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Plenty of life in the longevity risk market

After the finalisation of increasingly big pension risk-transfer deals in the UK, the provision of longevity insurance and reinsurance and the hedging of risk for pension fund managers is expected to grow globally in 2016, says William McCloskey, CFA, vice-president of longevity risk transfer at Prudential Financial

Insurance Risk: Where do you expect most activity to come from in the longevity reinsurance market in the coming year and why?

William McCloskey: The corporate finance benefits of longevity risk transfer can work for any defined benefit pension plan, and this solution is progressively going global. Often leveraged as the capstone to pension hibernation strategies in the UK, we expect the dominant demand for longevity insurance and reinsurance to continue there in 2016. We also see Solvency II as a driving force behind primary insurers' need to hedge longevity risk in their efforts to deploy capital across their balance sheets – a trend that we expect to continue next year.

Furthermore, we anticipate a growing effort by pension schemes in the UK to find innovative avenues for directly accessing longevity reinsurance, as was the case with the British Telecom (BT) transaction. To facilitate that deal, the scheme created its own captive insurer, which insured the longevity risk, and then reinsured the risk to The Prudential Insurance Company of America (PICA), creating a fully collateralised arrangement. We are seeing more and more schemes exploring similar approaches, and we expect these strategies ultimately to expand beyond the UK.


William McCloskey

Insurance Risk: How will Solvency II affect longevity reinsurance and buyout rates, and is any effect already visible?

William McCloskey: From January 1, 2016, Solvency II will require many European insurers to hold more capital in reserve. Some industry observers speculate that Solvency II could raise bulk annuity buyout pricing, but these assumptions are based on trends in insurance costs, and any increase in pricing would be determined by the specific conditions found in a particular pension scheme, such as the proportion of retired and deferred members.

We do not anticipate a material change in either the demand for or supply of longevity reinsurance as the result of Solvency II implementation. As mentioned earlier, Solvency II has created a need for insurers to manage risk more actively across their balance sheets, which in turn increases demand for solutions like longevity reinsurance. We anticipate this trend continuing throughout 2016 and potentially beyond.

Insurance Risk: How deep is the capacity of reinsurers to take on longevity risk?

William McCloskey: The marketplace has observed continued growth in UK pension risk-transfer activity, most notably in the progressively larger deals that have recently occurred, such as the Axa UK group pension scheme's £2.8 billion transaction, the Merchant Navy Officers' Pension Fund's £1.5 billion longevity risk hedge and Aviva's £5 billion longevity swap. These significant agreements show that there is no meaningful constraint on capacity at this time, and that primary insurers are finding the necessary capacity among longevity reinsurance providers to stay active in providing pension insurance.

Prudential Financial, Inc. (PFI) has been a prominent provider of longevity reinsurance since 2011. We have experienced significant growth over the past two years, demonstrated by the landmark reinsurance transaction we completed with a wholly owned insurance firm established by the BT pension scheme. That agreement involved more than $27 billion of pension liabilities. We fully anticipate that our growth will continue, and we are confident in our ability to remain a leading provider of longevity reinsurance globally. Our expectation is one of growth – not only for PFI, but for the industry as a whole.

Insurance Risk: Do you expect to see further innovation in 2016 in how deals are structured?

William McCloskey: Innovation has been crucial to the recent growth in pension risk transfer, as insurers and reinsurers have broken through the early barriers to transactions by perfecting a full range of solutions for pension funds of all shapes and sizes. Since the BT transaction, we have observed a more active market for schemes to directly access longevity insurance and reinsurance in more diverse and creative ways, and we anticipate that trend continuing in the coming years.

Longevity insurance and reinsurance – and pension risk transfer as a whole – is being employed by corporations from various industries. It is flexible and customisable, and enables those fund managers and trustees who proactively manage or transfer pension risk to fund their pension obligations with certainty. We are seeing variations on themes of successful transactions, and those variations are examples of structures that could work for a broader population of pension funds.

We are excited to be working with our clients and discovering new and innovative solutions for their longevity risk management needs, and developing solutions that are customised for their business, and for their members.