

Dive into pensions de-risking

# Insurance reforms – what might they mean for pension schemes?

On 21 February, the Government signalled what to expect from the post-Brexit world of UK insurance regulation, including dramatic headlines of a 10-15% cut in capital for life insurers and facilitating the investment of tens of billions of pounds in long-term assets. Could this have a significant impact on the buy-in and buy-out market, or will it turn out to be a damp squib?

## Context, context, context

The property market might all be about location, but here it's all about context. This was an after-dinner speech, not a 100-page consultation, so we should be careful to assign too much weight to the scant detail provided. However, it was the Association of British Insurers' (ABI) annual dinner, and the speaker was the Economic Secretary to the Treasury, so still not to be sniffed at. The insurance industry has been lobbying the treasury for change for some time, and this was a prime opportunity for Government to trail some of the highlights of what is to come. The ABI dinner is a good time to deliver some positive news to the insurance industry, but if there are wrinkles in there that you suspect the industry may not be so warm to, you might well save those for the 100-page consultation. There is also a political element to any messages that attribute positive business outcomes to Brexit. So with that context in mind, let's take a look at...

## The key points

The headlines<sup>1</sup> from the speech are:

- Substantial cut in the risk margin<sup>2</sup>, c60-70% for long-term life insurers (the buy-in/out insurers)
- Review of the matching adjustment<sup>3</sup> requirements, including increased flexibility for eligible assets
- Major cut in reporting and administrative burden

Overall, we were told the measures could cut capital held by insurers by as much as 10-15%.

<sup>1</sup> For a fuller summary of the points covered and a look at the impact on insurers, please see the recent [Newsflash](#) issued by Hymans Robertson's Insurance & Financial Services team.

<sup>2</sup> A component of insurance reserves that was introduced with Solvency II and is prominent for annuity business.

<sup>3</sup> Matching adjustment eligibility ensures that assets are capital efficient – broadly, for assets to be eligible for matching adjustment treatment, they need to have certainty of timing and amount of cashflow income and be a close match to liabilities.

# What might this mean for pension buy-ins and buy-outs?

## Increase in market capacity

When insurers think about how much buy-in and buy-out business they want to attract, they really think in terms of how much capital they want to deploy. If capital held by insurers were to fall by 10-15%, this would allow all existing insurers to write 10-15% more business.

This sounds appealing, and I imagine most will join me in welcoming the prospect of additional supply in the market, but we are some way off annual pension scheme demand utilising the full supply of capital, so I wouldn't expect to see an immediate impact from this additional capacity. The more interesting area to watch in the medium term will be the flexibility around investing in long-term assets such as infrastructure – if insurers are to meet growing pension scheme demand over time and retain commercially attractive pricing, the availability of these assets will be critical.

## Lower pricing

Insurers' regulatory capital needs do feed through into the price that pension schemes pay for buy-ins and buy-outs, though not pound for pound. Insurers will use a whole suite of metrics when setting a buy-in or buy-out price, albeit a key one of these will be the return the insurer is looking to earn on the capital it has to set aside for the liabilities. Less capital required means a higher return on that capital for a given premium, so either the insurer can pocket the extra return or pass it on to the customer with a lower premium. I believe that competition between insurers will drive them to pass on any benefits here to pension schemes.

We do not yet have sufficient detail to consider the quantitative impact on pricing, but from the information released I would expect the impact to be greater for longer duration liabilities – so, more of a possible reduction in the cost of full buy-out than for a pensioner buy-in.

## Less need for reinsurance

Insurers tend to use reinsurance to pass on the longevity risk within buy-ins and buy-outs to other parties, a trend that has been driven in large part by the nature and size of the risk margin. Bringing the risk margin down by 60-70% will make reinsurance look less attractive, as it would make it less costly to retain the risk on insurer balance sheets. There are many reasons why insurers may still use reinsurance – good risk management being a key one – but the economic benefits are likely to be less clear-cut, especially for non-pensioner liabilities. As with any potential reduction in capital, I expect that any benefit insurers see by retaining the risk, will ultimately be passed through to pension scheme buyers through the competitive dynamic of the market.

For pension schemes who are keen to hedge longevity using swaps, this is mixed news. On the one hand, if insurers have less of a need to hedge, then that means more capacity from reinsurers directed towards pension schemes – which will be welcomed by schemes. On the other hand, pension schemes implementing longevity swaps have been able to take some comfort from knowing that if they ever move towards buy-in or buy-out, insurers would have implemented a similar swap themselves, so any cost associated with the swap will have been money well spent. The situation could become less clear, as in the future some insurers might prefer to hold the longevity risk on their own balance sheet at lower cost.

## Lower policyholder security

Put very simplistically, lower capital held means lower policyholder security – it is hard to argue otherwise. But insurance regulation has always been about striking the right balance, holding policyholder security as priority number one, while ensuring that the regime is commercially viable. For many, certain aspects of the Solvency II regime always fell on the wrong side of this line, and change will be seen as possibly addressing these. I do not believe that this speech should concern those who currently hold buy-in policies, or those considering them at the current time, but it will be important to work through the details once available. It is worth also noting that insurers always aim to hold capital in excess of regulatory requirements.

## Damp squib?

Of course, this might all amount to not very much. There were some subtle hints in the speech at aspects of the review that could work against any reduction in capital for insurers. Depending on how these play out, it could be that once we see further details emerge, either through the Government's consultation scheduled for April 2022, or the PRA's more detailed consultation later in the year, the figures the Government has quoted turn out to be more soundbites than reality.

## Get in touch

If you have any questions about anything covered, please don't hesitate to get in touch.



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