Plotting the right course

As the pensions industry reacts to Covid-related volatility, the bulk annuity market carries on from its strong start to the year, still completing deals for schemes large and small. *Pensions Age* finds out from Aviva how the sector continues to glide along on these choppy waters

Navigating the coronavirus pandemic has been a challenge to all aspects of daily life, leaving many feeling lost at sea. But in times like these, plotting the right course is vital and hard work is key to maintaining progress in strong headwinds.

It hasn't been plain sailing for the bulk annuity market within the pensions sector. Having had a record-breaking couple of years, and with a buy-in/out still being the desired aim for so many DB schemes, industry eyes naturally turned to see how it would cope with the waves ahead. And as with any tightly-run ship, the bulk annuity sector has worked hard in the background to ensure business has continued pretty much as usual.

"Aviva's DB Solutions team has been open throughout Covid-19," Aviva managing director of annuities and equity release, Tom Ground, says, "continuing with deals even when the market was very volatile, such as in April. We carried on executing bulk annuity deals throughout the crisis."

Ground explains that Aviva was "probably a little bit conservative" in terms of market spreads, due to concern about availability within the corporate bond market. As a consequence, the company shortened its deal cycle and paused its offering of extended price locks, but has since returned to offering this to schemes.

While some DB schemes that had been hoping to soon de-risk had to wait due to the effects of the coronavirus pandemic – namely those that had been relying on member processes and sponsor contributions to be able to afford to buyout – other schemes found opportunity amidst the crisis.

"There has been a distinction between schemes that have been ahead of the curve with hedging interest rate risk," Aviva annuity asset origination director, Marcus Mollan, says. Those that had concerns that interest rates could go down and have hedged accordingly are in a better position to be able to de-risk than those that haven't, he explains.

"Similarly, those schemes that focused more on cashflow-aware strategies," Mollan adds, "have weathered the market volatility better than equities, which have had a volatile few months."

"Meanwhile, schemes that hold gilts have found that gilt yields had gone down so much they can now afford a buy-in," Ground states. He gives the example of the Co-operative Pension Scheme (Pace) securing a £350 million deal with Aviva in May, its second buy-in transaction deal this year with the company, having completed a £1 billion deal with the insurer in January.

The deal insured the DB pension liabilities of an additional 2,300 Pace members, after the initial Aviva deal covered approximately 7,000 members.

According to Ground, all parties had been closely monitoring pricing, given that current market conditions presented potential opportunities for the scheme.

"The transaction was completed in under two weeks from start to finish, with the existing 'umbrella contract' allowing the parties to transact smoothly and quickly," he explains.

Deals may have continued, but that doesn't mean that annuity insurers were simply able to glide through the market volatility without ever changing course. No, like all successful ships, they had to adapt when the environment called for it.

"Our capital position remained very stable throughout the crisis," Ground says, which was achieved through tracking the contraction of gilt yields and "our hedging process working fantastically".

Aviva is also using the size and strength of its considerable annuity volumes to invest for the benefit of society now and for future generations.

For instance, Aviva has invested around £15 billion in social infrastructure. This includes: £3 billion in the healthcare sector, such as hospitals, GP centres and drop-in clinics, £2 billion in education, such as schools and libraries, another £2 billion in student accommodation and other university financing, £3 billion in rail, £2 billion in renewables, such as offshore wind farms, and their associated infrastructure, £1.5 billion in housing, and nearly £1 billion in local services, such as street lighting, emergency services and policing.

The past two years alone have seen nearly £4 billion of Aviva's annuity premiums invested in this way and in 2019, the company decided to combine its revenue from both bulk and individual annuities, in order to further increase its buying power and make an even greater positive impact.

"We try to be flexible with this activity, depending upon what's happening within this market generally," Mollan says. "For instance, a lot of the private asset projects we were considering investing in have, if not completely switched off, been delayed, so instead we have focused on public assets. Our intention is to work in the background on longer-term projects."

Aviva is currently seeing green shoots of activity, especially in areas that were not so affected by the lockdown, such as renewable energy and ports, he adds.

Investing in social infrastructure projects benefit all generations, as the capital from middle and older generations are being invested for the long-term benefit of younger generations, while the older generations get to receive the interest returns from the projects, which will in turn provide economic prosperity for future generations.

The annuity industry is a way for that capital to be channelled through one part of the economy to another, and therefore from one generation to another, Mollan says.

It is also more receptive to making long-term investments to the benefit of society than other institutions, he adds, comparing the 20-25 year investment insurers make to the 5-6 year time horizon of banks, due to insurers needing to continue paying pensions out for many decades.

This is reassuring to the pension schemes, and their members, who wish for their money to be put to good use but would be too small alone to invest in social infrastructure projects.

"You have to be pretty large to be involved in private equity or loans to fund these assets," Marcus explains, "so it is difficult for smaller-sized pension schemes to access this market."

Aviva "may not be the most aggressive mover" into new and risky situations, Mollan says. Instead, it focuses its investments on projects where its long-term activity ties in to where the economy is going, and where Aviva can provide the benefit of its large scale and expertise.

It is not just expertise it provides, but as a large, well-diversified and financially strong insurer, it also provides security.

"When there is market volatility or an economic shock, it does drive home to people the value of more secure investments," Mollan says. "When markets are performing strongly, people are naturally forgetful that things can change quickly, but both individuals and pension schemes soon realise that managing complex market risks and short-term volatility is not something that they want to do, which this crisis is highlighting to many," he adds.

The pricing, as well as the timing, is also favourable right now for many schemes to look to an insurer to pass on their risks. The current volatility has provided positive market conditions for competitive bulk annuity pricing to occur, Ground explains, which is revealing itself through a significant pipeline of bulk annuity activity for Aviva in the second half of 2020.

So, no matter what the choppy waters may churn up for the second part of this turbulent year, Aviva remains on course to provide tailored de-risking solutions to UK DB schemes of all sizes.

Company profile

Aviva provides life insurance, general insurance, health insurance and asset management to 33 million customers worldwide.

It is one the UK's largest insurers and is also the largest corporate pension provider, with over £70 billion of pension scheme assets under management.

It takes a prudent approach to capital management and has a strong regulatory balance sheet, with Solvency II coverage of 182 per cent for Aviva plc (Q1 2020). Its financial strength is demonstrated by its ratings - AA- (Stable) by Standard & Poor's and AA- (Stable), and Aa3 (Stable) by Moody's (Jan 2020).

Defined benefit solutions

Aviva is a leading provider of tailored solutions for UK defined benefit pension schemes.

It has had over 10 years' experience in the bulk annuities market and has successfully created over 500 bespoke solutions for a diverse range of pension schemes, helping to provide certainty for their members.

All its scheme administration and member service is managed in-house. Aviva's dedicated service teams provide the highest levels of help and support and members will always speak to defined benefits experts if they contact the company.

Whether wanting to protect members or reduce liability, Aviva can help find the best solution for DB pension schemes.

Aviva managing director of defined benefit solutions, Tom Ground
Aviva annuity asset origination director, Marcus Mollan

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