An Overview of the Bulk Annuity Market

David Collinson, Head of Strategic Development, Pension Insurance Corporation

Uzma Nazir, Head of Origination Structuring, Pension Insurance Corporation

28 March 2017
About Pension Insurance Corporation

- Pension Insurance Corporation ("PIC") is a UK insurer authorised by the PRA and regulated by the PRA and FCA
- Specialist, focused insurer
  - Simple business model
  - Investing in customer care
  - Recognised for innovation via industry awards:
- Portfolio of clients
  - £22.6bn of assets*, 26% share of buy-in/buyout sector long term
  - Over 130,000 pension fund members insured
  - Over 130 schemes insured, including the two largest full buyouts in UK
  - Clients include:
- Shareholders and management
  - Experienced Board and management team: Jon Aisbitt, John Coomber, Tracy Blackwell, Rob Sewell
- Capital provided by:

*YE 2016

UK Market Current Status:
- Over one million people have now been insured through buy-ins and buyouts**

*Source: Hymans Robertson and LCP buyout reports

Share of buy-in/buyout sector by volume

2008-2016 (£70bn)

- PIC: 8%
- Legal & General: 26%
- Aviva: 9%
- JRP Group: 9%
- Scottish Widows: 4%
- Rothesay Life: 3%
- Others: 2%

YE 2016 (£10.2bn)

- PIC: 14%
- Legal & General: 32%
- Aviva: 13%
- JRP: 6%
- Scottish Widows: 9%
- Rothesay Life: 25%
- Others: 1%

Source: Hymans Robertson and LCP buyout reports

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Solvency II Impact

Key changes

- Risk Margin
- SF/Internal Model
- Matching Fund Rules
- Transitional Relief
- Fundamental Spread
- Qualifying Capital

Consequences for Annuity Insurers:

- Asset strategy and yield recognition
- Benefit from reinsurance
- Capital consumption and release profile
- Hedging approach
- Treatment of policyholder options and deal structuring

Impact on the Bulk Annuity Market:

- Pricing:
  - Pensioners: Neutral to Reduced
  - Deferred Pensioners: Increased
- Capacity
- Insurability of certain options
- Transaction structuring

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Asset strategy for annuities in the Solvency II world

Assets

- Non-Matching Assets
  - Deliver capital efficient long term returns on "permanent" capital and warehouse matching assets

- Matching Fund
  - Optimise MA contribution and capital requirements with eligibility rules:
    - Yield
    - Defaults haircut
    - Capital charge

  - Shorter-dated assets not correlated with MA assets
  - Listed corporate bonds UK and Overseas with currency overlay
  - Bilateral private debt (tailored to MA requirements)
  - Other secure long-term income streams transformed in an SPV (loans)
  - Strategic investments
  - Equity Release through SPV
Brexit Impact- Initial reactions and experience so far

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Brexit – Initial reactions and outcome so far

<table>
<thead>
<tr>
<th>Longer-term factors</th>
<th>Initial view on Brexit impact</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term prospects for the bulk annuity market</td>
<td>Neutral</td>
<td>Essentially a UK-to-UK market</td>
</tr>
<tr>
<td>Investment opportunities</td>
<td>Neutral</td>
<td>Possibly more barriers to EU-focused investments but volatility creates opportunity</td>
</tr>
</tbody>
</table>
| Regulatory framework                          | Neutral to positive         | ▪ Possibility that insurance regulation evolved to better reflect UK Life environment  
                                  |                              | ▪ Solvency II for pension funds already off the table                   |
## Brexit – Initial reactions and outcome so far

<table>
<thead>
<tr>
<th>Shorter-term factors</th>
<th>Initial view on Brexit impact</th>
<th>Actual experience</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pause in decision making</td>
<td>Negative</td>
<td>Neutral</td>
<td>In reality very few processes were changed or cancelled</td>
</tr>
<tr>
<td>Lower interest rates</td>
<td>Negative</td>
<td>Neutral to positive</td>
<td>H2 was very busy as well-funded, well-matched pension funds de-risked further with insurance, but market focused on buy-ins</td>
</tr>
<tr>
<td>Fall in sterling</td>
<td>Neutral to positive</td>
<td>Positive</td>
<td>Foreign currency investments outperformed and cost of funding deficits falls for non-UK sponsors</td>
</tr>
</tbody>
</table>
2016 Transactions and 2017 Predictions
Pilkington Pension Scheme – Case Study

Mature Fund: Total Assets £1.67bn*

- Bonds: 15%
- Equities: 82%
- Cash & Deposits: 1%
- Real Estate: 2%

Path to de-risking

- Longevity swap = £1bn in 2011
- Buy-in = £230m in 2016

Financial position

- Scheme benefitted from rise in value of gilts
- Secured favourable buy-in pricing during a time of market volatility

*Source: Pensions Fund Online

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Examples of buy-in transactions post-Brexit

Smiths   ICI   Rolls Royce
2017 Market Outlook – Demand for Buyouts

- 2017 market volume predictions
- **Buyouts**
  - Largely driven by availability of sponsor to plug deficit. Why pay?
  - Affordability to buyout will vary with market conditions
  - Accounting reasons may drive sponsor decision
  - Wider sponsor corporate activity requiring a buyout
  - Deficit to buyout weighted against the future uncertain contributions payable to the scheme
  - Size if scheme is small compared to sponsor
- **Innovation in assets to improve buyout pricing**
Infrastructure Investment

- Infrastructure investment;
  - £100m debt issue in Thames Tideway project: needed to protect from pollution
  - £75m in debt issued with Virgin Atlantic Airways secured on portfolio of landing slots at Heathrow
  - Over £500m of direct Housing Association transactions

- PIC continues to invest in;
  - Student accommodation
  - Project finance
  - Government-guaranteed infrastructure
  - Local authorities
  - Regulated utility space

CASE STUDY: Thames Tideway project

- Investments stretch out to 2054
- Yields of 1% over inflation
- Long deferral period with money going in over a five year period
Potential for buy-ins: c.50% of pension plan assets are now held in fixed income securities

Asset allocation of UK pension plans

Source: Pension Regulator’s ‘DB Pensions Universe Risk Profile 2016 (The Purple Book)’. ‘Other’ assets are increasingly swaps, insurance, and other liability matching assets.
2017 Market Outlook – buy-ins

- Innovations in the market
  - Slicing of liabilities
  - Umbrella contracts
  - Longevity swaps converting to buy-ins

- Slicing of liabilities - Tranche a buy-in to cover what is affordable today
- Repeat the exercise - After initial pensioner buy-in continue to de-risk

Smiths
Cadbury’s
NSG Group

2/5 selection of pensioners
All pensioners
Pensioners aged 65+

ICI
CAA

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Summary of Scenarios for 2017

<table>
<thead>
<tr>
<th>PIC Scenarios Analysis</th>
<th>Contraction and Global Recession</th>
<th>Muddle Through</th>
<th>Expansion US-led</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Macros trends</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Growth</td>
<td>Growth is unsustainable Trump ineffectual US wages flat</td>
<td>Modest “sub-par” growth continues</td>
<td>More Infra spending market prices 4 hikes this cycle</td>
</tr>
<tr>
<td>Policy Action</td>
<td>Dovish Central Banks Euro political risk resurfaces: China hard landing</td>
<td>3 more rate rises from US in 2017; no change from ECB China slowdown is controlled</td>
<td>Wage growth picks up in US; Fed seen as behind the curve Stronger commodity / Oil prices Inflation rises</td>
</tr>
<tr>
<td>Other</td>
<td>Messy Brexit</td>
<td>China slowdown is controlled</td>
<td>-</td>
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**Market Moves**

<table>
<thead>
<tr>
<th>30 Gilt Yields</th>
<th>Down</th>
<th>Flat</th>
<th>Up</th>
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<td>£ credit spread un89</td>
<td>Wider</td>
<td>Flat</td>
<td>Marginally wider</td>
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<td>$ credit spread (C9C0)</td>
<td>Wider</td>
<td>Flat</td>
<td>Marginally tighter</td>
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<tr>
<td>EM credit spread (EMHG)</td>
<td>Wider</td>
<td>Flat</td>
<td>Marginally wider</td>
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<tr>
<td>GBP/USD FX Rate</td>
<td>Dollar stronger</td>
<td>Flat</td>
<td>Dollar stronger</td>
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**Affordability**

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<tr>
<th>Partial buy-in backed by Gilts Buyout</th>
<th>More affordable</th>
<th>Unchanged</th>
<th>Unchanged- more affordable</th>
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<tr>
<td></td>
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