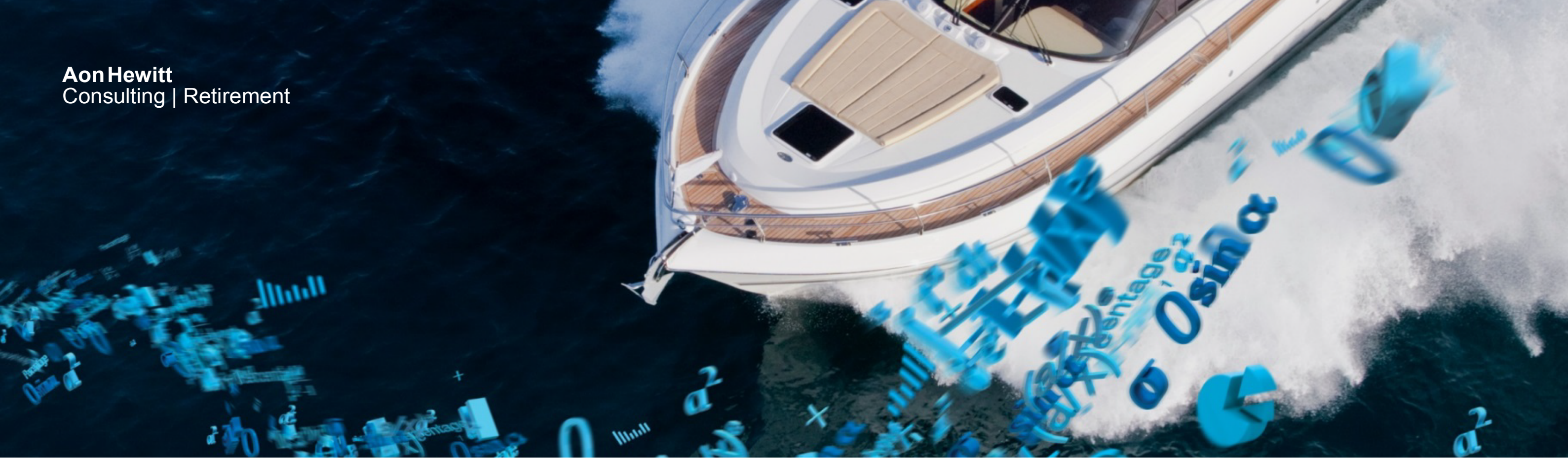


UK Risk Settlement

September 2017

2017 has continued to see improvements in bulk annuity pricing for a wide range of transactions.

In fact, for some schemes we expect the cost of securing all benefits with an insurer has reduced by as much as 10% over the last 12 months.

The key drivers are:

1. Asset opportunities. Insurers are using a range of high yielding illiquid assets to back their annuities – asset classes that are not always attainable for individual pension schemes. They have also been taking advantage of yield opportunities in the US bond market; and
2. Competitive tension. Although insurers generally have different preferences for the size and maturity of liabilities taken on, most auctions currently attract substantial competitive pressure.

The graph below summarises recent pensioner pricing. The step change shown in July 2017 reflects impressive final auction prices achieved over the summer. A similar positive change has been seen for pricing for non-pensioner members, making full scheme buy-out more attainable.

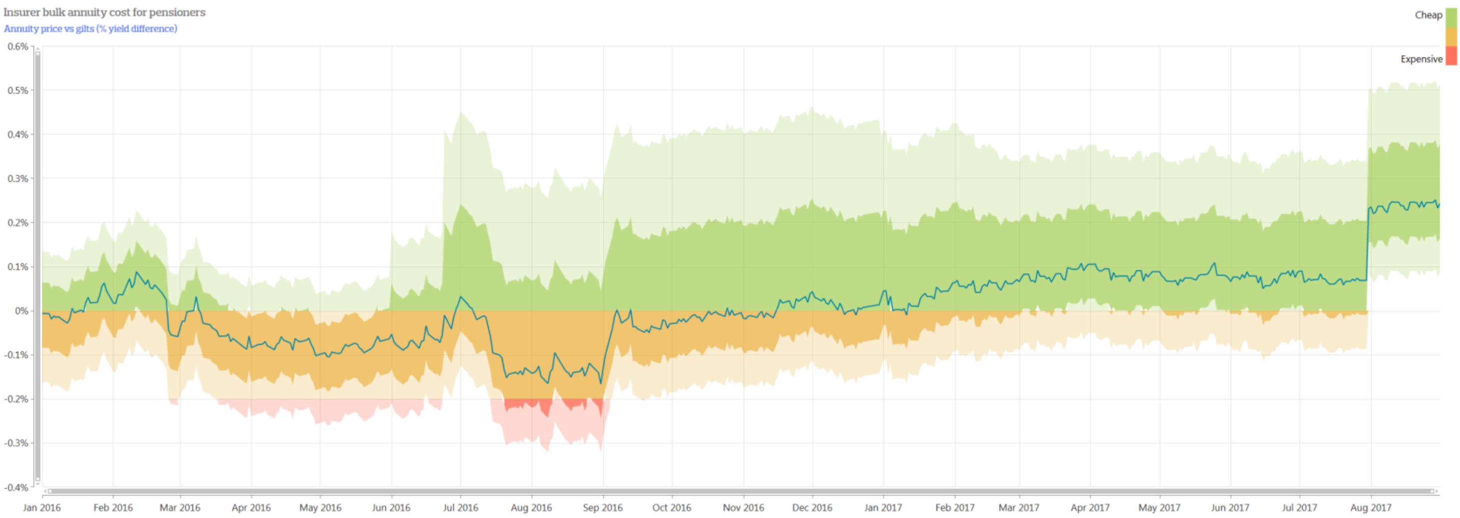
Whilst both of these drivers are variable, there is little evidence to suggest that this surge of good pricing will let up in the short term. The market will see more £1bn+ auctions in 2018, including expected opportunities to buy existing insurance back-books from other insurers, so capacity may reduce for a period later in 2018.

With a number of pension schemes looking to capitalise on this current wave of exceptional pricing, it is likely that this level of pricing has peaked. Some recent prices represent the best pricing seen since the Credit Crunch. So our message is, 'why wait for prices to rise?'.

How to read this chart

- This shows the return from a bulk annuity for pensioners, relative to the yield on a comparable gilt portfolio
- Annuities shown as 'Cheap' if giving a better return than gilts
- This comparison ignores the material value from annuities giving a better hedge including longevity cover
- Expected pricing for a typical scheme is shown by the blue line
- Best prices typically fall in the darker shading, some auctions fall in the lighter shading. Pricing outside the shading typically represents an unusual liability profile

Chart sourced from Aon's Risk Analyzer



Empower Results®

Bridging the buy-out deficit – closer than you think?

In our August Bulletin we commented that the funding gaps to meet full buy-out have closed dramatically over 2016-2017 for many schemes, particularly those that had substantially hedged interest rate risk and benefitted from strong overseas equity returns last year.

This means that the deficit against buy-out – the cost of paying an insurer to take on the responsibility of paying the member's benefits – could be quite different to that stated at your last valuation.

If you then also allow for the effect of future company contributions already committed to the scheme on the projected deficit, and the expected improvement from future asset returns, you may then only be a few steps away from affording full buy-out.

With buy-out pricing at its current levels, most sponsors should view this as an opportunity to reduce pension risk for a considerably better price than expected and bring nearer (if desired) the settlement of the scheme liabilities.

The "Deficit Bridge" illustration below is taken from our Risk Analyzer tool, which can also show the sensitivity of improvements in the deficit to different actions.

It shows that the natural maturing of the Scheme liabilities also reduces the buy-out deficit over time.

Some member options exercises, such as Enhanced Transfer Value or Flexible Retirement offers, not only offer members greater flexibility in the way they receive their incomes in retirement, but they can also remove risk at a cost that is lower than buy-out. Exercises can also make the remaining liabilities more attractive to an insurer, by simplifying them or allowing members to receive more of the value of their benefits sooner, reducing the duration of the scheme liabilities.

Most schemes considering a bulk annuity purchase are currently planning phased buy-ins; securing benefit commitments for a proportion of the pensioners at current favourable prices, and then consider further transactions when they are both feasible and well-priced. Pensioner annuities are currently providing a return with an unusually healthy margin over the yield on a gilt or LDI portfolio, and can reduce risk more completely, so now is a sensible time to secure a manageable part of the liabilities for many schemes.

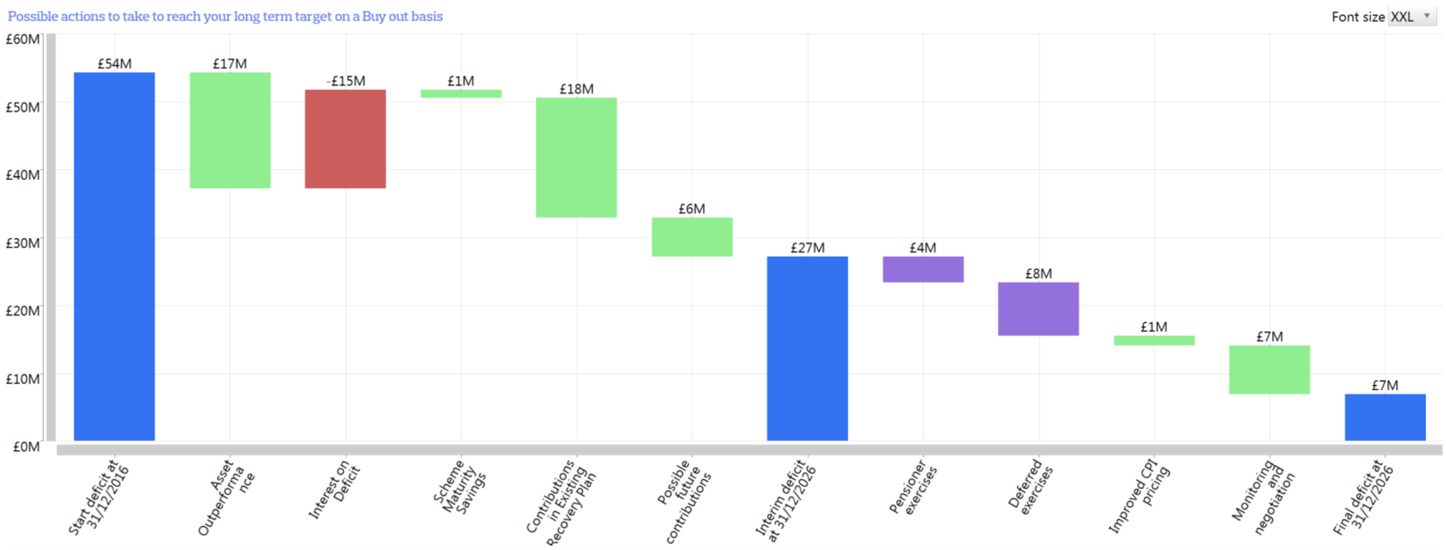


Chart sourced from Aon's [Risk Analyzer]

Contact information

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