Better endgame decisions

Martin Bird takes us through the findings of Aon's 2022 risk settlement survey

With the world now a somewhat different place compared to the time of Aon's previous risk settlement survey in 2020, we were keen to understand how attitudes to risk settlement opportunities may have changed for UK defined benefit (DB) pension schemes. Following an unprecedented worldwide focus on mortality rates in the past two years, and global and local economic market changes impacting on schemes' funding levels, we sought answers to the question of what is keeping schemes' stakeholders awake at night – and their proposed solution for dealing with these issues.

One of the key findings from our survey relates to longevity risk. When looking at schemes of all sizes in 2020, investment risk was considered the largest risk, followed closely by longevity risk. However, now in 2022, **longevity risk is seen as the biggest threat** for large pension schemes (those with assets over £1 billion). Many respondents indicated that longevity risk is now their only unhedged risk, suggesting these schemes have worked hard to eliminate key financial risks and will now turn their attention to managing demographic risks. Unlike hedging interest rates and inflation, hedging longevity risk can only be managed through the insurance market. As such, it is crucial that pension scheme stakeholders understand the options at their disposal. As the two most popular options in the risk settlement market are bulk annuities and longevity swaps, we asked stakeholders how easy they think it is to find an insurance provider for their scheme.

The results varied by scheme size. Overall, around a quarter of schemes either thought it may be difficult to find an interested bulk annuity provider, or did not know how difficult it would be. This rose to half for small schemes (those under £100 million). When asked the same question about longevity swap providers, this figure increased to just under three-quarters of schemes thinking it would be difficult, or not knowing how difficult it would be.

These statistics suggest that there are still **gaps in trustees' and sponsors' knowledge** about the de-risking options available to them.

Tackling longevity and other risks requires trustees and sponsors to be aligned on the scheme's endgame and the journey to get there. The results of our survey suggested that this is generally the case for most schemes, with **more than half the respondents indicating that both parties are supportive of de-risking actions such as buy-in or buyout.** This will stand those schemes in good stead as insurers often have this as a prerequisite before quoting.

Securing liabilities with insurers does not have to be an all-or-nothing affair, with many schemes choosing to do this through a series of buy-ins before an ultimate buyout. In fact, most of **our respondents suggested they expect to de-risk in stages** (56 per cent). We have seen an increasing pattern of insurers particularly prioritising repeat buyers when they have short-term pricing opportunities. They know these schemes can move quickly as a result of established governance frameworks.

For most schemes, the journey to settlement is a marathon, not a sprint. While most respondents still have a wide range of timescales to reach their endgame, the **percentage of schemes who expect to be managing their liabilities more than 10 years from now has almost halved** since our 2020 survey, moving from 41 to 23 per cent. As DB schemes mature, it is expected that more schemes will more actively consider their endgame. This, coupled with many schemes experiencing an improvement in funding levels since 2020, suggests that this could be another very busy year for the insurance market, with the best prepared schemes likely to achieve the most insurer engagement and therefore the best pricing.

To view our survey report in full, visit our Risk Settlement hub or contact Aon at talktous@aon.com to request a copy and to allow us to guide you through any of the points discussed in this article.

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