MILLIMAN REPORT

Considerations for new entrants to the pension risk transfer market

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Introduction

As described in our 2023 paper "Global pension risk transfer market outlook," DB pension schemes exist in various regions across the globe, and in that paper we covered key aspects of the pension risk transfer (PRT) market in the UK, the US, the Netherlands and Ireland. With the PRT market experiencing a period of growth in many of these countries, there is a potentially attractive opportunity for new entrants to these PRT markets.

In the UK and US, new entrants are a particularly hot topic in the PRT market, as there are several firms who have recently entered the market, with even more firms reported to be considering an entry. Additionally, in the Netherlands some new insurers have entered the PRT market, driven by the market opportunity arising from the Dutch pension reform.

However, there are several potential pitfalls for a new PRT insurer in these regions. Getting the target operating model (TOM, as described later in the paper) right is crucial to being successful in the PRT market, not only to win business in the first place in a competitive market with discerning trustee boards but also to deliver the long-term returns desired by investors.

There are many parallels which can be drawn across the three markets, despite the differing regulatory and competitive environments impacting on the market opportunity. In particular:

- Setting up a brand new insurance company to write PRT business and gaining the necessary regulatory approval is typically a multi-year process, which is likely to be quite a material undertaking. There are case studies of established insurers expanding from their existing insurance lines into writing PRT, and parties considering the acquisition of an existing insurer due to their insurance license.
- In all markets, new PRT insurers are entering a competitive market where they will need to convince trustee boards to choose them over a competitor, and trustees will want to be confident that their customers will be in safe hands with an insurer set up for the long haul.
- There are key considerations within the TOM which are relevant to all markets, including the importance of careful consideration of asset sourcing and management, the benefits of having efficient technology and modelling across pricing and reporting, and having strong administration capabilities.

In this paper, we will cover the most important aspects to consider regarding an entry into the PRT market in the UK, US and Netherlands. For each region, we cover the key considerations for potential new entrants, including:

- The market opportunity in that region, including existing or emerging alternatives to PRT and barriers to entry for firms
- Available options to access the market, including strategies for entry and recent case studies from the US and Netherlands markets
- The key aspects of the TOM that are crucial to success

United Kingdom

Market Opportunity

INTRODUCTION

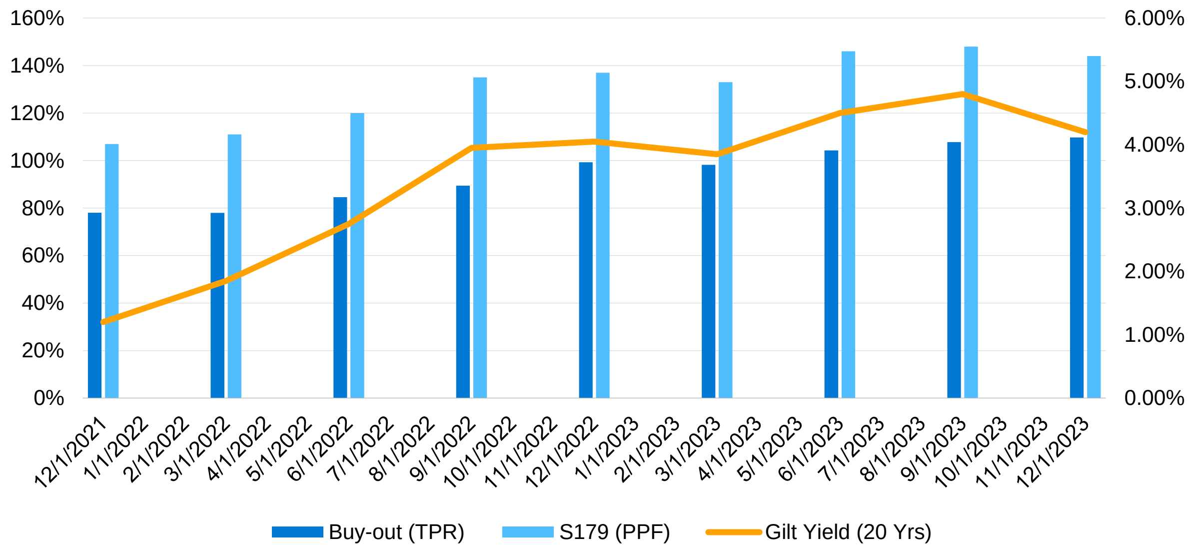
For a firm considering entry in some form into the UK PRT market, it is of course essential to seek to determine the expected future size of market, especially for the segment of the market targeted. Scheme funding levels are a key driver of volumes of PRT business; however, this must also be considered alongside trends in chosen endgame solutions and whether there is a potential impact on the future demand for PRT transactions.

SCHEME FUNDING LEVELS

The funding ratios of UK defined benefit (DB) pension schemes correlate strongly with long-term gilt yields, and Figure 1 shows the relationship over the period from December 2021 to December 2023. Gilt yields have risen significantly over this two-year period, and the 20-year rate is around 4.6% p.a. at the time of writing (September 2024). The result has been a rapid and material improvement in DB scheme funding levels on a buyout basis during 2022 which continues to be supported by elevated gilt yields. Many schemes may therefore have chosen to “lock in” their improved funding levels, in anticipation of a buy-in or buyout.

Late in 2023, market expectations were that the Bank of England would likely implement several interest rate cuts during 2024. As 2024 progressed, there have been material falls in inflation with CPI falling below 2% for the first time since 2021, despite the pace and scale of interest rate cuts being modest. It is expected that there will continue to be interest rate cuts over 2025.

FIGURE 1: UK DB PENSION SCHEME FUNDING LEVELS 2021 - 2023[1]



Currently there is a supportive environment for continuation of the strong demand for de-risking (or endgame) solutions that we noted in our previous paper “Global pension risk transfer market outlook” in November 2023.[2] To illustrate this, we show in Figure 2 data from XPS Group’s bulk annuity market tracker[3] that provides an historical view of PRT market volumes together with recent projections of market volumes developed by Lane Clark & Peacock (LCP). We note that total PRT market volumes in 2024 announced so far are approximately £39 billion,

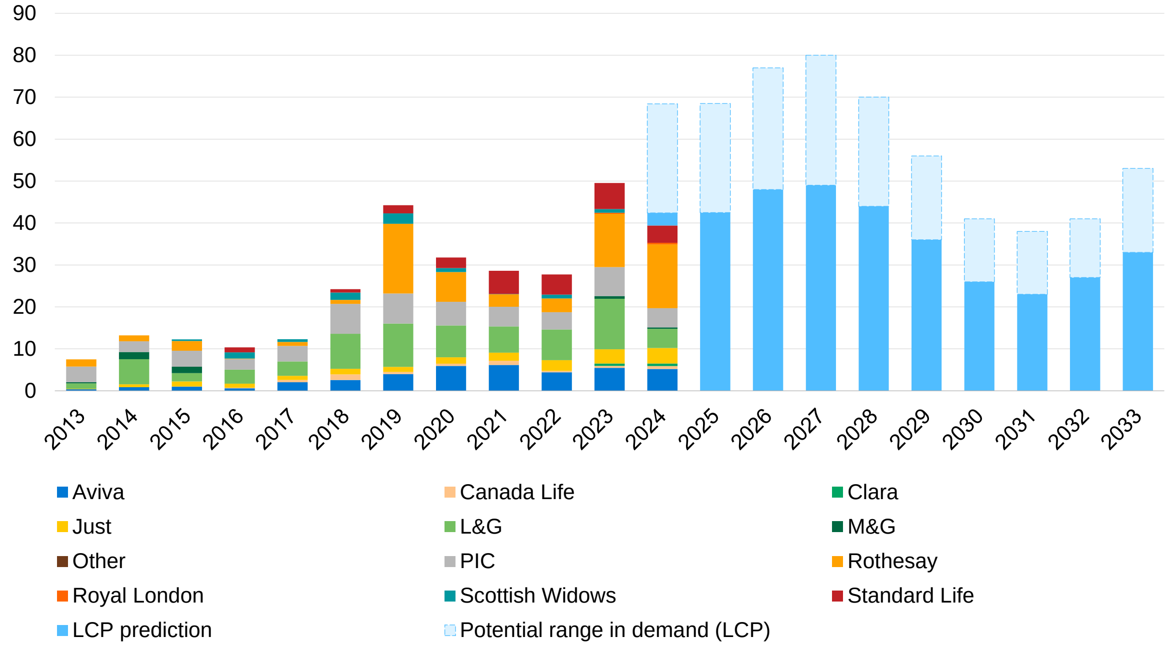
1. The Pensions Regulator (TPR). Review of impact on DB landscape following LDI Episode report.
Pension Protection Fund (PPF). 7800 Index. Available at: https://www.ppf.co.uk/PPF-7800-index.
Bank of England. Gilt Yields. Available at: https://www.bankofengland.co.uk/statistics/yield-curves.

2. Crowson, J., van Delft, L., Manning, K., et al. (November 2023). Global pension risk transfer market outlook. Milliman report. Available at: https://www.milliman.com/-/media/milliman/pdfs/2023-articles/11-7-23_global-prt-market_risk-transfer.ashx.

3. XPS Group. XPS Bulk Annuity Market Tracker. Available at: https://www.xpsgroup.com/what-we-do/technology-and-trackers/xps-bulk-annuity-tracker/.

which is close to market predictions for the year, though this includes a record-breaking £11bn buy-in announced in November 2024[4].

FIGURE 2: UK MARKET BPA PREMIUM VOLUMES: HISTORICAL AND PROJECTED[5]



Research undertaken by the Pensions Management Institute (PMI) and Schroders[6] found that, in response to funding improvements, the majority (83%) of schemes are now defining their endgame strategy, and of these schemes there was a 53/47 split between buyout and low dependency.[7] They also noted that the size of the scheme strongly influenced this decision, according to the research, which showed that larger schemes (over £500 million by assets under management [AUM]) favoured low dependency whilst those with an AUM under £500 million favoured buyout. Additionally, a 2024 survey by Mallowstreet found that 54% of schemes surveyed were targeting a buyout, so whilst there is a range of results depending on the schemes surveyed, a material proportion of schemes in general are considering buyout as their endgame option. The tilt towards buyout amongst smaller schemes especially is not surprising, as these can suffer significant diseconomies of scale. Smaller schemes are also likely to be less well placed to manage a low-dependency asset strategy, which requires technical investment expertise and active oversight from the trustees of the scheme.

The same PMI and Schroders research also noted shifts in the endgame solutions now being contemplated by schemes as follows:

It is also interesting to note how trustees' thinking concerning endgame solutions has evolved in recent years. Until very recently, bulk annuitisation was seen as the only viable option. While 45% of the surveyed schemes are considering this, 40% are considering the alternative of run-off. Many smaller schemes may also be considering the new option of DB consolidation.

Thus, while market activity remains strong at present, it's not a completely cloudless sky for UK PRT insurers as scheme sponsors and trustees are faced with a growing range of options which we discuss in the next section.

4. Sky News (November 2024). NatWest in £11bn deal to offload pension payments. Available at: https://news.sky.com/story/natwest-in-11bn-deal-to-offload-pension-payments-13248774

5. XPS Group. XPS Bulk Annuity Market Tracker. Historical PRT volume data. Available at: https://www.xpsgroup.com/what-we-do/technology-and-trackers/xps-bulk-annuity-tracker/.
Lane Clark & Peacock. Projected PRT volume data. Available at https://www.lcp.com/media/c5chkm0o/lcp-s-predictions-for-the-pensions-risk-transfer-market-in-2024.pdf.

6. Pensions Management Institute (March 2024). Navigating the key issues facing schemes in 2024. Available at: https://www.pensions-pmi.org.uk/knowledge/reports-and-guides/navigating-the-key-issues-facing-schemes-in-2024/.

7. Under a low-dependency funding basis, the cash flows from a scheme's investments are broadly matched to its payouts, and therefore no further contributions are expected from the sponsor.

ALTERNATIVE DE-RISKING APPROACHES

Deferral of de-risking – "Running-on"

Overview

Improved funding levels are clearly resulting in some schemes, which could buy out with an insurer, to contemplate deferring de-risking and opt to run-on[8] the scheme instead. A full exploration of the pros and cons of this is beyond the scope of this paper, but we note that there are some regulatory developments aimed at making this a more attractive option than has been the case historically. In particular:

- In February 2024 the government consulted on a statutory override[9] which would allow all schemes to choose to share surplus with the scheme sponsor subject to a proposed safeguard mechanism based on funding adequacy.
- From April 2024, the tax rate applied to any surplus extracted from a DB scheme was reduced from 35% to the standard corporation tax rate of 25%, and as for some schemes it is expected that more surplus overall could be extracted under a run-on strategy than under a buyout (albeit over a longer time period), the tax rate reduction would therefore have a greater benefit for schemes opting for a run-on strategy. For schemes already set on buyout, however, this is unlikely to be a material factor in their decision whether to buyout.

Implications for the PRT market

Some large and relatively well-funded schemes on a buyout basis may opt to run-on, who otherwise would likely have been approaching the buyout market. Consequently, if running-on does become more prevalent, it has the potential to negatively impact buyout demand.

DB consolidation

Overview

Pension superfunds are a relatively new feature of the market. Thus far, one superfund, Clara Pensions, has been approved by The Pensions Regulator (TPR) under an interim regulatory regime and has completed two deals at the time of writing covering around 20,000 members and £1.2 billion in assets.[10]

The Department for Work and Pensions (DWP) sees scope[11] for superfunds as a de-risking solution where schemes are not able to access an insured solution on a timely basis. To avoid potential arbitrage between the insurance and superfund regimes, entry to a superfund is subject to the so-called "gateway test."[12] The DWP envisages that schemes that are currently funded to between 70% and 90% on a buyout basis are the most suitable for transfer to a superfund and likely to pass this gateway test. The rationale is that such schemes are unlikely to be able to access buyout for some time but are likely able to afford the price of superfund transfer, which modelling by the Government Actuary's Department (GAD) has indicated at around 10% below the cost of buyout.

Implications for the PRT market

The DWP gateway test is clearly intended to target superfund transfers at schemes that are not able to access buyout in the foreseeable future. If this were fully effective, then, in theory, the superfund and buyout markets would be distinct, with superfund transfers having little to no implication for buyout volumes. However, there are reasons to believe such a clear outcome is unlikely—for example, recent experience (see Figure 1) has illustrated just how quickly and significantly scheme funding levels can change, so it is hard to rule out the possibility of schemes entering a superfund that may have become buyout-ready in the not-too-distant future. Having said this, we note that the stated strategy of the only currently authorised superfund, Clara Pensions, is to provide a "bridge to buyout," with the firm aiming to get its schemes into a position to buyout within 10 years.

8. Schemes opting to run-on (also referred to as run-off) have an investment strategy that provides a high probability of meeting payments to members as they fall due, with a low (or no) dependency on the scheme sponsor. This strategy includes investment into a wider range of investment opportunities than those available in a low-dependency strategy.

9. Gov.UK (February 2024). Options for Defined Benefit schemes. Available at: https://www.gov.uk/government/consultations/options-for-defined-benefit-schemes.

10. Clara Pensions (March 2024). Clara appoints new Chief Operating Officer and three other new members of staff. Available at: https://clara-pensions.com/news/clara-appoints-new-chief-operating-officer-and-three-other-new-members-of-staff/.

11. Gov.UK (July 2023). Government response: Consolidation of defined benefit pension schemes. Available at: https://www.gov.uk/government/consultations/defined-benefit-pension-scheme-consolidation/outcome/government-response-consolidation-of-defined-benefit-pension-schemes - July 2023.

12. The gateway test determines whether a scheme is eligible to transfer to a superfund. The test determines whether the scheme can buy out now or in the foreseeable future, and if not then, it may then be eligible for transfer to a superfund.

Given this, buyout volumes may not be materially changed and indeed, in the longer term, should be increased if schemes that would otherwise have been unable to buyout are eventually able to do so. Nevertheless, uncertainty remains as other players may enter the superfund market and adopt different approaches with less benign implications for the insured market.

Public sector consolidator

Overview

A further twist in the DB consolidation tale arises from the DWP's proposals to create a public sector consolidator (PSC). These proposals were announced in the 2023 Autumn Statement and consulted upon by the DWP in February 2024 – "Options for Defined Benefit schemes."[13] The consultation set out an aim to establish a PSC operated by the Pension Protection Fund (PPF) by 2026. The consultation notes that *"entry into the consolidator could also be considered on the basis that a scheme demonstrates an inability to join a commercial consolidator or secure insurance buyout."*

Implications for the PRT market

The implication of the PSC for the buyout market feels very limited. Nevertheless, there may be a second-order impact if the PSC were to take schemes away from the commercial superfund consolidators,[14] at least some of whom would ultimately seek to transfer these schemes to the insurance market.

UK REGULATORY LANDSCAPE

As noted in our 2023 paper on the PRT market outlook,[15] the increasing number of deals in the UK market (and the expectation for this to increase further) has led to a strong focus from the PRA (the UK prudential regulator) on PRT. New entrants will of course need to demonstrate a thorough understanding of the current and future regulatory landscape, as well as establish a good relationship with the PRA from the outset. There is a balance to be struck between operating in a capital-efficient manner and maximising shareholder value, whilst maintaining sufficient buffers and demonstrating a suitable level of prudence.

Solvency UK

UK PRT insurers are regulated by UK Solvency II rules, also known as Solvency UK. In 2023, the PRA consulted on a range of reforms to the Solvency II rules, including to the matching adjustment (MA) and risk margin. In June 2024, the PRA published a second set of proposed reforms[16] to Solvency II in the UK, covering various areas including investment flexibility, credit ratings under the MA and a requirement for senior management to attest to the size of the MA. The final policy came into force on 30 June 2024 and works alongside the UK government's MA reforms to form Solvency UK.

Various changes arising from Solvency UK are having (or are expected to have) an impact on PRT insurers, although new entrants will not need to consider transitional arrangements for Solvency UK and will need to operate in line with current Solvency UK regulations from the outset. Solvency UK is broadly expected to have the following impacts:

- The reduction in risk margin has had a positive impact for insurers; however, the impact is dampened by the use of reinsurance and rises in interest rates.
- The MA reforms are expected to have a mixed impact, with a negative impact expecting to arise from the MA attestation requirement for some firms, as it is generally expected that for some firms there will be a small rise in the fundamental spread (FS). This is partially offset for some providers by improved flexibility for sub-investment grade assets and some limited capacity to invest in a wider range of assets: those with highly predictable (HP) rather than fixed cash flows. It should be noted that some firms already made allowances within their capital requirements for risks that, going forward, will be reflected in the FS, and therefore the MA attestation requirement may not have a material impact for those firms.

13. Gov.UK (March 2024). Options for Defined Benefit schemes.

14. Some concerns have been raised around this point. For example, see the Association of Consulting Actuaries (ACA) public response to the February 2024 DWP consultation: https://aca.org.uk/aca-responds-to-options-for-db-schemes-consultation/.

15. Crowson, J., van Delft, L., Manning, K., et al. (November 2023). Global pension risk transfer market outlook.

16. Ginghina, F., Jenkins, J., Smith, W., et al. PRA PS10/24 – Review of Solvency II: Reform of the matching adjustment. Milliman briefing note. Available at: https://uk.milliman.com/en-gb/insight/pra-ps-10-24-review-solvency-ii-reform-matching-adjustment.

Funded re

One key focus of the PRA has been the use of funded reinsurance (or funded re), also referred to as asset-backed reinsurance. Under a funded re contract, the reinsurer takes on a proportion of the insurer's existing or new liabilities in return for a single premium. Funded re has been used by many UK insurers, as it often improves capital efficiency on the tranches of business covered, and in addition reinsurers have been known to offer competitive pricing for this type of business, allowing insurers to compete more effectively. There are however various risks arising due to the use of funded re, including a material exposure to the risk of reinsurer default, which is more pronounced for funded re than the more widely used longevity reinsurance. For longevity reinsurance, the insurer's economic exposure to the risk of the reinsurer defaulting is limited to the difference in the actual and the expected pension cash flows. By contrast, under a funded re contract, the reinsurer is responsible for paying the whole liability agreed to be covered, and therefore the insurer is exposed more materially to the risk of reinsurer default. As a result, the collateral arrangements attached to funded re contracts are critical to achieving adequate security for the ceding insurer.

New entrants are likely to rely on commitment from institutional investors for their capital needs for the first few years. However, it may be possible for a new entrant to consider some use of funded re after they have generated a material back book, subject to sensible limits driven by the risk appetite for counterparty credit risk exposure, e.g., the size of business covered by funded re may be limited to a certain percentage of the back book.

The PRA published its final policy on funded re in July 2024,[17] including detail of the requirements for recapture plans, collateral policies and setting limits on exposures to single (or highly correlated) counterparties using an "immediate recapture" metric. The impact of the new regulation on the market's usage of funded re is currently unclear.

Management of the MA

It is essential that, once a new entrant has approval to use the MA, the insurer allocates sufficient resources with the necessary expertise to manage it. This is because the MA impacts not only the solvency position and balance sheet but also the pricing that an insurer can offer due to the impact it has on the capital requirements. In our experience, where we have seen companies entering the PRT market, firms who perform better from a start-up position are those who have managed to put the right resources behind the management of the MA.

Accessing the market

SETTING UP A NEW INSURER

Establishing a new insurance company represents one avenue for market entry. This method involves creating a brand new insurer from scratch, requiring an application for an insurance license in the UK. The regulatory process is often viewed as a significant hurdle due to the comprehensive planning required and the time-consuming nature of obtaining approval, a process that can span multiple years.

The application process demands early and proactive engagement with UK regulators, specifically the PRA, which ultimately provide the authorisation, and Financial Conduct Authority (FCA). The steps towards authorisation are outlined below:

1) **Early stages:** At this initial phase, entities considering becoming insurers should consider fundamental questions about their intended operations and whether an alternative structure might better serve their purpose. Engaging with both the FCA and PRA is crucial during this period, and a high-level overview of the proposed activities is discussed with the regulators.

17. Bank of England, Pensions Regulation Authority (July 2024). Funded reinsurance, Supervisory statement SS5/24. Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2024/ss524-july-2024-update.pdf.

2) **Pre-application:** This more formal stage involves producing and sharing documents, such as a draft business plan that will eventually form part of the application, and having detailed discussions with regulators to ensure that the aspiring insurer comprehends all requirements. This phase helps the regulators to identify and address any early concerns they may have. The structure follows a series of meetings described below:

    a. Initial meeting: Following the submission of a high-level summary of the business plan, this meeting serves to elaborate on the proposed operations and allows for queries about the authorisation process.

    b. Feedback meeting: After reviewing a near-complete business plan and other draft documents that support the application, the regulators provide feedback, allowing for changes to be made before the formal application.

    c. Challenge sessions (if necessary): These discussions delve deeper into the proposal, with the expectation that feedback will be integrated into the final application.

3) **Application stage**: Both the PRA and FCA evaluate the business plan, focusing on various critical aspects such as viability, financial resources, funding sources, ownership, governance, risk management, customer experience, outsourcing, IT infrastructure, policies and continuity plans.

A new PRT entrant should focus on how they can leverage any existing expertise to the new venture when describing these key business plan aspects within their application. For example, drawing from Milliman's experience, we have assisted a prospective new PRT market entrant in producing a business plan application that highlighted an existing strong asset management operation and utilised an existing client base (where those asset owners were pension schemes) when describing the business strategy and particularly the rationale of how the company would win business.

A new entrant would also need to consider how they intend to raise capital and the implications of being a new entrant in doing so. Credit rating agencies are likely to view an untested business model with some caution when deciding on a rating, as seen when Fitch Ratings rated Warwick Re.[18] Such decisions, including the issuance of debt, may be impacted by this.

Establishing a new insurance entity offers several distinct advantages, including the opportunity to define a bespoke strategy and operating model from the ground up. This approach allows for the adoption of successful market practices while avoiding strategies that have historically resulted in inefficiencies. Setting up operations within the UK provides full access to the domestic market, unlike indirect entry methods such as reinsurance, which are subject to constraints imposed by the PRA. Additionally, a newly established insurer would not inherit the "baggage" or legacy issues that often accompany the expansion or acquisition of existing entities.

Conversely, the competitive landscape is difficult, with numerous established players that may well be preferred by schemes looking to transfer their liabilities. Building customer confidence in a new entrant will require time and a demonstrable track record. Furthermore, the significant costs associated with establishing a new insurer from scratch must be carefully considered.

In our experience, a thorough and well-thought-out set of financial projections for the medium to long term, based on expected business volumes and current market conditions, is vital to help the PRA in their review of the application. Milliman has assisted in this area by providing modelling solutions to prospective new entrants, helping them demonstrate the financial viability of their venture to the PRA.

The PRA's assessment can last six to twelve months, depending on the application's completeness, culminating in a formal decision on the new insurer's approval.

Upon approval, the new insurer will undergo ongoing supervision similar to all authorised insurers. While the outlined steps cover the formal application process, additional measures, such as implementing actions from the business plan and applying for MA or volatility adjustment (VA) (as well as a full or partial internal model) to

18. Fitch Ratings (December 2023). Fitch Publishes Warwick Re's 'BBB' Insurer Financial Strength Rating; Outlook Stable. Available at: https://www.fitchratings.com/research/insurance/fitch-publishes-warwick-re-bbb-insurer-financial-strength-rating-outlook-stable-08-12-2023.

remain competitive by optimising capital requirements, will be necessary. Some of these actions, such as the application process to gain MA approval from the regulator, may be possible to be done in parallel to the application for the insurance license from the UK regulator.

In the UK, an example of this approach is a new entity backed by Brookfield,[19] which has applied to the PRA to set up an insurer with the intention of participating in the UK PRT market.

EXISTING INSURER EXPANDING INTO PRT

Another viable strategy for entering the PRT market involves an existing insurer already registered in the UK, leveraging their existing capabilities to start writing PRT business. This approach offers several advantages, chief among them being already authorised by the UK regulator, as they are already operating within the insurance domain and do not need to progress through the steps as described above for a new insurer, although some permissions would need to be updated to reflect the relevant class of business. Furthermore, an existing insurer will already have certain roles and functions already in place in the organisation, and to adapt these for functions for a new line of business may be relatively more straightforward when compared to setting up an entirely new insurer.

However, there are several considerations for existing UK insurers aiming to venture into the PRT market:

- **Updates to the operating model**: Existing operational frameworks may need adjustments to accommodate PRT activities. This could involve updating systems, models and other internal processes to manage the new risks from PRT business effectively. The extent of the cost and effort required will depend on how adaptable and malleable the existing infrastructure and processes are to accommodate a different line of business than they are used to.
- **Updates to regulatory approvals**: Insurers with existing Solvency II reporting approvals, such as the use of internal models, the MA, or the VA, will need to revise these in light of incorporating PRT operations. This includes modifications to internal models and the management of MA portfolios.
- **Impact on existing business**: Integrating PRT business will necessitate operational changes, including model updates and potentially expanding or retraining the workforce. It could also divert management's attention from other business areas. Additionally, the integration of PRT operations should be assessed for its overall impact on the business, including the potential diversification benefits from longevity risks, which could lead to reduced capital requirements.

Since the beginning of 2023, the UK has seen two existing insurers (Royal London and M&G) enter the PRT market with announcements of their initial deals, as well as other existing insurers, such as Utmost[20] announcing their intention to enter the market.

Investing in an existing insurance company

Some entities interested in entering the market may find that investing in an existing insurance company presents a more accessible method. The allure of potential high returns over a long time horizon from such investments, coupled with the capital-intensive nature of the PRT business, makes it a particularly attractive option for entities with substantial capital looking for a place to grow their investments.

However, investing in an insurance company is not without its challenges. Potential investors may face obstacles, such as limited knowledge of the full scope of the business operations and the risk of uncovering less favourable aspects of the business, which could expose the new owners to unforeseen liabilities. If there are issues emerging within the company, it may be costly to remedy these, and therefore an appropriate valuation in any bid to acquire an insurer should undergo a thorough due diligence process. Additionally, as an investor, regulation can affect the ability to extract surplus from a venture, especially during a change of ownership. Consequently, the regulator can influence the potential returns an investor is able to achieve.

19. Kokoszka, P. (July 2024). Brookfield's entry into UK bulk annuity market marks next wave of new entrants. IPE.com. Available at: https://www.ipe.com/news/brookfields-entry-into-uk-bulk-annuity-market-marks-next-wave-of-new-entrants/10074542.article.

20. Cundy, C. (April 2024). Utmost confirms plans to enter UK bulk annuity market. InsuranceERM. Available at: https://www.insuranceerm.com/news-comment/utmost-confirms-plans-to-enter-uk-bulk-annuity-market.html.

It's important to note that investing in an existing insurer merely changes its ownership without increasing the overall number of competitors in the market. Consequently, this does not expand the range of available insurers to pension schemes seeking to transfer their risks, although it could increase market capacity by providing additional capital to the acquired firm.

In the UK, there has been speculation[21] about entities showing interest in investing in some of the established privately owned players within the market. However, at the time of writing, no significant recent transactions have been confirmed.

Providing funded re to the UK market

Providing funded reinsurance to the UK PRT market, whether as an existing reinsurer or a new entrant, presents an alternative pathway to gain market exposure. As previously discussed, the use of funded re has been on the rise in the UK, offering entities the opportunity to gain indirect market access.

Reinsurers have the option to establish an entity in another jurisdiction, thereby being authorised by that country's regulator, whilst still providing capital and gaining exposure to the UK market. Notably, some reinsurers have successfully provided capital to the UK PRT market by setting up operations in regions such as Bermuda. These firms should also take note of the PRA's final policy on the use of these arrangements, as this would likely diminish the willingness of UK insurers to transfer risks using this method.

STRATEGIES FOR ENTRY

In order to be successful, new entrants will need to have a clear view of how they plan to win business, i.e., their unique selling proposition, and this should be aligned with their targeted segment of the PRT market. We will now consider both of these factors in more detail.

Target market

There are various factors to consider when determining the target client, including the size of scheme, membership (pensioners and/or deferreds) and the complexity of scheme benefits.

New entrants must consider the size of schemes they wish to target, whether this will be one or a combination of small (up to £200 million), mid-sized (£200 million to £1 billion), or large (£1 billion+, also known as "jumbo") schemes. Certain sizes of scheme, in particular mid-sized schemes, are more competitive and thus are likely to be more difficult to win for non-established players. One option for new entrants to try to win these deals could be to offer a deeper discount for the initial few deals in order to build a track record; however, this may be insufficient in isolation to convince the pension scheme trustees to choose a new entrant over an established player. Although small schemes are numerous and often less competitive, with all sizes of deals there is a degree of core work necessary regardless of the premium size as well as the insurer's overheads to be covered, so making efficiencies and writing sufficient volumes will be key for this segment of the market to be feasible or profitable. Large schemes generally come with increased complexity and lengthy processes, so are unlikely to be feasible for a new entrant without a track record and well-established processes.

New entrants also need to consider various other scheme factors when deciding on the type of scheme they wish to target, including the proportion of deferred annuitants within the scheme (and whether to write deals with deferred annuitants at all, at least initially), and the complexity of the scheme. Deferred annuitants are viewed as more complex to insure than immediate annuitants for a few reasons:

- They have a longer cash-flow duration than immediate annuitants, sometimes over 20 years, for which it can be difficult to find sufficient matching assets.
- They are more expensive to reinsure (although we note that reinsurer pricing for deferred annuitants has improved over recent years).
- Members can transfer out, and therefore the insurer needs to be able to offer transfer values for buyouts with deferred annuitants.
- The cash-flow profile is lumpy due to the option for members to take tax-free cash.

21. Financial Times. Apollo, Carlyle and KKR weigh bids for Pension Insurance Corporation. Available at: https://www.ft.com/content/a4d2867f-0c3d-4e0d-aaba-d11f60af8592.

Scheme complexities can be present due to unusual scheme benefits and rules—for example, unusual inflation linkages or benefits such as bridging pensions.[22] They can also be present due to non-standard transaction features, such as requests for a deferred premium or an in-specie asset transfer. Some complexities are open for negotiation, and others must be accepted as part of writing that particular deal; this is discussed in further detail in Milliman UK's article on complex PRT deal features.[23] New entrants should determine the types of complexity that they feel comfortable to price and manage, and their risk appetite for each of these complexities. In our view, it is likely that new entrants will focus on writing "vanilla" (i.e., non-complex) schemes for the first few years until they become more established. It is also likely that the regulators may prefer this cautious approach; any business plan that is too ambitious in terms of anticipating writing complex schemes from the outset is likely to come under elevated regulatory scrutiny, and applications will require substantial evidence to demonstrate feasibility and having the required capabilities in place.

Strategy to win business

For schemes of any type, there are various aspects (aside from the price) that trustees are likely to consider when making their decision on their chosen provider. These aspects can be key for a new entrant to win business. This can include having some sort of existing relationship with the trustees or sponsor, therefore having "warm leads"—for example, as their asset manager or provider of other products or services.

A key aspect which can impact the decision of trustees is having a trusted brand with a clearly stated purpose and business philosophy. A poll carried out by PIC[24] of various trustees, consultants and lawyers found that the majority (63%) in attendance thought that the biggest challenge facing new entrants was their track record with trustees. Having a track record or brand name will take time to develop for a new entrant, unless they are an existing insurer already selling other products, or part of a larger, well-established group. Member experience post-buyout is also an important consideration for trustees of schemes considering a buyout, as the scheme members would then become customers of the insurance company. It is important for an insurer to be regarded as having high-quality administration capabilities, perhaps through a well-established third-party provider. Other factors that trustees may consider include having a strong financial solvency level and a commitment to sustainable investments.

One option to build the track record necessary to be competitive in the PRT market is to do a "dry run," if possible, with the new entrant company's own pension scheme. For example, Royal London completed a deal with its own DB pension schemes in 2023, ahead of its planned participation in the wider PRT market. This dry run would act as a proof-of-concept, allowing the new insurer to test its end-to-end deal process, including testing the pricing and reserving models, operational and onboarding aspects, and investment capabilities. This will help demonstrate to the market, including trustees, that the new firm has the capabilities to write business, and fill any gaps in expertise before writing schemes in greater numbers. However, we do note that the trustees of the company's own DB scheme may seek additional quotes from other insurers to be satisfied that the pricing and terms offered by the in-house insurer are in line with the market.

Target Operating model

OVERVIEW

The design of the target operating model (TOM) is a crucial element to the success of a new PRT market entrant, and indeed for the success of existing PRT writers. A TOM sets out how the firm will to operate in order to deliver on its targeted business metrics, and covers a range of areas including capabilities, people, processes, technology and outsourcing. In this section we touch on a range of the most relevant TOM areas for PRT insurers, focussing particularly on the choice of carrying out key business functions in-house or outsourcing to a third party (either initially as a temporary measure or on a more permanent basis). New entrants will need to be clear about where their strengths and expertise lie, and for which functions there is the opportunity to save costs

22. A bridging pension is a benefit that is temporarily higher at outset and then reduced when the member is at state pension age (SPA).

23. Ginghina, F., Ford, M., & Crowson, J. (June 2024). Complex bulk purchase annuity deal features. Milliman.com. Available at: https://us.milliman.com/en/insight/complex-bulk-purchase-annuity-deal-features.

24. Pension Insurance Corporation (October 2024). PIC's poll of trustees and advisers anticipate bulk annuity market in 2025 will be up to £60 billion. Available at: https://www.pensioncorporation.com/news-insights/press-releases/2024/pic-s-poll-of-trustees-and-advisers-anticipate-bulk-annuity-mark.

or achieve better returns by carrying out that function in-house, and conversely which functions may be best suited to a third party. This choice need not be static, and indeed as the insurer gains experience, they may seek to bring further functions in-house. Many aspects of the TOM discussed here are also relevant for new entrants within the other two markets discussed in this paper.

ASSET MANAGEMENT

Having set the desired investment strategy, execution of the strategy requires a choice of which asset classes are best sourced and/or managed in-house, and which are best sourced and/or managed by a third party. It is possible for an insurer to outsource the origination and/or the management of certain types of assets only—for example, liquid credit of certain denominations, or specialised illiquid assets where it does not have the relevant expertise. This decision of what types of asset origination and management to outsource will depend on the expertise of the individuals within the insurance company, any existing or new infrastructure that will be in place to originate and manage such assets, and of course the costs charged by a third party. Insurers may consider whether they can obtain competitive pricing for the outsourcing of the origination and management of so-called vanilla asset classes where there is no material competitive advantage of using in-house resources. However, we note that it is becoming increasingly common for the sourcing and management of liquid assets to be carried out in-house, with external asset managers more likely to be used for sourcing and managing specialised illiquid assets. It can be a competitive advantage if a PRT insurer has a shareholder or another group company with asset origination or asset management capabilities.

CAPITAL AND LIQUIDITY

Following a transaction with a pension scheme and the payment of a premium, PRT writers trade to invest assets in line with what was assumed within their pricing basis. If the new entrant is on a Standard Formula solvency capital requirement (SCR) model, there are limitations, as the Standard Formula approach may not fully reflect the characteristics of some assets and could result in relatively penal capital treatment in the SCR for some asset types. Even if a new entrant did have approval for an internal model, it might be the case that they are not able to fully invest in their planned portfolio due to difficulty sourcing the assets. New entrants are initially unlikely to have a warehouse of illiquid assets which can then be allocated to deals, and therefore it may take some time to source these. If it takes longer to reach the target portfolio than assumed within the pricing basis, this could result in lower than expected earnings and higher capital requirements arising from a reduced MA and potentially higher SCR, creating a capital drag which could reduce the return on capital for shareholders, or even necessitate capital injections.

It is also essential that there should be expertise present within the insurer on liquidity matters to reduce the risk of running out of liquid assets, with a particular focus on the risks associated with liquidity-intensive hedging programmes.

MODELLING CONSIDERATIONS

Having efficient models and processes in place for pricing and reporting is key for PRT insurers. Models should aim to reduce as far as possible the need for manual data manipulation, benefit set ups and basis inputs within pricing, as well as having fast run times to be able to generate cash flows under various scenarios for schemes with large data sets.

Elements of the process can be automated within the model for speed and to reduce risk of error. For example, this could include reading in the latest data on discount and inflation curves automatically for the given financial conditions date, having a built-in data checker to identify data issues and anomalies, and having common benefit rules already set up in the core model (e.g., for valuing guaranteed minimum pension (GMP) benefits in line with "Barber" equalisation rules[25]). Models used for pricing should also be robust enough to remain usable and accurate over time, as they may be required on a more ongoing basis—for example, to provide regular cash-flow forecasts to reinsurers. It is also key for there to be an efficient point-of-sale process for the data to be transferred to the reporting system. This could be achieved by having one modelling system for both pricing and reporting, to avoid potentially arduous reconciliation exercises between two systems.

25. On 17 May 1990, the European Court of Justice ruled that occupational pensions are a form of deferred pay and therefore pension schemes must treat men and women equally; this is known as the "Barber" judgement. This has been incorporated into UK law and there have been various subsequent rulings. Fundamentally, trustees must provide the same historical benefit to male and female members for GMPs accrued between 17 May 1990 and 5 April 1997 (i.e. when GMP accrual ended).

We do note that some aspects of the modelling process—for example, the generation of cash flows to be used in pricing—can be outsourced to a third party for all or particular types of schemes. This choice will depend on the expertise in-house and weighing up the time/cost of doing so.

PENSION SCHEME ADMINISTRATION CAPABILITIES

An entity entering the UK PRT market must ensure that it has an effective administration system capable of managing the complexities of PRT business data. For entities writing buyouts, of vital importance is an administration team capable of dealing effectively with day-to-day queries from pensioners who have become customers of the insurer, as well as notifications of deaths, goneaways[26] etc.

It is therefore in our view likely that a new entrant setting up a new insurer would seek to use a third-party administrator with a strong track record of customer satisfaction, unless it had pre-existing systems and was prepared to invest in its administration capabilities. Acquiring an existing player is likely to involve much less effort, as administrative capabilities (either in house or via an existing outsourcing arrangement) will already be in place.

PEOPLE

Entering the UK PRT market requires a highly skilled workforce with specialised expertise. While the UK insurance industry boasts many talented professionals, finding individuals with niche PRT-specific skills may be challenging, as they are often already employed by existing insurers.

Skilled individuals are essential in several key areas. BPA insurance necessitates capabilities in asset origination, capital and asset liability management, capital modelling including for credit and longevity risk and the MA in stress, and BPA pricing. In the asset origination team, for example, professionals who understand asset requirements and the availability of illiquid assets in the UK are particularly valuable. These assets are crucial for backing the liabilities of a pension scheme, which in turn can enhance the pricing offered to pension schemes.

For individuals discharging approved person or senior management function (SMF) roles, such as the chief actuary function, chief risk function, etc., new entrants may seek out people already approved by the PRA/FCA, or those who have past experience fulfilling such roles. In our experience, it is also the case that these roles can be fulfilled by an experienced external consultant on an interim basis, as hiring individuals with sufficient experience and regulatory approval into a new company can take time. Alternatively, individuals taking on these roles for the first time could be mentored by an external consultant with substantial experience of these roles, to enable them to successfully transition into the role.

Conclusion

With substantial demand expected from UK pension schemes for the foreseeable future, there is a potential opportunity for firms seeking to enter the PRT market. Despite the growing popularity of alternatives such as “running on” which may suit some schemes, a substantial proportion of UK pension schemes continue to target a buyout.

However, as there are now nine PRT-writing insurers in the UK and potentially more on the horizon, a new entrant will need to carefully consider how they will win deals to get a share of the market, and offering a discount to the market rate may not be sufficient to get business through the door. Additionally, for the business to be a viable proposition, investing time and allocating the necessary expertise to getting the target operating model right will be an investment very well spent, for PRT insurers old and new alike.

26. "Goneaways" refer to scheme members where the scheme provider has lost contact with the member—for example, due to out-of-date or incomplete data records for correspondence address.

United States

Market Opportunity

The past several years have seen a significant increase in activity for the United States pension risk transfer market. Single-premium pension risk transfer activity reached a record high in 2022, with transaction amounts of $51.9 billion, representing an increase of over 36% from the prior year, which itself represented the highest level of activity in the past decade. While transaction totals declined to $45.4 billion in 2023, the number of transactions in grew by 25% relative to 2022, showing a sustained level of both supply and demand over multiple years.

The first quarter of 2024 has continued the trend; historically, market activity is the lowest in the first quarter and picks up later in the year, as plan sponsors generally aim to complete transactions before year-end. The $14.2 billion in transactions in 2024 Q1, however, is higher than either of the final two quarters in 2023, suggesting that the significant market activity seen in recent years will continue into 2024.

Despite the significant recent market activity, there is a substantial amount of pension liability still outstanding that could continue to fuel market activity in the years to come. As of 1 January 2023, there were over 11,000 plans with plan assets over $1 million covered by the Pension Benefit Guaranty Corporation (PBGC), with a combined liability of over $2 trillion (on a PBGC liability basis). While the liability does not directly transfer to transaction amount, it does contextualize the significant size of pension plans that may look to transact at some point in the future.

Accessing the market

OVERVIEW

Recent entrants to the US PRT market have typically leveraged existing insurance companies and platforms. This is particularly true for insurers participating as direct insurers in the PRT market. In the US, setting up a new life insurer is a multi-year investment often requiring application and product filings on a state-by-state basis. For those interested in PRT business, US Department of Labor (DOL) fiduciary standards governing PRT transactions may present additional challenges for a newly formed insurer. For these reasons, the process of setting up a new US insurer is outside the scope of this paper, as most new PRT writers have taken alternative approaches to enter the market. For example, companies can accelerate the process by acquiring an insurance platform with legacy insurance business, as having other business lines provides beneficial risk diversification. While it is most advantageous for the acquired platform to have existing PRT product filings, a number of companies have successfully entered the PRT market by leveraging an existing insurance platform.

RECENT CASE STUDIES

A recent example of a successful entrant is Fidelity & Guaranty Life (F&G). F&G was established in 1959 and headquartered in Iowa, and historically sold their products through retail channels, focused on universal life, fixed annuities and fixed index annuities. In 2021 they expanded their institutional business into the PRT space. Since entering this market, F&G has seen rapid growth in executing PRT transactions, reaching over $5 billion of cumulative PRT sales in less than three years.

Another recent major player in the market is RGA, one of largest US reinsurers focused on life and health reinsurance solutions. They were initially established in 1973 and headquartered in Missouri, but now have a global presence with $3.7 trillion of life reinsurance in force. In recent years, RGA has been active in the jumbo US PRT market. They have partnered with Legal & General Retirement America (LGRA) on an split-transaction approach to PRT, in which LGRA provides the servicing and administration of the contracts. RGA completed one $309 million transaction with LGRA in May of 2023 and another $700 million transaction in March of 2024. Subsequently, RGA partnered with Prudential on another large PRT transaction in March of 2024, splitting $5.9 billion of pension obligations, while Prudential assumed responsibility for administration. RGA has also sponsored Missouri-based reinsurance sidecar Ruby Re at the end of 2023, seeded with existing asset intensive business. The sidecar structure, which can be on- or off-shore, allows investors such as private equity firms to access insurance markets; a sponsoring insurer may provide liabilities via reinsurance to the sidecar, while investors provide the necessary capital. This particular sidecar was retroceded $2.5 billion of liabilities from RGA at the end of 2023, and it is expected to receive a quota share of up to 25% of future RGA transactions.

F&G, RGA and other new market entrants must be able to satisfy plan fiduciary considerations around financial strength, risk management and benefits administration. After Executive Life Insurance Company failed in the 1990s, the DOL published Interpretive Bulletin 95-1 (DOL IB 95-1) which provided guidance on fiduciary standards required of plan sponsors, giving criteria for plan sponsors to consider when selecting the “safest available” annuity. These criteria include the insurer’s investment portfolio characteristics, level of capital and surplus, and the size of the insurer relative to the contract itself. Plan sponsors will also scrutinize an insurer’s risk management processes, statutory accounting statements and ratings history. Entities interested in entering the market must show strength in these categories to satisfy the “safest available annuity” standard, which is a foundational threshold to competing in the market.

REGULATORY AND LEGISLATIVE DEVELOPMENTS

Recent legislation and regulatory changes impact potential new life insurer entrants as they consider entering tin the US PRT market. Here are some examples of legislation and regulatory changes that are relevant:

The SECURE Act (Setting Every Community Up for Retirement Enhancement Act) includes several provisions that enhance retirement security, such as increasing the required minimum distribution age and allowing more flexibility for annuity options within retirement plans. Plan sponsors have safe harbour to offer annuities within defined contribution plans. Plan sponsors that are paternal in nature that have been shying away from terminating their defined benefit plan may feel that they can now do so, by allowing a lifetime income protection option in their defined contribution plan. SECURE 2.0 further promotes the use of lifetime income products, such as annuities, within defined contribution retirement plans.

Statutory regulations require that companies maintain adequate reserves and capital to ensure that policyholder obligations are met. In the US, statutory requirements for PRT and other insurance products fall under the supervision of the National Association of Insurance Commissioners (NAIC). Currently, statutory reserves reflect a deterministic calculation with prescribed valuation rates (based on transaction date) and mortality assumptions. Required capital is determined based US risk-based capital (RBC), a factor-based framework with prescribed factors for asset risk (varying by asset class), insurance and market risk, and business/operational risk. Many companies writing PRT business will target an RBC ratio to address regulatory, rating agency and internal risk considerations.

The NAIC regularly updates its model regulations, with significant recent changes including updates to the Standard Valuation Law and the Valuation Manual. In particular, major updates to VM-22 regulations are currently in field testing, which will directly impact statutory reserves for future PRT and other annuity business. These changes will move statutory reserves to a principles-based reserving (PBR) framework, which will be more closely tied to company’s asset portfolio, reinvestment strategies, and prudent best estimate assumptions for mortality and policyholder behaviour. Similar changes to capital requirements are also under consideration, though these are still being developed as of 2024. For new entrants, these changes will require developing or leveraging pricing and valuation systems that are capable of performing the more complex PBR calculations, including stochastic projections of assets and liabilities.

RECENT LITIGATION

A federal class action suit was filed earlier this year which charged Lockheed Martin and its plan adviser, State Street Global Advisors, with failing to pick the safest available annuity in 2021 when they replaced Lockheed’s $9 billion pension with a group annuity from Athene Life and Annuity. The suit was filed by a group of the plan’s participants.

The regulation at the heart of this case appears to be IB 95-1, which requires the fiduciary responsibility owed to plan participants in the selection of the "safest annuity available." It also discusses how "[c]ost consideration may not … justify the purchase of an unsafe annuity; nor is it appropriate to rely solely on insurance rating services.” Thus, fiduciaries need to examine a variety of factors when choosing an annuity provider.

The lawsuit alleges that Lockheed Martin and State Street Global Advisors failed to fulfil their fiduciary duty under ERISA by not selecting the "safest available annuity" for the pension plan participants. The plaintiffs argue that Athene Life and Annuity, the chosen annuity provider, was not the safest option available, thereby exposing retirees to undue risk.

Athene has publicly rejected the allegations in the lawsuit. Athene has said 1) they are a safe and secure provider of annuity benefits, with outstanding financial strength, proper reserves, excellent capitalization and strong credit ratings, and 2) they have deep expertise in managing annuity obligations, are subject to robust regulation and hold regulatory capital to protect policyholders. While not a defendant in the lawsuit, the lawsuit has created an additional challenge for Athene as it considers offering new US PRT annuities.

How plan sponsors are reacting to the lawsuits:

1. Enhanced due diligence: Plan sponsors are intensifying their due diligence processes. They are examining the financial stability, credit ratings and overall risk profiles of potential annuity providers with greater scrutiny.
2. Consulting fiduciary advisors: Many plan sponsors are increasingly consulting with fiduciary advisors and legal experts to ensure compliance with ERISA requirements. They are documenting their decision-making processes more thoroughly to defend against potential litigation.
3. Preference for higher-rated insurers: Plan sponsors are showing a growing preference for selecting insurers with higher credit ratings and stronger financial metrics to mitigate the risk of similar lawsuits.

Impact on other life insurers in the PRT market:

1. Heightened standards: Other life insurers in the PRT market may face heightened standards and expectations from plan sponsors. Insurers considering entering into the PRT space will need to demonstrate their financial stability and risk management capabilities more convincingly.
2. Competitive landscape: The competitive landscape could shift, with insurers that are considering entering into the US PRT space and have higher credit ratings and stronger financial profiles gaining a competitive edge. Further, this might lead to market consolidation, with smaller or lower-rated insurers finding it harder to compete.
3. Legal precedent: The outcomes of these lawsuits could set legal precedents that influence future litigation and regulatory actions. Insurers will need to adapt their practices to align with any new standards that emerge.

Target Operating Model

ADMINISTRATIVE CAPABILITIES

Although the not specifically called out in DOL IB 95-1,[27] the administrative capabilities of an insurer often play an important role in PRT selections. Plan sponsors are accustomed to offering higher-level customer service either internally or through a third-party administrator, and plan participants frequently utilize call centres and websites to service and model their retirement benefits.

While price is still the leading factor in most PRT transactions, plan sponsors are also considering the needs of their participants in making their decisions. Several factors may be taken into account, including name recognition of the insurer, access to call centre services in foreign languages, website capabilities, cyber security and client satisfaction. For insurers with extensive annuity experience, many of these capabilities can be developed in-house by leveraging existing systems and expertise.

For insurers or firms that do not have experience in administering annuity benefits, there are multiple options. The first option is to develop an administrative platform in-house. The investment required to develop the ability to administer benefits to large groups of participants with differing plan provisions can be very costly, and plan sponsors may be wary of insurers with little proven history of the ability to administer pension benefits.

The other option is to contract with a third party to administer benefits. Many plan sponsors, particularly smaller companies, do not have the personnel necessary to administer plan benefits for their pension plans. Oftentimes these companies will outsource plan administration through a managed service provider. Many of these third parties also administer the benefits insurers take on in PRT transactions. For entities interested in entering the PRT market, utilizing a third-party provider is most likely the fastest way to obtain proven administration capabilities without heavy investment in technology and personnel.

27. DOL IB 95-1 mentions the “the ability to administer the payment of benefits” as a potential consideration, but does not reference other aspects of administrative capabilities or services.

TECHNOLOGY PLATFORM

There are many economic and competitive challenges to entering the market, chief among them the operational challenges to pricing, bidding and successfully executing on hundreds of deals throughout the year. For new entrants, the technology stack is a foundational piece of a platform that enables growth and scalability, while optimizing each deal's return and risk metrics for accurate pricing and efficient capital deployment.

New entrants can realize significant returns by leveraging technology to evaluate and price PRT opportunities rapidly and incorporating all key aspects relevant to the specific deals during the bidding process (i.e., jurisdictions for different legal entities). Building one technology platform for pricing, financial reporting, risk management and regulatory valuation also provides significant cost savings and shortens the onboarding time period. It can also be a key part of establishing a reputation as a trusted partner among brokers and plan sponsors.

STRATEGIC ASSET ALLOCATION

A new entrant's asset capabilities will be a key driver of successfully winning transactions. Since US private pension characteristics tend to be less complex than in the UK, the distribution of bid prices tends to be narrower, particularly for in-pay lives, making the accurate modelling of the assets selected to back the liabilities core to successful bids. Given the level of sensitivity to asset modelling and the complexity of structured assets, careful and thoughtful modelling is crucial to capturing the timing of the expected cash flows and the relationship between the expected return and risk profile.

Being able to model the market value and cash flows of complex assets under various interest rates and market stresses will enable management to make decisions based on comprehensive analysis. As PRT transactions often unfold over a period of a few months, it is critical that insurers are able to rapidly adapt pricing assumptions and returns to changes in market conditions. Periods of increased market volatility can render initial bids outdated; insurers that are able to quickly adapt strategies and assumptions using robust SAA analysis can remain competitive in bidding and appropriately assess the risk-return profile of various asset portfolios and their impacts on transaction profitability.

PRICING LIABILITY ASSUMPTIONS

The primary demographic assumption in pricing PRT transactions is longevity. Lapse risk for retiree benefits is negligible, and most pensioners receive fixed, level payments, so the determining factor in the number of payments made is the lifetime of participants (and beneficiaries, if applicable). Few pension plans are large enough to produce credible plan-specific mortality assumptions, so market participants need another source for a base mortality assumption to which they can apply plan-specific adjustments.

A common assumption is ZIP Code mortality modelling. Because nine-digit ZIP Codes are often available as part of the data provided in a transaction, and geographic location has been proven to provide a meaningful variable in mortality modelling, market participants with sufficient in-office data may develop their own mortality assumptions based on ZIP Code. Participants who do not have the size or the years of experience to develop in-house mortality modelling may utilize third parties for mortality assumptions to be used in pricing.

For insurers interested in bidding on transactions that include deferred lives, assumption-setting can become much more complicated. In addition to mortality, deferred life pricing must set assumptions for when deferred participants will retire, what annuity type they will select, etc. These behaviours will be highly dependent on individual plan provisions and can vary significantly from plan to plan. This can present a challenge when setting assumptions to price transactions with little experience and a higher concentration of deferred lives,

DATA AVAILABILITY

Data provided during a PRT transaction can present several challenges for insurers:

- **Standardization** – Plan data may come in differing formats. Different plan administrators may store or provide data differently, which can pose a challenge when trying to process data for pricing.
- **Unique plan provisions** – For transactions that include participants with deferred benefits, the plan provisions for calculating the benefit amounts can be very complex, particularly for plans with multiple benefit definitions from past plan mergers or plan amendments. Processing the fields and formulas for these benefits can be time and resource intensive.
- **Incomplete data** – While plan sponsors usually clean data before a transaction, plans may not be able to fill all missing data entries or provide all requested fields (e.g., beneficiary date of birth). Market entrants would need to develop procedures or assumptions to compensate for any missing data.

Conclusion

The outlook for the US PRT market continues to be strong. Jumbo transactions of over $1 billion have continued at a steady pace since the record-breaking volume in 2022, while the record number of transactions in 2023 indicates robust small and mid-sized segments. Despite some potential headwinds in the form of litigation and regulatory changes, the sheer size of the outstanding defined benefit pension pool, combined with high funding levels, provides new entrants a market with long-term opportunities for differentiation and robust growth.

Netherlands

Market opportunity and barriers to entry

The number of pension funds in the Netherlands has decreased dramatically over recent years. In 2000, the Netherlands had approximately 1,000 pension funds; in 2024 this number has decreased to approximately 140. This decrease has arisen due to consolidation and regulatory changes aimed at improving the financial stability and management of pension schemes. This trend reflects a broader movement towards larger, more robust pension funds that can better manage risks and ensure long-term sustainability for their participants.

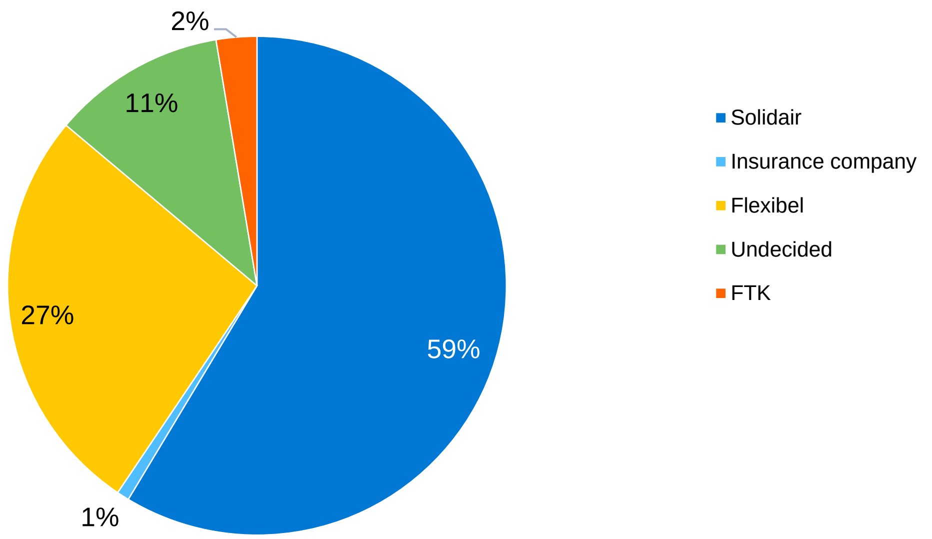
The upcoming pension reform (typically abbreviated in Dutch media as Wtp, short for Wet toekomst pensioenen) is the latest push in the further consolidation of the pension fund market. The upcoming pension reform aims to move the entire landscape of the pension funds from a defined benefit scheme to a defined contribution scheme. One major aspect of the pension reform is the process of transferring existing pension rights and entitlements from the current DB pension system to the new DC pension system. This in effect means that the risk of the pension funds will be transferred to the participant, in Dutch this process is called “invaren.”

The c. 140 pension funds currently in the market can generally be categorised into three main groups:

- **Industry-wide pension funds (Bedrijfstakpensioenfondsen):**
  - These pension funds serve entire industries or sectors. They are typically mandatory for all employers and employees within a specific industry, ensuring broad coverage and risk pooling.
  - They benefit from economies of scale, which can lead to lower administrative costs and more diversified investment portfolios. They are often governed by representatives from both employers and employees within the industry.
  - Number of funds: 43, with total asset under management around €1.240 billion.
- **Professional group pension funds (Beroepspensioenfondsen):**
  - These pension funds cater to specific professional groups, often those with a high degree of professional autonomy or self-employment.
  - These funds are designed to meet the unique retirement needs of professionals within the group. They often have specialized governance structures that reflect the professional nature of their members.
  - Number of funds: 9, with total asset under management around €33 billion.
- **Corporate pension funds (Ondernemingspensioenfondsen):**
  - These pension funds are established by individual companies for their employees. They are tailored to the specific needs and circumstances of the company and its workforce.
  - Corporate pension funds can offer customized pension plans that align closely with the company's compensation and benefits strategy. However, they may face higher administrative costs compared to industry-wide funds due to smaller scale.
  - Number of funds: c. 90, with total asset under management around €290 billion.

For the pension risk transfer market, the corporate pension funds are the main candidates for a risk transfer to another entity. In the process of evaluating strategic options with regard to the pension reform, risk transfer is a very logical strategic option. However, with the deadline of the pension reform in 2028 approaching, most of the pension funds have made plans to transfer to a defined contribution scheme. These transition plans, as they are called, are public, so the information can be used to analyse the market potential. Figure 3 summarises the split of pension schemes in the market by planned solution stated within transition plans (in assets under management).

FIGURE 3: CORPORATE PENSION FUND TRANSITION PLANS



The two main parts are Flexibel and Solidair, which are the two DC schemes the pension fund can choose from under the new pension law. There is a small proportion of the pension funds which have plans to move to an insurance company of around €2 billion. There are a number of closed pension funds with around €7.5 billion assets under management which will opt to stay within the old DB scheme (i.e., not move to another system under the new pension law). These could also be potential candidates for the pension risk transfer market in the future. The remaining corporate pension, approximately €33 billion of assets under management, have yet to make a decision, but the main options expected due to the trends we are seeing so far in the presented transition plans to a DC scheme. This is in contrast to expectations previously held in the market of the opportunity for PRT business, where estimations held that up to 25% of the smaller pension funds could consider a PRT transaction.

The potential for the pension risk transfer in the Dutch market is challenging, with a limited number of pension funds currently noting themselves as PRT candidates (in their transition plans) with around €10 billion of assets under management.

Accessing the market

SETTING UP A NEW INSURER

One potential approach to market entry involves creating a brand-new insurer from scratch, requiring an application for an insurance license in the Netherlands. Although it is possible for foreign insurance companies who are subject to prudential supervision in another European country to write some simple business in the Netherlands, this would not be possible for more complex deals such a pension risk transfer transaction.

The application process demands early and proactive engagement with Dutch regulators, specifically the Dutch Central Bank (DNB) and the Autoriteit Financiële Markten (AFM). DNB defines 10 steps for a life insurance license application which include preparation, a file check, a company visit and the judgement by DNB. For writing PRT business, a Solvency II life insurance license[28] would be required. An application form should include a business plan describing the envisioned market share, reinsurance structure and intention to transfer risk abroad (outside the Netherlands), three-year financial outlook, capital management policy and liquidity outlook. Furthermore, the application package should also include a recovery plan and resolution plan.

It is recommended by the DNB to involve an actuarial advisor in the process; this will increase the success rate of the application process by a significant amount. Milliman has a local Dutch team with extensive experience in the insurance regulatory space who can support in this process.

28. For small insurance entities with a technical provision of less than €26.6 million, a "basic" (non-Solvency II) license is also available. Note that there is a separate application process for each type of business (general insurance, life insurance, funeral insurance and reinsurance).

Obtaining an insurance licence in the Netherlands is not straightforward itself, but there may be further challenges emerging subsequently. Similar to the UK market, one of the major challenges a new entrant in the Dutch market will face is to compete against more established insurance brands which have been active in the Dutch market for many years. Most pension fund boards tend to be conservative, and if they consider a buyout transaction then they will potentially be hesitant to consider a new insurer; typically they would rather do business with one of the more respected brands that have been around for a longer period. Like the UK and US markets, in the Netherlands it is important to obtain a decent credit rating, as this is also an important element for Dutch pension fund boards when deciding on transferring their pension books towards an insurance company.

Another key challenge are the solvency requirements: under the Solvency II regime a high risk-based capital is imposed by the Dutch regulator for this kind of business. This puts pressure on certain target metrics such as the return on capital. Larger competitors in the Dutch market already executed several buyout deals in the last couple of years and have the advantage to use scale in order to keep expenses at a lower level. They also have other business lines that help to lower the required capital via diversification.

EXISTING INSURER EXPANDING INTO PRT

Another approach to entering the PRT market is to expand the business of an existing life insurance company in the Netherlands. By leveraging an existing insurance licence, it would not be necessary to go through the extensive application process with the DNB as described above.

An example of an existing Dutch insurance company that entered the market was ASR. With the acquisition of Aegon Netherlands they also bought the capabilities and experience to more efficiently operate in the PRT market in the Netherlands. PRT is now one of the main growth strategies in the life and pension business of ASR. Another larger insurance group in the Netherlands, Achmea, is in the process of setting up a new joint venture for their life and pensions business. Part of the strategy for this new joint venture could be growing the business in the PRT space.

Additionally, foreign private equity firm Sixth Street partners entered the Dutch market by acquiring a small existing Dutch insurance company with a license to operate in the Dutch market in place. Using the acquired company they created a new company called Lifetri. Their initial strategy was largely driven by growing in the PRT space, with a large number of expected deals arising from the changes in the pension landscape coming from the new pension law (Wtp) in the Netherlands. Earlier this year, they decided to change direction in their strategy and move away from PRT deals.

Other (non-Dutch) players could also enter the market by acquiring a (small) Dutch insurance company that has an active life insurance license for the Dutch market. Targets might be scarce due to the consolidation we have seen in the Netherlands in the last decade, but there are still some smaller companies remaining that fit the profile. When considering diversification potential, insurance companies with funeral business on their books might be a lucrative target, given the mortality exposure that would diversify against the longevity risk involved with defined benefit pension books.

Although the insurance licence would already be available if an existing insurance company were to be acquired, there is still a lot of work to be done before the acquired company would be ready to successfully pitch for PRT deals. To build the capabilities required, the firm needs to have individuals with relevant expertise and experience. PRT deals are also very capital intensive, so sufficient financing needs to be available.

Note that the same challenges can apply as those mentioned for new insurance start-ups if the insurance brand is not well established. This could partly explain the recent announcement by Lifetri that they no longer actively quote for new PRT deals and are re-shifting their strategy to efficiently running off their existing closed book.

INVESTING IN AN EXISTING COMPANY

Investing in one of the current active players in the PRT segment could be worthwhile to avoid the options of creating an insurer from scratch or building up capabilities and knowledge within an existing insurance company.

At this moment, three out of the four big insurance companies in the Dutch market are active in the PRT space. However, Athora (Zwitserleven brand) is owned by private equity, so the need of external financing will probably be limited since they will probably have sufficient capital to fund PRT deals themselves. The other two active players (ASR and NN Group) are publicly traded, but investing in common stock is not a targeted investment in PRT-related business (due to the various other activities that both insurance companies undertake).

Other opportunities to invest in PRT business could develop in the near future. Currently there are not that many deals in the Dutch market, and therefore there is still enough capital available to fund the next round of buyout deals. However, if the anticipated number of deals were to increase when approaching the deadline of the new pension agreement in the Netherlands planned for 2028, it could be the case that additional external capital is required by insurers to fund the bigger PRT deals.

External financing can be set up in various ways. For Dutch mortgage loan financing, several mortgage funds were set up for institutional investors. An example is the Dutch mortgage fund from Aegon, where it is possible to invest in Dutch mortgage loans without having to deal with the origination and administration of these mortgage loans. A similar setup could be applied for PRT deals if demand for capital is high and there are investors available who are willing to finance this kind of business.

Another possibility that is also applied in the Dutch mortgage loan market is the use of a structured product. For mortgage loans, several residential mortgage-backed securities (RMBS) were launched in the Dutch market. These have been very successful for financing mortgage loans, and potentially a similar structure could be leveraged for PRT deals. This would make investing in the PRT business much more accessible for foreign and/or institutional investors.

STRATEGIES FOR ENTRY

Any firm considering an entry into the Dutch PRT market will wish to keep on top of developments around the Dutch pension reform. There are some pension funds considering a buyout, but alternatively they could also transfer their pension book towards a DC scheme. If the actual number of PRT deals is increasing over the coming years, then also the additional need for external financing will increase.

In order to be successful in the Dutch market, it is also important to keep in mind some key dynamics in that market—for instance, that pension fund boards typically are looking for established brand names when they are considering a buyout. Starting an insurance company from scratch is therefore a long, steep route which can turn out to be a long-term affair in terms of both getting the license to operate from the Dutch regulator and getting the first deals landed in the conservative Dutch market.

Partnering with or acquiring a small to medium-sized insurer is probably more fruitful, but this also requires a long preparation with setting up the systems and getting the right people lined up. Another possible entry to the Dutch PRT business is via alternative investment routes such as a PRT fund for institutional investors or structured products. However, these investments typically will come with some management fees and other expenses which reduce the earnings potential.

Target operating model

OVERVIEW

In the section on the TOM for the UK market, we noted the importance of a well-thought-out business plan for an insurer looking to enter the PRT market. Below we will cover a number of topics, namely: asset management, capital and liquidity, modelling considerations, pension scheme administration capabilities, and people. In the Netherlands, the regulator typically refers to this as the "Bedrijfsplan" (company plan). There is a big overlap in both the “what” and the “how” when comparing the Netherlands to the UK. We will refrain from repetition as much as possible, and instead focus on highlighting where the Dutch market differs from the UK.

ASSET MANAGEMENT

In the Dutch market, insurers apply all options referred to in the UK section. There are some insurers who have the (interest and spread risk) rates matching fully in-house from quantitative analysis up to the purchasing and selling of specific asset classes to cover said risk in an optimised fashion. There are other insurers which only have the quantitative analysis in-house and after giving a hedge proposal (e.g., how much to increase the interest rate risk sensitivity for markets going up or down), leave the selection and purchasing/selling of assets fully to an external party.

CAPITAL AND LIQUIDITY

Perhaps the biggest difference between the Dutch and UK prudential regulatory regime for PRT business is that in the Dutch market the matching adjustment is not in play. Without the matching adjustment, one could say in comparison to the UK there is somewhat limited room for SCR optimisation in the Netherlands. At the same time, due to the recent quiet PRT market, liquidity has not been a challenge (yet). So while no advantage can be taken of a matching adjustment, there is no shortage of liquidity and/or suitable illiquid assets.

MODELLING CONSIDERATIONS

Pricing exercises for PRT are operationally expensive, as client data is seldom without error and/or in the expected format, and due to the low transaction activity in the market in the past five years (previously due to the now live pension reform law) optimisation of operational processes has not been a top priority. In recent history pension funds potentially looking for a buyout were obtaining quotes from several (if not all) insurance companies interested in making PRT transactions. Whilst a high number of quote requests could be a reason for optimising processes, the lack of closed transactions curbs management appetite for investing in operational processes.

Outsourcing has not been a big theme in the modelling of pricing and reporting cash flows for PRT market players in the Netherlands so far.

PENSION SCHEME ADMINISTRATION CAPABILITIES

In the Dutch market, active PRT players (NN, Zwitserleven and a.s.r.) have a long history with pension administration. There are third-party providers available for new entrants that have been successful supporting a number of the existing players and smaller non-active parties in their general administration. Most of the large players in the Dutch market rely on third-party software for their pension business, although these software packages are sometimes locally optimised to suit their portfolios. This does however showcase that a party looking to enter the market could use these third-party software providers to establish an insurance administration system relatively quickly.

PEOPLE

Similar to the UK market, it will not be easy if an existing insurance company wants to scale up their PRT expertise, or establish a new actuarial team to support PRT business. There are not a lot of PRT experts in the Dutch market, as the transaction volume has been low in recent years. Teams of pension actuaries have in many cases slimmed down to mainly support the existing business, with target products focused on relatively simple (compared to traditional products) DC systems. Hence a smaller workforce has been required for pension business, and more automation of standard practice.

Due to the lack of the matching adjustment in the Dutch market, in contrast to the UK market the specific requirements regarding to asset origination teams is not applicable. Securing key personnel who have fulfilled roles as chief actuary function or chief risk function could also be a challenge in the Dutch market. From roughly the 2000s to today, the amount of registered insurance companies in the Netherlands has shrunk by almost two-thirds. Due to the consolidation in the market, there are fewer individuals with the necessary expertise and seniority to fill these positions.

Conclusion

The upcoming pension reform in the Dutch market will drive some PRT market opportunities, as a buyout is one of the strategic options available to pension funds.

In order to be successful as a new entrant, it is important to keep in mind some key dynamics in the Dutch market—for instance, that pension fund boards typically are looking for established brand names when they are considering a buyout. Starting an insurance company from scratch is a material undertaking which can turn out to be a long-term affair in terms of getting the license to operate from the Dutch regulator, as well as landing the first deals in the conservative Dutch market. Partnering with or acquiring a small to medium-sized insurer is perhaps a more fruitful option. However, at the same time, this also requires a material amount of preparation in setting up the systems and lining up individuals with the required expertise.

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