIE pensions to ensure analysis is done on a like-for-like basis. This could be pre-PIE pensions or PIE factors, together with flags for which members accepted a PIE.

Common issues

- Suspended/pending members should be included within in-force data, and flagged as such.
- Postcodes should be those of the member at death as noted above, but we sometimes see that postcodes are for hospitals or those of the informant rather than the member.
- Omitted amounts - if administrators supply data with missing amounts, then this data needs sourcing and populating.
- Similar checks should be carried out on other blank/empty fields.
- Multiple members with the same dummy amount, created because the amounts are missing on the system.
- Amounts that do not represent pension – for example including death lump sums. Amounts should solely be annual member pension.
- Inconsistent lives and deaths – for example IDs in both extracts or (on investigation) in neither.
- Movements backdated – for example retirements set up with past-dated dates. It is preferable that date of entry represents the first date on which if the death occurs it would be listed as a death from that status. For example, if date of retirement is backdated a year that represents false pensioner exposure as had they died in that window they would have been recorded as a death from deferred.
- Members with multiple records. There are good reasons (e.g. multiple service periods, pension entitlement both as a member and a spouse) for multiple records. IDs with identical dates of birth/postcodes/genders should be checked to confirm that they are the same individual with multiple service periods and not a duplicate record. Multiple records should not be aggregated when presented to insurers.
- Dates of death must be true date of death (reconciling with the death certificate) ***not*** date of death reported or date of last/next payroll.
- Data that is not self-consistent (e.g. exit dates reported prior to retirement or after the extract end date). Data should be reviewed before issuing to insurers for errors such as these.

Contact details

Please do contact us if you have any questions or would like our view on how any decisions you are making would influence our pricing approach.

newbusinesspricing@rothesay.com and bd@rothesay.com

mallowstreet survey results

While buy-out readiness is improving, endgame paths diverge in 2021

Our most recent survey results indicate that funding levels generally held up well in 2020 and schemes have become more focused on their endgames.

Those targeting buy-out are concentrating on cleansing data as well as staying liquid in case opportunities arise. Those targeting self-sufficiency are increasing their hedging and looking to take advantage of illiquid assets.

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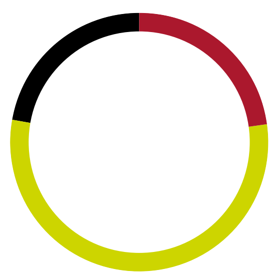
BUY-OUTS ARE APPROACHING

Despite the ups and downs of 2020, 42% of UK pension funds targeting buy-out believe their endgame is still achievable within the next five years – double the proportion a year ago.

2020



Time to endgame <5 years	23%
Time to endgame 5-10 years	55%
Time to endgame >15 years	22%

2021

Time to endgame <5 years	42%
Time to endgame 5-10 years	46%
Time to endgame >15 years	12%

DATA IS A PRIORITY

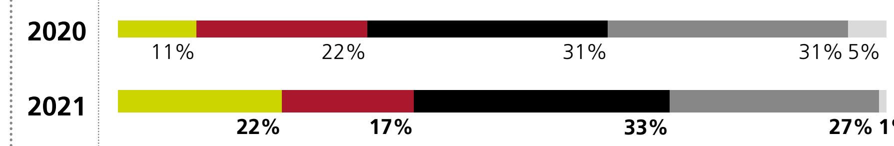
Even though there is still no preferred route to GMP equalisation, it has become one of several driving forces for member data checks – along with pension dashboards and endgame preparations. Data preparedness continues to improve and has become a top priority for 53% of UK schemes, overtaking de-risking and liability management exercises.

PRIORITIES	2020	2021
Getting member data in check	42%	53%
De-risking our investments	42%	48%
Conducting a liability management exercise	26%	19%
Increasing expertise in pension risk transfers	8%	9%
Engaging with sponsor to speed up decision-making	15%	9%
Finding a counterparty to transact with	9%	6%
Hiring an experienced external resource	0%	0%

PATHS TO ENDGAMES ARE DIVERGING IN 2021

But looking under the bonnet, endgame paths are starting to diverge. While buy-out preparedness has continued improving amongst well-funded schemes, the pandemic has taken a toll on those with funding levels below 70%. One in five schemes falls in this group – double the proportion a year ago. As a result, the road to buy-out looks distinctly different from the path to low dependency. We explain how on the following pages.

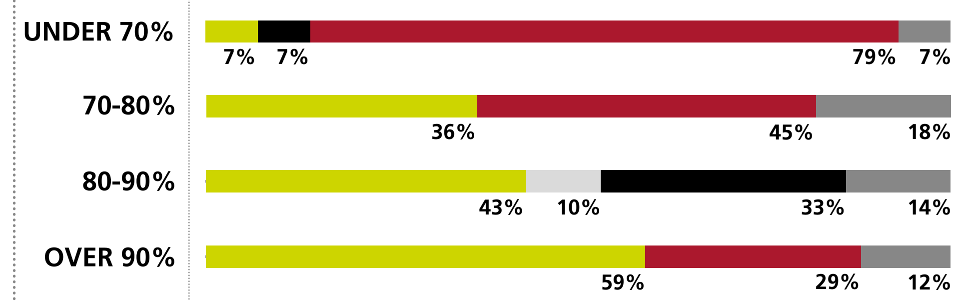
FUNDING LEVELS ON A BUY-OUT BASIS



Under 70%
70-80%
80-90%
Over 90%
Does not apply

WELL-FUNDED SCHEMES TARGET BUY-OUT

Nearly 60% of schemes with a solvency level exceeding 90% are targeting buy-out – compared to just 7% of schemes which have achieved a solvency level below 70%. Underfunded schemes are much more likely to choose low dependency as their endgame instead.



Buy-out
Consolidation
Other
Self-sufficiency/low dependency on sponsor
Undecided

BUY-INS KEY TO BUY-OUT

For a consistent two-thirds of those working towards buy-out, buy-ins remain a vital step on the path towards buy-out – and about 50% continue with a series of transactions, rather than relying on a single one. With many schemes having completed one or multiple buy-ins, their ability to buy-out is improving.

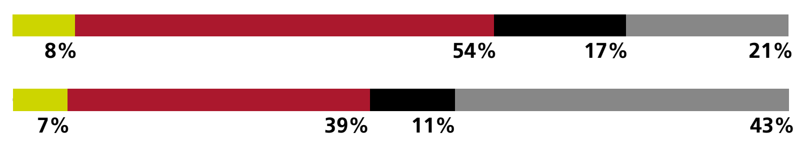
*In 2020, the answer option about longevity swaps was phrased in a more ambiguous way ("Hedging via a swap or similar"), which may have overlapped with "Moving into hedging assets" and similar answer choices. This makes year-on-year comparisons of the demand for longevity swaps more challenging.

DE-RISKING TOWARDS BUY-OUT	2020	2021
Moving into hedging assets	50%	75%
Moving into cashflow matching assets	27%	42%
Buy-ins (one or multiple – see breakdown below)	68%	67%
Hedging via longevity swap*	41%	17%
Other	5%	4%
Moving into cash	0%	0%
We are not currently de-risking	5%	4%
Buy-ins:		
A series of buy-ins	50%	46%
A single buy-in	18%	21%

Figures in the charts may add up to 99% or 101% due to rounding of percentages

PRICING CHECKS ARE PART OF PREPARATIONS

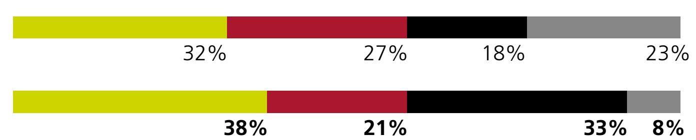
Three out of every five schemes targeting buy-out check insurance pricing regularly – and 71% think it will remain at least as expensive as it was at the start of 2021.

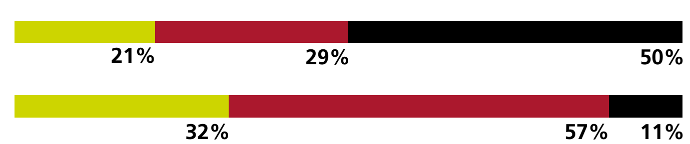


BUY-OUT SCHEMES MAINTAIN LIQUIDITY

Schemes working towards buy-out are also monitoring their liquidity. Allocations to illiquid assets have decreased somewhat, with 38% not holding such assets at all.

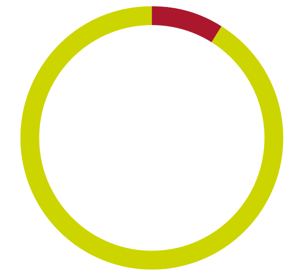
Additionally, half of UK pension funds targeting buy-out plan to divest from such allocations – meaning buy-out providers are less likely to be expected to accept in-specie transfers of illiquid assets in a transaction.

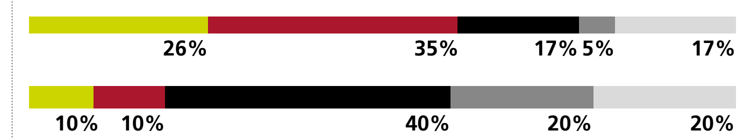




AVOIDING TRAPPED SURPLUS WHEN BUYING-OUT

Mechanisms to prevent trapped surplus risk are key for schemes moving towards buy-out. Where surplus can be released back to the sponsor, 91% of schemes have agreed an endgame – and 61% are funding the scheme on a gilts flat or more conservative basis, which cannot be said in cases where the surplus would go to the members. A conservative funding basis can help schemes prepare for a transaction.

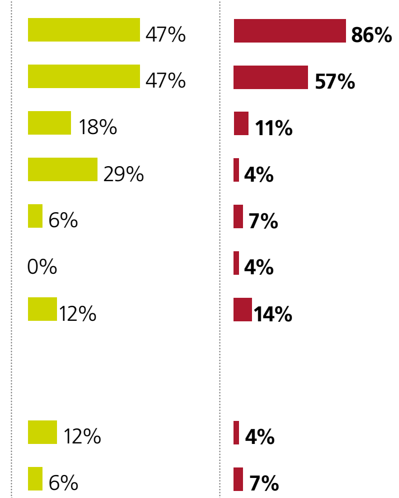




HEDGING FOR SELF-SUFFICIENCY

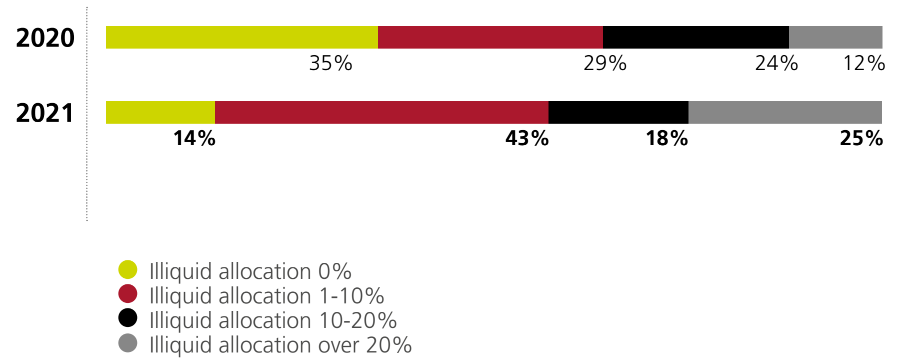
Schemes aiming for low dependency on their sponsor are less interested in buy-ins and longevity swaps than those working towards buy-out. Instead, 86% are increasing other hedging assets – double the proportion last year. This suggests that schemes working towards self-sufficiency are perhaps overlooking the advantages of insurance solutions, focusing on LDI and CDI instead.

*In 2020, the answer option about longevity swaps was phrased in a more ambiguous way ("Hedging via a swap or similar"), which may have overlapped with "Moving into hedging assets" and similar answer choices. This makes year-on-year comparisons of the demand for longevity swaps more challenging.



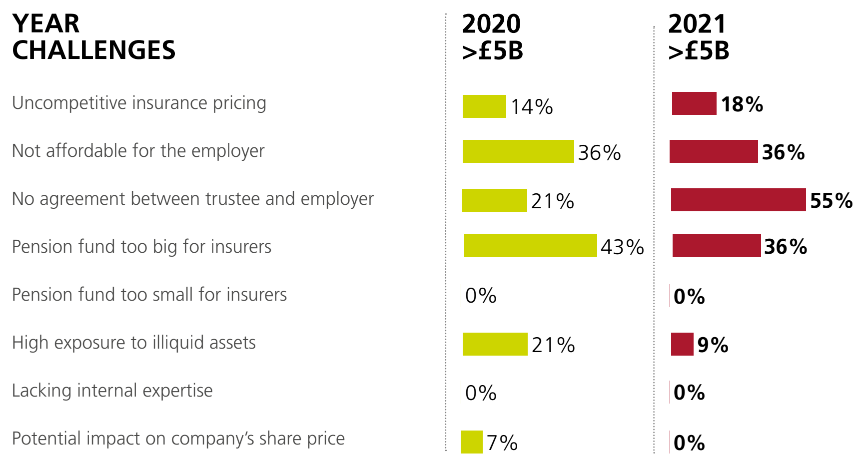
APPETITE FOR ILLIQUIDS

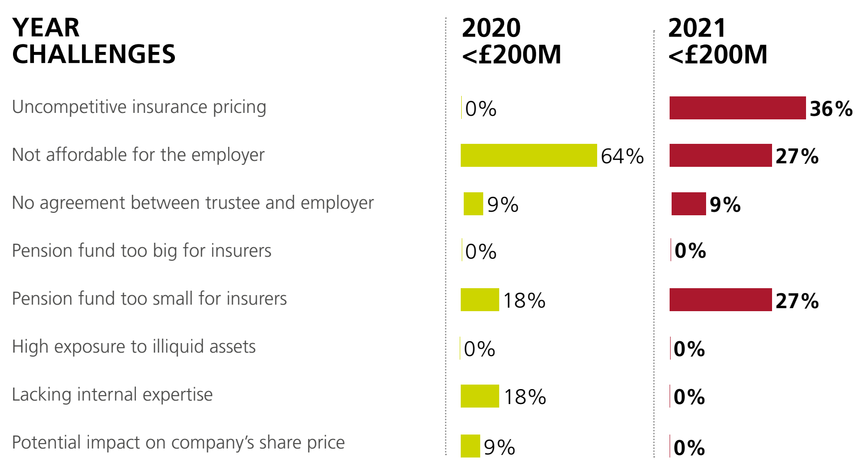
Schemes working towards self-sufficiency have also increased their allocations to illiquid assets. Just 14% lack an exposure to such assets, and the proportion of those investing over 20% of their portfolio has doubled compared to last year. Illiquid assets can provide both a return enhancement and secure cashflows, so the interest in them reflects the need to bridge funding gaps, as well as the match future cashflows.



TOO BIG TO INSURE OR TOO SMALL TO GET GOOD PRICING?

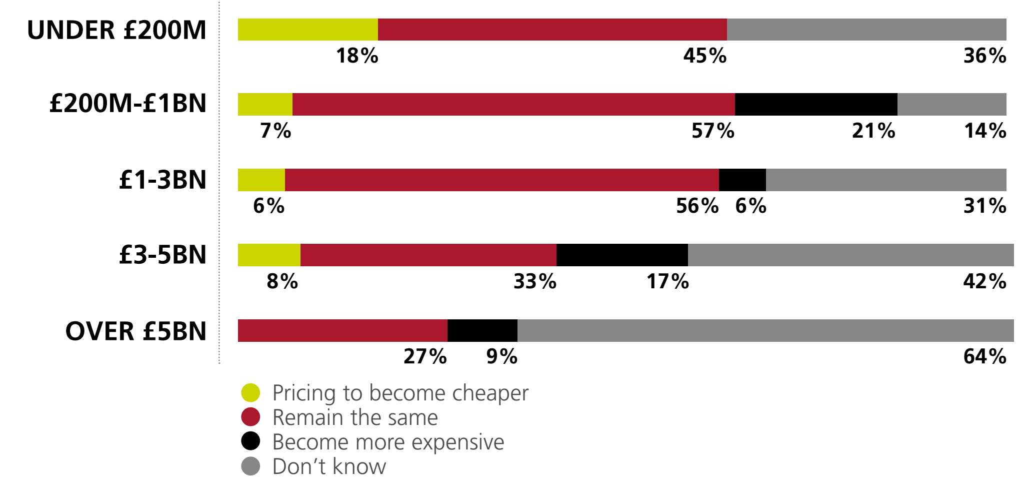
Nearly two out of five schemes with assets over £5bn think they are too big to insure, while at the same time this proportion within the £3bn to £5bn range has fallen from 33% to 0%. This development reflects the growing capacity – and appetite – of buy-out providers to do bigger transactions. However, smaller schemes with assets below £200m are now increasingly saying that insurance pricing is "uncompetitive" – 36% worry about this, up from 0% last year.





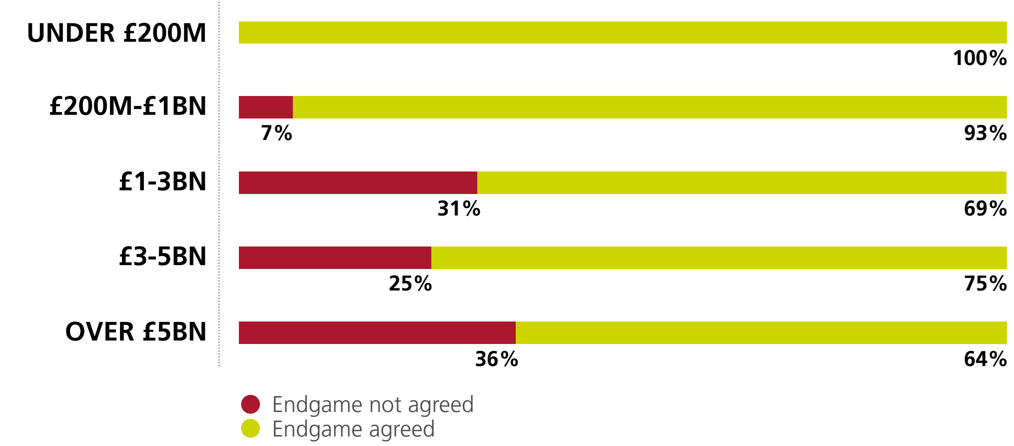
CURRENT VIEW ON INSURANCE PRICING

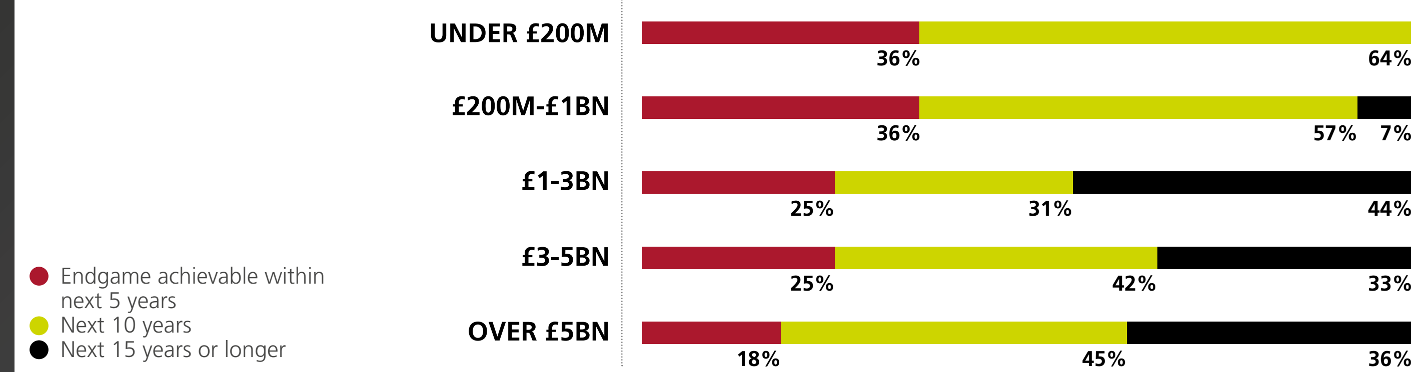
One out of five small schemes expect insurance pricing to improve in the future – twice the proportion of larger schemes.



INSURANCE MARKET LESS ACCESSIBLE TO SMALLER SCHEMES

This means that smaller schemes with assets below £200m are having trouble accessing the insurance market, despite their greater likelihood to have agreed endgame plans with their sponsor and achieve it within the next ten years.





CONSOLIDATION IS STILL NOT A VIABLE ENDGAME

Although The Pension Regulator has provided guidance on superfunds, consolidation is still not considered. On rare occasions, it is on the radar of smaller schemes with weaker sponsors. To consolidate, schemes are required to secure 100% of benefits – but some may prefer to forgo a part of the benefits for the additional security offered by an insurance company.

92%
are not considering consolidation

Figures in the charts may add up to 99% or 101% due to rounding of percentages

mallowstreet survey results

mallowstreet

The survey results in this publication are based on a survey of 64 pension schemes. Key statistics on the participating schemes are detailed here.

We are a members-only online community website, with a portfolio of educational in-person and digital events that sits alongside. Both the website and the events are specifically for professionals in the institutional pensions industry and are accredited by the Pensions Management Institute.

"mallowstreet's mission is to empower every pension fund to make better decisions, meaning every person can have a better retirement."

STUART BREYER
CEO

ALLY GEORGIEVA
Head of Insights

RYAN DALEY
Senior Investment Researcher

Figures shown in brackets represent the number of schemes (one respondent per scheme).
Some figures may not add to the total due to rounding.

BY ASSET SIZE

>£5bn	**17%** (11)
£3-5bn	**19%** (12)
£1-3bn	**25%** (16)
£200m-£1bn	**22%** (14)
<£200m	**17%** (11)

BY COVENANT STRENGTH

Strong	**34%** (22)
Tending to strong	**47%** (30)
Weaker	**19%** (12)

BY ENDGAME

Buy-out	**38%** (24)
Self-sufficiency	**44%** (28)
Undecided	**14%** (9)
Consolidation	**3%** (2)
Other	**2%** (1)

BY BUY-OUT DISCOUNT RATE

Gilts plus 1-50 bps	**22%** (14)
Gilts flat	**27%** (17)
Gilts minus 1-50 bps	**19%** (12)
Other	**8%** (5)
Unknown	**25%** (16)

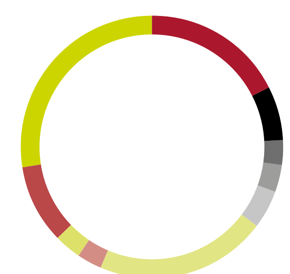
BY FUNDING LEVEL ON BUY-OUT BASIS

>90%	**27%** (17)
80-90%	**33%** (21)
70-80%	**17%** (11)
<70%	**22%** (14)
Does not apply	**2%** (1)

BY TIME TO ENDGAME

Next 5 years	**28%** (18)
Next 10 years	**47%** (30)
Next15 years or longer	**25%** (16)

BY SPONSOR SECTOR



Finance/Banking	**17%** (11)
Construction	**6%** (4)
Government	**3%** (2)
Healthcare	**6%** (4)
Information Technology	**5%** (3)
Manufacturing	**20%** (13)
Oil and Gas	**3%** (2)
Transport and Logistics	**3%** (2)
Wholesale Retail	**9%** (6)
Other	**27%**(17)

BY SCHEME SURPLUS RECIPIENT

The Company	**37%** (23)
The members	**16%** (10)
Other	**17%** (11)
I don't know	**30%** (19)

BY POWER TO WIND UP THE SCHEME

The sponsor	**17%** (11)
The trustee	**27%** (17)
Jointly agreed	**36%** (23)
I don't know	**20%** (13)

J2B2021 JARGON BUSTER

JARGON BUSTER

Specialists in any topic tend to develop their own terms to describe the various aspects and operation of their market. To aid the reader of this and other reports in the market the pensions team at Linklaters has put together a summary of some key terms used in buy-in, buy-out and longevity transactions. Terms in **bold** and ***italics*** are defined terms.

TERM	EXPLANATION
All-risks	All-risks refers to a ***bulk annuity*** insurance policy which covers residual risks that a ***buy-in*** or ***buy-out*** would not normally cover i.e. potential liabilities outside of the core benefits. They vary in the scope of their cover and are often called ***residual risk*** policies (because they don't cover all risks in a literal sense).
Balancing Premium	This is the balancing amount which is payable under a ***buy-in*** to the trustee or to the insurer once the ***data cleanse*** has been completed. Also called a ***premium adjustment***.
Benefits mismatch	This is where the benefits insured by the insurer do not exactly match those provided under the scheme.
Benefit specification	This document summarises all the benefits which are going to be insured by the insurer under the ***buy-in*** or ***longevity swap***. It will also capture discretions and practices (e.g. in relation to pensions payable where there is financial dependency) and may look to codify these.
Best estimate of liabilities/BEL	The "best estimate of liabilities" is an insurer's best estimate of the net liabilities that it will have to pay out over the life of an insurance contract or group of insurance contracts. The ***termination payment*** (if any) in a ***buy-in*** or ***buy-out*** contract is often linked to the best estimate of the liabilities at the time of termination.
BoE	The Bank of England
Bulk annuity/bulk purchase annuity/BPA	A bulk annuity or a bulk purchase annuity is an insurance policy taken out by the trustee. The insurance policy is in the trustee's name and is an asset of the scheme. The insurer will make scheduled payments under the policy to match the trustee's insured liabilities. The trustee and its administrator continue to operate the scheme as usual but are funded by payments under the insurance policy. Members do not have direct rights against the insurer.
Business as usual	Standard operations or procedures relevant to a particular entity and commonly used to describe the status of a buy-in once the data cleanse and premium adjustment have been completed.
Buy-in	A buy-in is a ***bulk annuity*** policy that is held by the trustee. This can either be held for the long term or simply just for the period of time before moving to ***buy-out***. A buy-in will always precede a ***buy-out***. This is because the first step in buying-out will always be a ***bulk annuity*** policy with the trustee (the buy-in policy) before the insurer issues ***individual policies*** for beneficiaries which achieves the ***buy-out***.

TERM	EXPLANATION
Buy-in price or initial premium	The initial amount which the trustee will pay to the insurer on signing the ***buy-in*** policy to go ***on-risk***. Subject to adjustment as part of the ***data cleanse***.
Buy-out	A buy-out refers to the process where the insurer steps into the shoes of the trustee, and issues ***individual policies*** directly to scheme members. The members' benefits are then provided directly by the insurer and members have direct rights against the insurer. The trustee is discharged from liability in respect of those benefits it has bought out. If all benefits are bought out, the scheme usually winds up. A ***buy-in*** will precede a buy-out. A ***buy-in*** that is intended to move to buy-out is often called a buy-out.
Collateral	Collateral refers to a pool of assets held as security in return for an insurer's obligations under the insurance policy. If the insurer goes insolvent, or if certain triggers occur, the trustee can have recourse to those assets. If a transaction is "collateralised" this means that there is collateral being held. The collateral is usually held by a separate custodian. There is no obligation to have collateral and most ***buy-ins*** do not.
Consolidator/superfunds	The consolidators or "superfunds" are occupational pension schemes that are set up "for profit". A consolidator will take on the assets and liabilities of other defined benefit pension schemes by way of a bulk transfer. It is a single employer scheme with no link to the transferring pension scheme (or its sponsoring employers). No benefits are built up whilst in the consolidator's scheme. The consolidator will hold a capital buffer which sits outside the scheme.
Coverage/cover	The insurer will only insure the benefits and risks the trustee asks them to, and what they insure is the "coverage". Therefore, any liabilities outside the scope of the coverage described in the contract or the ***benefit specification*** will not be insured and the trustee will have to meet these from scheme assets. Whether or not a certain risk (e.g. GMP equalisation) is covered will be a matter of negotiation and may be subject to the payment of an additional premium.
Data cleanse (often also referred to as verification)	This is a process where the administrator will cross-check and verify certain data they hold for the members of the scheme (usually referred to as the ***Initial Data***) for the purposes of the ***buy-in***. For example, this may involve checking members are still alive; whether their date of birth is correct; and whether their sex is correct. This is often referred to as verification. The data cleanse will likely be followed by a ***Balancing Premium*** also known as a ***Premium Adjustment***. This can be a complex and lengthy process and can be carried out in advance of a de-risking project, or after the transaction has been entered into and before ***buy-out***. The aim is to make sure the data is as accurate and complete as possible.
Deed poll	A declaration and undertaking by the insurer that, in accordance with the terms of the ***buy-in***, the insurer assumes the obligation to pay benefits directly to scheme members. This is used to allow the insurer to assume the obligation to pay the benefits directly to scheme members before issuing ***individual policies*** and ***buy-out*** occurs at that point rather than when ***individual policies*** are later issued.
Dis-intermediated structure	Some ***longevity swaps*** are structured this way. The insurer accepts limited liability and acts as a "pass through" or go-between and the trustee contracts with the ***reinsurer*** as much as possible. Also referred to as a pass through structure.
Due diligence	The insurer or reinsurer will usually undertake some form of review before a ***buy-in*** or ***longevity swap***. This is checking the scheme, its operations and its data to check they are happy to enter into a contract with the trustee and to identify any issues they have.
ESG	ESG covers environmental, social and governance issues (but consensus on details of the meaning can vary).
Exclusivity	Where the trustee agrees to only negotiate with a certain insurer for a possible transaction. It will usually last for a limited time. There is no obligation to transact at the end of it. Exclusivity may be documented in an exclusivity letter and is often provided as part of the insurer agreeing to a ***price lock***.

JARGON BUSTER

TERM	EXPLANATION
Experience data	The data the trustee holds about the exits (including deaths and transfers) from the scheme.
FCA	The Financial Conduct Authority.
Finalised Data File/Verified Data	This is the member data post-***data cleanse/verification*** (i.e. it has been checked, errors corrected), and the insurer and the trustee have agreed that this is the final form data. There is often a ***Balancing Premium*** to pay once the final data has been agreed.
FSCS/Financial Services Compensation Scheme	This is the Financial Services Compensation Scheme, which is a scheme that compensates holders of insurance policies if the insurer goes insolvent, subject to certain conditions.
Fully-intermediated Longevity swap	Some ***longevity swaps*** are structured this way. The trustee enters into an insurance policy under which the insurer takes on full liability to the trustee. The trustee has no visibility over the insurer's own hedging arrangements.
Gap policy	This relates to the insurer's ***matching adjustment requirements***. If an insurer wants to place the assets held under the trustee's ***bulk annuity*** policy into its ***matching adjustment portfolio***, the policy has to comply with certain terms. If a term or payment (e.g. payment on termination of the policy) does not comply with the ***matching adjustment requirements***, the insurer may request this is covered by a separate policy (known as a gap policy) so as to avoid invalidating the whole ***buy-in*** contract from qualifying for ***matching adjustment***. This gap policy is just a separate insurance policy, which is not eligible for ***matching adjustment***.
Implementation	After the ***buy-in*** is executed, the operational aspects of the ***buy-in*** are put in place.
Inception	The date the policy is effective and the insurer goes ***on-risk*** for the benefits.
Individual annuity/policy	These are the insurance policies issued by the insurer on a ***buy-out*** in the name of each scheme member entitling them to benefits equivalent to their rights under the scheme. The trustee and scheme cease to be liable to the member.
Individual policies	Insurance policies issued by the insurer in the name of scheme members, these are issued at the point of ***buy-out***.
Individual surrenders (e.g. CETVs)	Where a member or beneficiary surrenders or commutes their benefits instead of receiving benefits from the scheme or insurance policy. Common examples are a cash equivalent transfer value (CETV) or a trivial commutation lump sum.
Initial Data File/Initial Data	This is the spreadsheet, or other file, containing the key data for payment of members' benefits (e.g. names, National Insurance numbers, dates of birth, pension in payment). This is normally provided right at the start of the transaction, and then once the documents are signed the ***data cleanse/verification*** period begins. The ***initial premium*** (i.e. the price the trustee pays at the start of the transaction) is based on the Initial Data.
Initial period	The period under the contract before the ***Finalised Data File*** is confirmed.
Insurer factors	These are the factors the insurer uses to calculate benefits such as reduction to pension for early payment or the factors used when pension is being commuted for tax-free cash. These are usually different to the scheme specific factors.
ITQ/RFP	Invitation to quote or request for proposal: This is essentially a tender which goes out at the start of the process to insurers, who will return their price on the basis of that document. It is usually accompanied by the ***benefit specification***.
Joint working group	This can be a working group set up by the trustee with or without the scheme sponsor and is used as part of managing entering into a ***buy-in***, ***buy-out*** or ***longevity swap***.
Longevity	How long members live for.
Longevity swap	An insurance policy similar to a ***buy-in*** but the only risk the insurance policy covers is longevity. It covers the risk of members living longer than expected. The survival of dependants is usually covered as well.
Longevity swap novation/ conversion	This is where a ***longevity swap*** is turned into a ***buy-in*** with the reinsurer counterparty in the ***longevity swap*** providing the reinsurance to the ***buy-in*** insurer.

TERM	EXPLANATION
Marital status data	This is data that confirms the member's marital status that can be useful for insurers and reinsurers when pricing a transaction.
Marital status survey	A survey a trustee may undertake of its scheme's members to get details of members' marital status. This can be useful for insurers and reinsurers when pricing a transaction.
Matching adjustment/MA/ matching adjustment portfolio	How much capital an insurer has to hold is determined in part by the value of its liabilities. Insurers value the present value of their liabilities using a discount rate. A matching adjustment is an upward adjustment to the discount rate, which has the effect of reducing the amount of liabilities and therefore also the insurer's ***Solvency II capital requirements***. An insurer can only use a matching adjustment where it meets certain conditions and has a matching adjustment portfolio. When an insurer has a matching adjustment portfolio, this means that it sets aside a portfolio of assets to support a known/predictable portion of their liabilities. The return on the assets in the matching adjustment portfolio match the liabilities attributable to that portfolio – i.e. the assets match that proportion of liabilities, and so the overall risk is reduced, and the insurer is able to use matching adjustment to reduce its ***Solvency II capital requirements***. An insurer may put a ***bulk annuity*** contract into a matching adjustment portfolio, which means that the contract needs to comply with the matching adjustment requirements. If a term is non-compliant, it may be put into a ***gap policy***.
Material change	This is where as a result of the ***data cleanse*** there is a large change in the data and can lead to the insurer being able to re-price the transaction or in some circumstances even terminate if the change is large enough.
Minimum capital requirement	This is the absolute minimum level of capital that insurers can hold without losing their licence. As described below, ***Solvency II*** requires a level of capital high above that minimum.
Missing beneficiaries	Members of the scheme that the trustee does not know about.
Mortality risk	The risk that a person dies. Where insurers have provided life cover that pays out on death they often ***reinsure*** this mortality risk in the life ***reinsurance*** market. When the same ***reinsurers*** also insure ***longevity risk*** for pension schemes or ***bulk annuity*** insurers, the two risks can offset and reduce the capital requirements for the ***reinsurer***.
Non-disclosure Agreement	This is put in place when the trustee wants to pass scheme (including member) data to the insurer so the insurer can quote a price. This governs the insurer's use of that data and includes protections for the trustee.
On risk	The point in time at which the insurer becomes liable under the ***buy-in*** or ***longevity swap*** in respect of the insured benefits (and goes "on risk").
Part VII Transfer	This is a court-approved regulatory process for an insurer to transfer some or all of their business to another insurer. The process is overseen by the court, the ***PRA*** and the ***FCA***, and an independent expert is appointed to consider the impact of the transfer on policyholders, including any trustee who holds an insurance policy.
PPF+ buy-out	This is a ***buy-out*** where benefits are secured at a level below full scheme benefits but greater than PPF compensation. This is usually done either following the sponsor's insolvency (where the scheme is funded above PPF levels) or as part of a restructuring to allow the survival of the sponsor (such as a regulated apportionment arrangement).
PRA	The Prudential Regulation Authority.
Premium adjustment	This is where the premium paid by the trustee to enter into the ***buy-in*** may change. This is often because of a ***true-up*** due. This is also called a ***Balancing Premium***.

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TERM	EXPLANATION
Price lock/gilt lock/Price-Lock Portfolio/asset lock	At the outset of the transaction, the insurer's pricing terms may be agreed relative to market conditions. Therefore, over time, the exact amount of the premium moves in line with market conditions or the insurer's investment strategy. This leads to a risk that the premium moves so much that the trustee can no longer afford it. In order to pay the premium, the trustee will usually set aside cash and assets (e.g. shares, bonds, gilts) to fund the premium. Under a "Price-Lock Portfolio" the insurer agrees that their premium will be tracked in line with a portfolio of identifiable assets; usually gilts but often also including corporate bonds and swaps. If it is entirely made up of gilts then it is called a gilt lock. This means that the trustee can make sure the movement in their assets matches the movement in the premium. Where the Price-Lock Portfolio matches assets held by the trustee then it is often called an asset lock. The "price lock" is usually agreed at the outset of ***exclusivity***.
Pull admin payroll	This is the payroll mechanism provided for in the ***buy-in*** where the trustee calculates the amount due for each payroll and informs the insurer of the amount payable to the trustee.
Push admin payroll	This is the payroll mechanism provided for in the ***buy-in*** where the insurer calculates and pays the amount due for each payroll.
Query log	As part of the insurer or reinsurer's ***due diligence***, they may ask certain questions about the scheme's data and benefits. The queries and answers will be recorded in the query log.
Reinsurer/reinsurance	The insurer with whom the trustee transacts may itself insure some of its liabilities with another insurer, called a reinsurer. The reinsurer will not be involved with the trustee in the ***buy-in*** or ***buy-out*** transaction as they do not have the right regulatory permissions to deal with the trustee directly. The insurer may have restrictions on its ability to insure certain benefits if it cannot obtain reinsurance in the market. The trustee may have more interaction with the reinsurer under a ***longevity swap*** depending on the structure.
Residual risks	These are types of risk outside of the core benefits that a ***buy-in*** or ***buy-out*** would not normally cover, for example, the risk of ***missing beneficiaries*** within the scheme or that the benefits provided are incorrect. A policy that covers residual risks is sometimes called an ***all-risks*** policy even though this is a misnomer as it doesn't cover all possible risks.
Risk margin	Risk margin is an amount in addition to the ***best estimate of liabilities*** that is designed to represent the additional cost of getting a willing insurer to take over the liabilities. It acts to increase the capital that the insurer is required to hold and is calculated in accordance with ***Solvency II***.
Run-off cover	This is insurance cover the trustee can take out on winding up the scheme which covers risks not covered by the ***buy-out***, ***all-risks*** or ***residual risks cover***. Examples of the cover provided includes cover for costs in defending any claims that may be brought against the trustee. It is usually provided by the general insurance market and is separate from the ***bulk annuity*** policy.
SEFT site	A site which allows for secure transfer of data electronically. This is often used to provide the insurer or reinsurer access to the scheme's data in a transaction and ensure the data is protected.
Selection risks, anti-selection	The risk where one party uses information the other does not have to its advantage. For example, if the trustee had done a medical questionnaire of its membership and knew that the health of the members it was choosing to insure was above average and the insurer is not aware of this.
Single premium	This is where the ***Initial Premium*** is the only premium due and no ***Balancing Premium*** will be payable.
Solvency II	Solvency II is an EU directive which regulates how insurers can carry out their business. It imposes ***Solvency II capital requirements*** on insurers, so that they can withstand economic and other shocks. The requirements of Solvency II are linked to the amount of an insurer's liabilities.

TERM	EXPLANATION
Solvency II capital requirements/ SCR/Regulatory Capital/reserves	Under ***Solvency II***, insurers have to hold sufficient capital to withstand a "1 in 200" shock event – i.e. enough capital so that there is at least a 99.5% chance that they will be able to meet their liabilities over the next 12 months.
Statutory discharge	Pensions legislation provides a statutory discharge to trustees who buy-out benefits in accordance with the legislation. The discharge will provide protection to the trustee in respect of the benefits bought out.
Termination	This is where the ***buy-in*** or ***longevity swap*** is terminated if certain events occur. Different parties may have different rights on when to terminate. On termination an amount will become due from one party to the other. The amount and who it is owed to depends on the circumstances of the termination and the terms agreed.
Termination payment	Also referred to as the cancellation payment, this is the amount which will be paid if the policy terminates (if there are termination rights). The amount often depends on whether the termination was the fault of the trustee or the insurer, and often has a relationship to ***BEL***.
Tracing	This is a process to check whether pensioners and beneficiaries receiving pensions from the scheme are still alive or to identify correct contact details.
Transaction schedule	A schedule to an ***umbrella contract/umbrella bulk annuity policy*** which sets out the terms specific to that ***buy-in*** transaction.
Transition team	The team at the insurer who will help the scheme establish the ***buy-in***, complete the ***data cleanse*** and then move from ***buy-in*** to ***buy-out***.
Trapped surplus	This is a surplus in the scheme (i.e. scheme assets exceed its liabilities) which the employer cannot access. It can be caused by the sponsor making additional funding to facilitate a ***bulk annuity*** transaction in circumstances where the additional funding turns out to have been unnecessary.
True-Up	This forms part of the ***Balancing Premium/premium adjustment*** and represents the difference in the benefits which have been paid during the data cleanse from what should have been paid in light of the ***Finalised Data File***.
Umbrella contract/ Umbrella bulk annuity policy	A pre-agreed set of terms for a ***bulk annuity*** policy that can be used for a number of ***bulk annuity*** policies between the same trustee and insurer. Transaction specific terms will be included in a ***transaction schedule***.
Vendor due diligence	This is any review that the trustee may do of the scheme, its data and processes in preparation for a transaction. The trustee may choose to share the results with the insurer or reinsurer, usually on a non-reliance basis.
Warranties	These are various statements each party will make in the contract giving the other party assurances that a particular statement of fact is true. This can include warranties from the trustee about the scheme's data that has been provided to the insurer or reinsurer for pricing purposes.

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Sarah is a Partner in Linklaters' pensions team and has specialised in pensions law for over 14 years. Sarah advises trustees and corporates on all main areas of pensions law with a focus on buy-ins, buy-outs and longevity swaps. Sarah spoke at the PLSA Investment Conference in March 2021 on "Legal implications of longevity risk".

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Phil is a Partner in Linklaters' pensions team with significant experience advising trustees and corporates on all areas of pensions law. He has a wide range of experience on de-risking buy-in and buy-out transactions and on liability management projects such as Pension Increase Exchange (PIE) and Enhanced Transfer Value (ETV) exercises.

Between them, Phil and Sarah have worked on the following recent de-risking transactions: Allied Domecq Pension Fund (£3.8bn buy-in with Rothesay); Marks and Spencer Pension Scheme (6 transactions with 3 insurers totalling c.£3.5bn of liabilities); Aviva Staff Pension Scheme (2 transactions with Aviva Life totalling c.£2.5bn of liabilities); and 3i Group Pension Plan (£650m buy-in with Legal & General); and Co-operative Pension Scheme (four transactions with two insurers totalling c.£2.76bn of liabilities).

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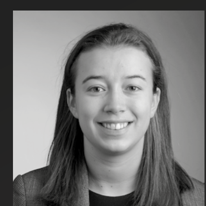

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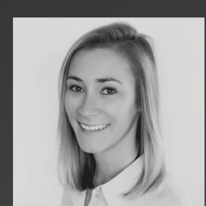

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