SPP events

THE SOCIETY OF PENSION PROFESSIONALS

leading pension thinking

UK Life Insurers – COVID-19 impact

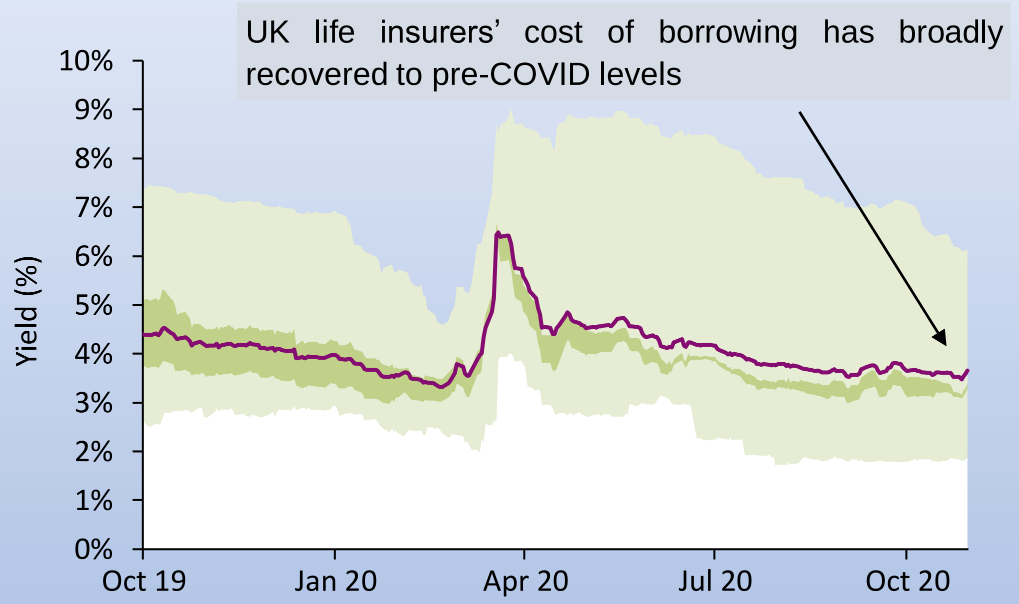
Adolfo Aponte - Lincoln Pensions

7 December 2020

2020 year-to-date

- COVID-19 driven market turmoil presents challenges to institutions that invest in the real economy, including UK life insurers
- The PRA has encouraged UK insurers to further bolster balance sheets
- Moreover, unprecedented levels of government and central bank support, including changes to UK insolvency law, have softened the immediate economic and financial impact
- So far, UK life insurers have managed to adapt to the new environment well
- What market factors could impact UK Life insurers in 2021?

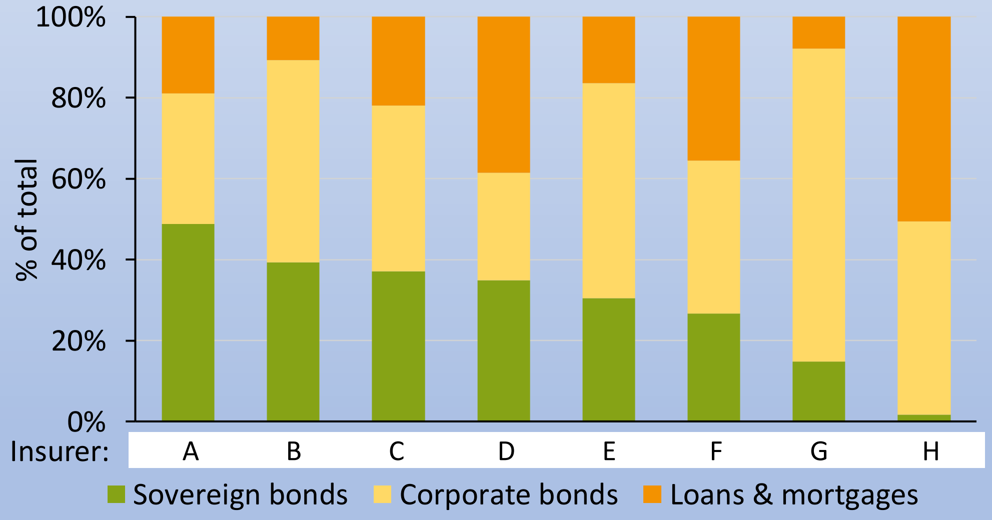
Lincoln's Life Insurer Cost of Capital Index



The use of Matching Adjustments

- Matching Adjustment ("MA") plays a crucial role in the UK life insurance sector as it embeds most of the credit/property risk carried by insurers
- At YE19, MA across the 8 UK life insurers amounted to £26bn of £50bn capital resources; the impact varies widely across individual insurers
- The effectiveness of MA relies on:
    - a Life insurers' ability to accurately model long-term asset risks (e.g. future credit defaults, downgrades and recoveries)
    - no sudden changes to Solvency II / regulatory playbook

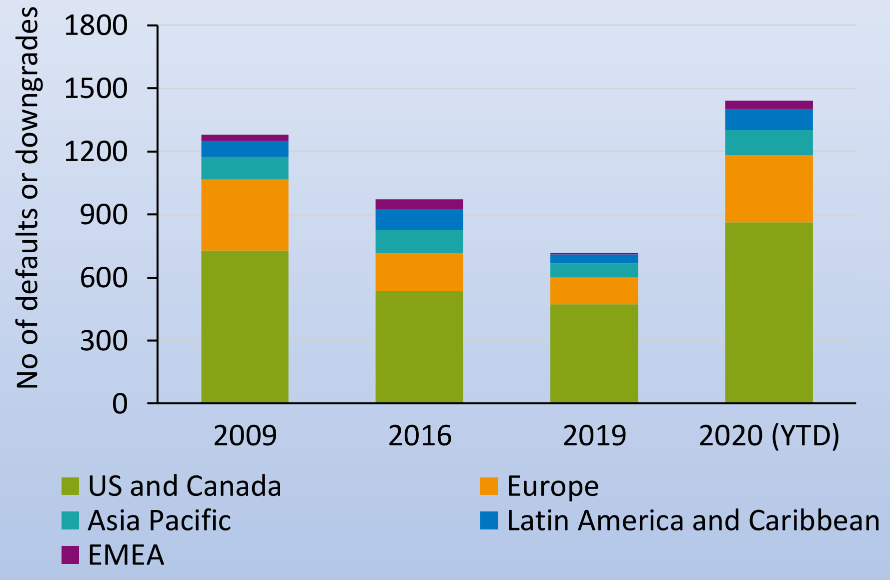
Investment portfolio



Credit risk – defaults & downgrades

- Credit defaults and downgrades have been low since the introduction of Solvency II in 2016
- We are living through the first real test of the Solvency II regime
    - companies / countries ratings (or outlook) downgraded have spiked
    - 2020 has also been a record-breaking year for ‘fallen angels’ impacting around $360bn of debt
    - the tally of corporate defaults reached 200 as of Oct’20 led by the US and Europe (first time since 2009)
- S&P Global: *“the COVID-19 shock will double company default rates across the US and Europe over the next 9 months”*

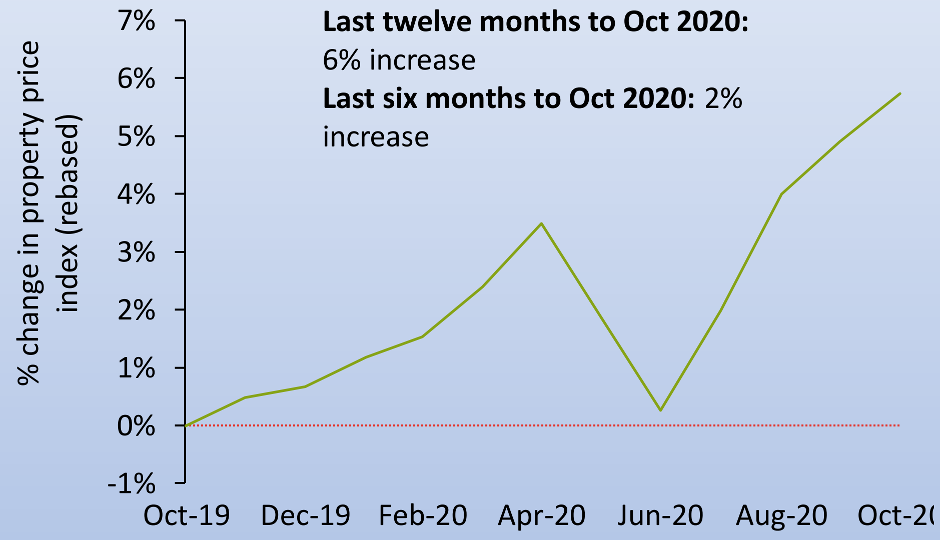
Breakdown defaults and downgrades (S&P)



Property risks – commercial & residential

- Some insurers have significant exposure to property (through holdings in commercial mortgages, ERMs, etc.)
- Residential property prices have been relatively resilient to the crises
- But commercial property prices have fallen c.8% since the start of the pandemic (n.b.: think ‘work from home’)
- Commentators expect property prices to fall in 2021

Change in residential property price index



Closing remarks

- Most UK Life Industry is well-capitalised and have so far been resilient to market shocks
- The impact of COVID-19 on the real economy will likely play out over the next 18 months or so (once government support measures end)
- Practitioners need to recognise that some insurers will be more impacted than others if corporate credit and property markets deteriorate in 2021 as expected
- Weakness in one insurer (or a subset) could raise questions over the PRA's overall approach
- Recommendations over the next 18 months:
    - *Stress testing insurers' balance sheets*
    - *Understand what management actions are available to trustees and sponsors, should risks start to crystallise*
    - *Monitor insurer developments*

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Risk settlement in the current market

John Towner

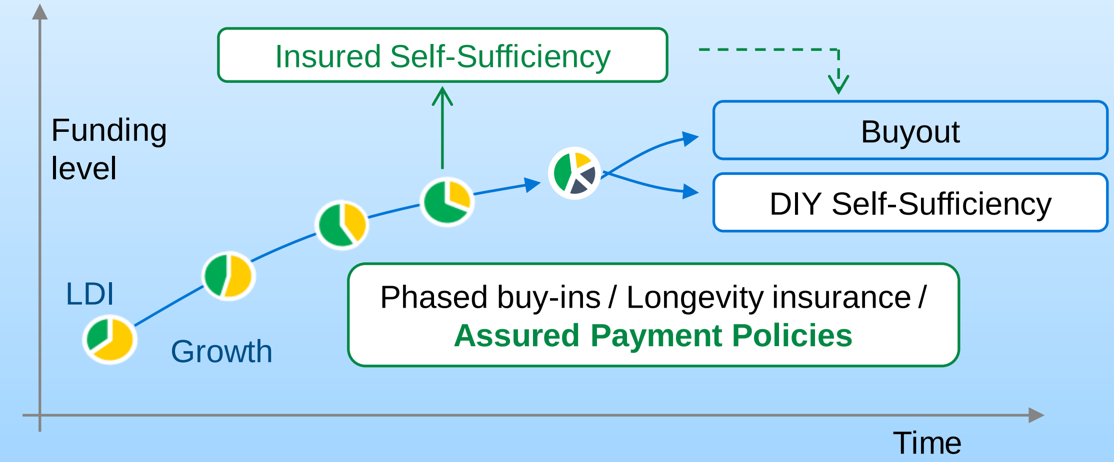
Head of New Business

Pension Risk Transfer, Legal & General

7th December 2020

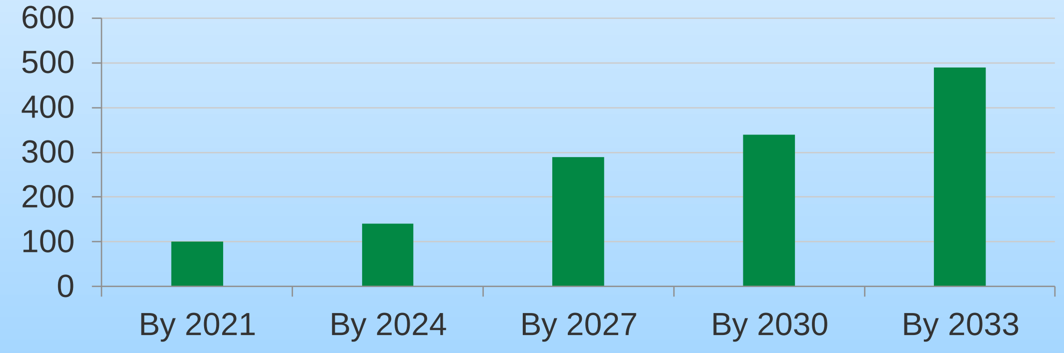
The buy-in/out market goes from strength to strength

DB pension scheme journey plans



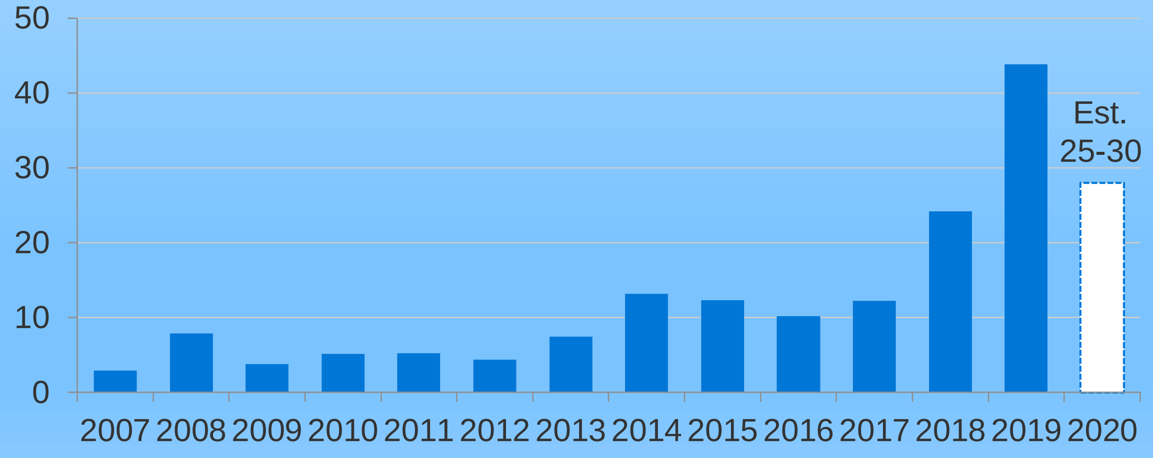
FTSE100 schemes reaching full funding on a buyout basis

Volumes of liabilities in £bn



Source: LCP Pensions De-risking Report, March 2019

Annual UK buy-in/out volumes in £bn



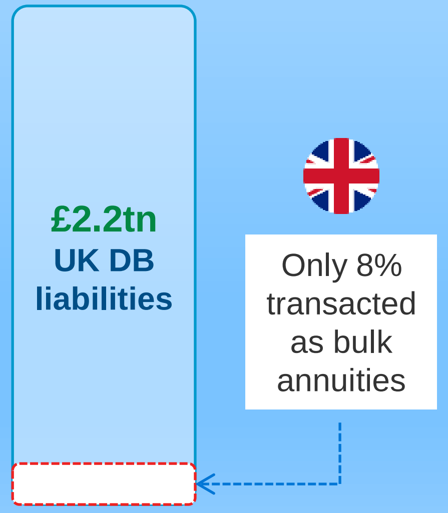
Source: LCP Pensions De-risking Report,, July 2020; Future predictions: WTW, Aon, LCP, Mercer

The wider picture

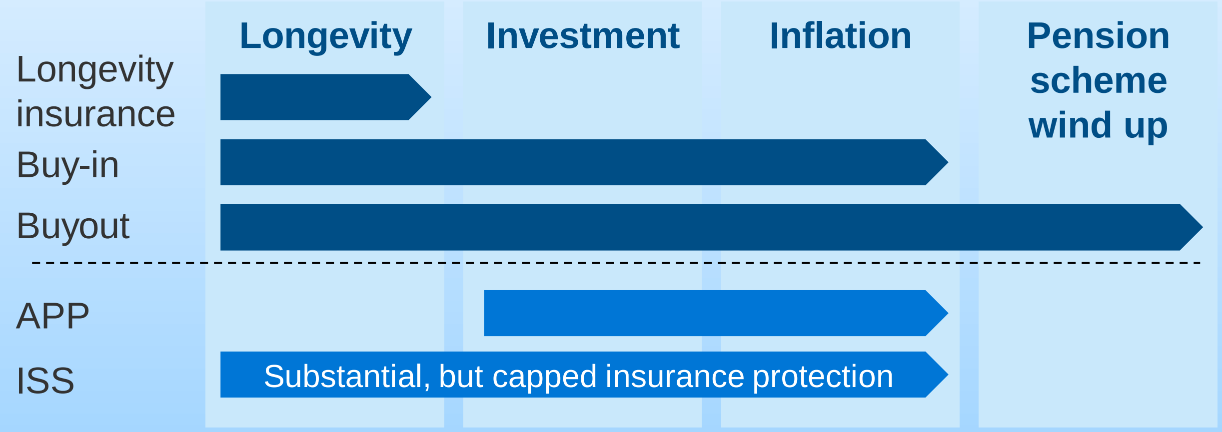
Schemes maturing

More stable funding levels and resiliency during pandemic

Changing longevity expectations



New approaches deliver greater access and flexibility



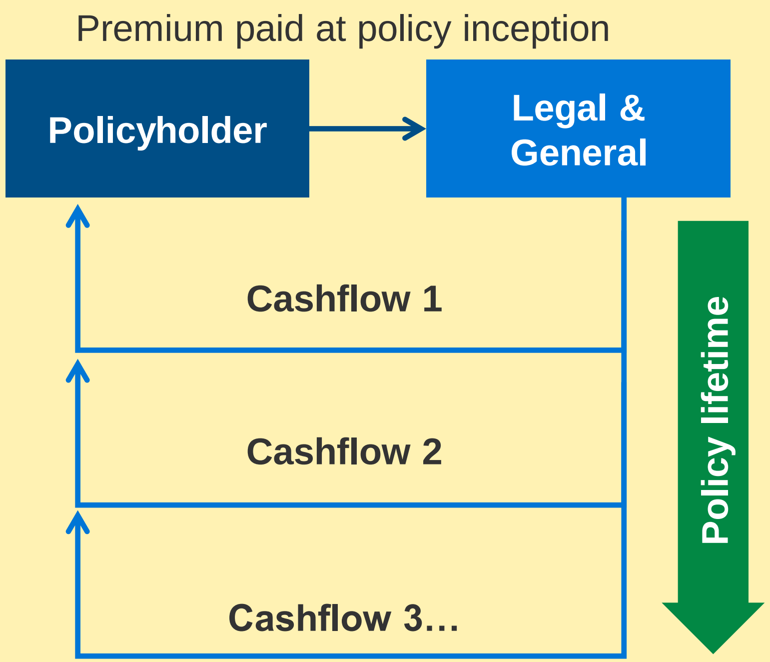
Insured self-sufficiency

Investment solution
LGIM
LGIM delivers a low-risk and holistic cashflow-matched investment strategy

+

Insurance solution
LGRI
LGRI provides a substantial capital buffer to protect against adverse experience

Assured Payment Policy



Pre-agreed series of cashflows – fixed or inflation-linked – which do not vary with longevity or other demographic experience

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Pension risk settlement in uncertain times

Ken Hardman – Lane Clark & Peacock LLP

- 7 December 2020

How has the pensions risk settlement market fared over 2020?

Business volumes have remained robust throughout the Covid-19 crisis

From a pricing perspective, value-for-money improved sharply over the crisis due to movements in financial conditions

Long term drivers continue to push pension schemes towards higher funding levels and more de-risking actions

Buy-in and buy-out transaction volumes on track for second largest year to date

Insurer perspective on the impact of Covid-19

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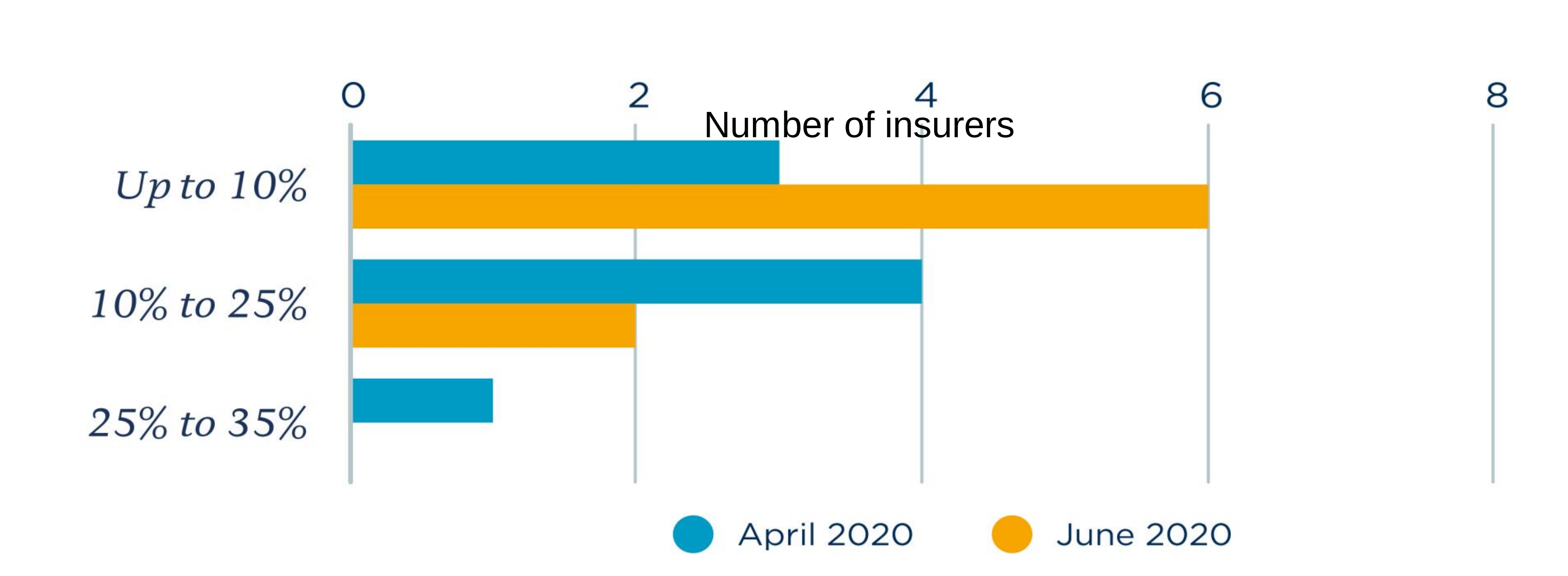
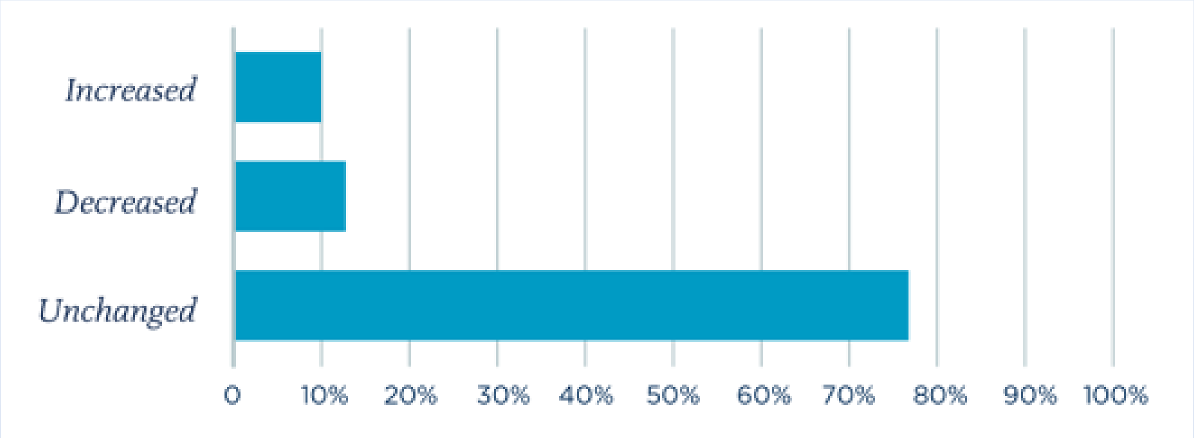
What proportion of the transactions that you have been involved in have been delayed, postponed or cancelled?



Insurer 2020 target volumes largely unchanged

Insurance pricing over 2020

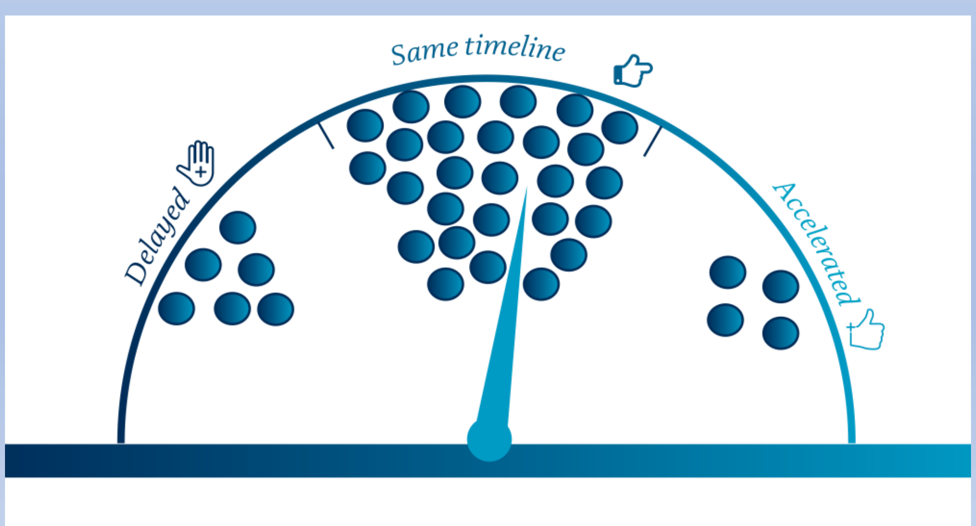
How have pension schemes reacted to the crisis?



Survey of pension schemes in April 2020: What impact has the fallout from Covid-19 had on your appetite to de-risk?

How did LCP clients proceed with transactions in the wake of Covid-19?

LCP completed 10 transactions during the first lockdown – 4 of these were accelerated



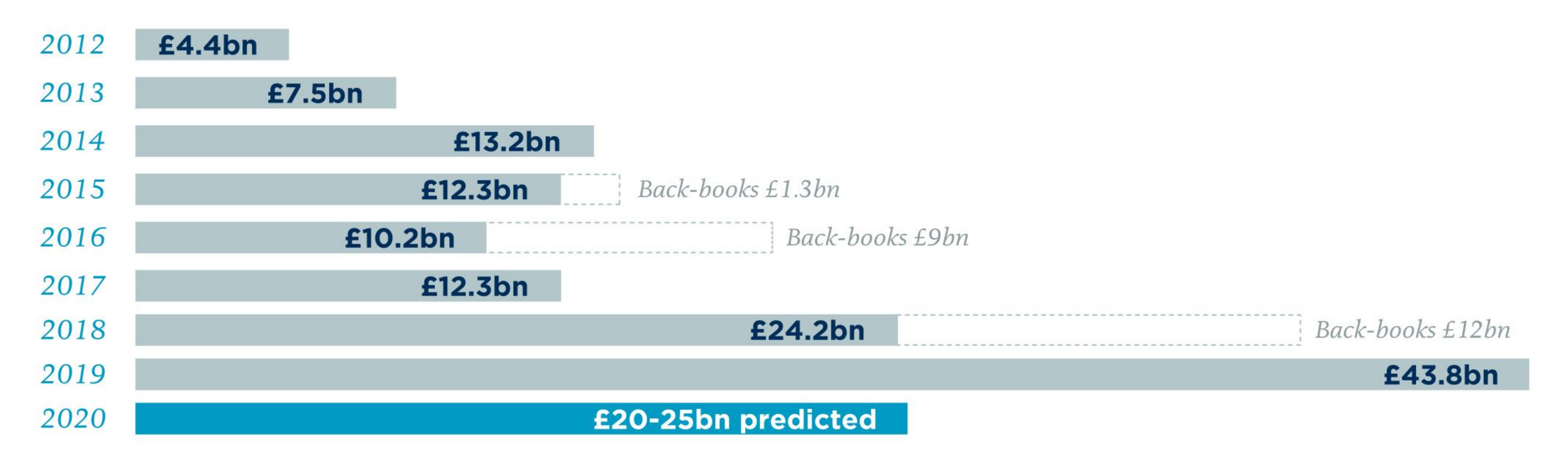
The wider context for pension de-risking

New pensions scheme funding regime will embed de-risking

Pensions bill to increase restrictions on corporate actions

Maturing DB schemes increasingly a legacy issue for corporates

LCP prediction last May:
Market volumes for 2020 to reach £20bn to £25bn



I expect this prediction was slightly conservative and 2020 volumes will be in the £25bn – £30bn range

Long-term drivers will continue to create demand from pension schemes

Our team

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