Pensions endgame: Levelling up

Although still rare, longevity swap to buy-in conversions are on the increase as schemes look to make the next step on their de-risking journeys. Natalie Tuck reports

Over the past five years, there has been just eight longevity swap to buy-in conversion transactions completed, but three of those have been in 2020 alone, LCP data shows.

Still a rare phenomenon, these transactions are becoming more popular as schemes that previously completed longevity swaps look to make the next step on their de-risking journey. Pension Insurance Corporation (PIC) chief origination officer, Jay Shah, notes that many schemes enter into longevity swaps with the expectation of converting to buy-in when their funding position improves or they receive attractive buy-in pricing.

"It is not surprising that over time we are seeing an increase in the number of these converting to buy-ins. Buy-in pricing has also improved over that period. The natural maturation of pension schemes (ie the average age of members increasing given schemes are largely closed to new members) also makes buy-ins more attractive," he adds.

Most recently, LV= Employee Pension Scheme converted a longevity swap, held with ReAssure, to a £800 million buy-in with Phoenix Life. The longevity swap had been reinsured by Swiss Re, which will continue to cover the longevity risk by providing reinsurance to Phoenix Life.

Hymans Robertson partner, Richard Wellard, explains that usually in a longevity swap there are three parties – the pension scheme, the reinsurer that takes on the longevity risk and some intermediary structure that sits in between (that may or may not hold some of the longevity risk itself).

"In theory, there are a few different ways that a longevity swap could be converted to a buy-in. In practice, all cases to date have involved the pension scheme entering into a buy-in with their chosen insurer and, at the same time, arranging for the reinsurer to continue to hold the same longevity risk as before, but now taking it from the chosen buy-in insurer rather than the pension scheme."

Wellard explains that buy-in insurers generally like to transfer longevity risk on to reinsurers. The challenges come from the fact that insurers typically arrange the contractual terms for this transfer between themselves and their chosen reinsurer.

"When a pension scheme is looking to convert a longevity swap to a buy-in, it is effectively taking to the buy-in insurer a particular reinsurer counterparty and a particular set of contractual terms that the insurer did not chose and may not suit their specific needs. So, there is naturally a process where the insurer and the reinsurer need to reach agreement on how to adjust the contractual terms the pension scheme agreed when the longevity swap was originally put in place," he explains.

Whether this is complex or not, depends on the terms of the original longevity swap. Generally, however, Wellard says that all parties are well motivated to reach agreement – the insurer wants the new buy-in business and although the reinsurer is not gaining any new business from the conversion, they have and want to maintain strong relationships with the insurers.

"One thing to note is that some pension scheme longevity swaps involve more than one reinsurer, so conversion could involve reaching this agreement between multiple parties," Wellard says.

In terms of the length of time it takes to complete the process, Shah says it is between three and six months from the point that it is agreed that a longevity swap is to be converted, the buy-in insurer has been chosen and the outline of the conversion has been agreed.

Written by Natalie Tuck