

HOW WELL DO YOU KNOW YOUR INSURER? INSURER COVENANT ASSESSMENTS FOR BULK ANNUITY TRANSACTIONS

APRIL 2021



The Irish bulk annuity market experienced strong growth through 2020 driven by the competitive pricing environment, availability of tailored buy-in solutions and the continued focus on prudential risk management by Scheme Sponsors and Trustees. Annuity Buy-In and Buy-Outs (BIBO) offer Trustees a very efficient investment opportunity in a market where the search for yield using traditional investment classes has become ever more challenging.

The implementation of IORPII and the move to a more risk based governance structure is likely to increase the level of due diligence completed in respect of future BIBO transactions which will include more detailed insurer covenant reviews. Irish Life have partnered with Lincoln Pensions, who specialise in covenant assessments, to provide some insights for Irish Trustees when considering BBO transactions. Lincoln Pensions are one of the largest international specialists providing covenant advice to Trustees and Sponsors with market leading expertise in the assessment of insurers who provide bulk annuity solutions. This research into the Irish market provides Trustees/Sponsors with a framework to risk assess providers operating in the market.

"Whilst life insurers operate within a robust regulatory regime, the regime is not designed to be risk-free, and no two insurers within the regime are the same".

"A trustee's decision of which insurer to transact with is not purely based on price, but should also take in to account appropriate considerations of the security and risk implications of transacting with a selected insurer, which is particularly important for Irish pension scheme trustees given the lack of an insolvency compensation scheme."

"In our view, insurer covenant should be central to the trustee decision making process involving bulk annuity transactions."

Adolfo Aponte - Managing Director Lincoln Pensions

WHAT IS THE REAL DOWNSIDE RISK OF A WEAKER COVENANT?

No Trustee would knowingly enter into a contract with an insurer where they felt there was a real and imminent risk of default. However, the position can change over time and it's important that Trustees consider how resilient their insurance counterparty is and how things might change in a more stressed economic environment.

While the ultimate risk of default may be considered an extreme event there are other considerations that may arise. For example a scheme or supporting sponsor may have to consider including an impairment charge in their accounts in respect of an insurance contract if the backing insurer gets into financial difficulty down the line.

There are also more routine implications that can manifest as the business becomes less strategic and is restructured or sold on. The ultimate owners of the business can change through a sale or acquisition and the business could be far less strategic to new owners which will lead to underinvestment in the infrastructure required to support the contract.

There will be a cost to the Trustees of dealing with change associated with a contract being restructured. The Trustees will need to carry out due diligence on a new counterparty or service providers and establish their rights and options in these circumstances. They will also have to communicate the changes to members and handle member service issues, which could result in different cohorts of scheme members being subject to different administration standards.

WHAT SHOULD TRUSTEES/SPONSOR CONSIDER WHEN ASSESSING AN INSURANCE COUNTERPARTY?

Annuity contracts are long term investment decisions that are typically irreversible. It is important that Trustees consider their choices very carefully and not only look to the current operating environment but how that might change into the future and how these changes could affect the ongoing operation of the contract.

For buy-ins, this includes the real probability they will become buy-out at some stage and end-customer pensioner servicing is a consideration.

SOLVENCY CAPITAL POSITION AND FINANCIAL STRENGTH

- Headline Solvency Position
- Stability of Solvency Position
- Financial Strength Rating
- Insurer Financial Strength Rating
- Reliance on 'soft' capital techniques
- Risk management policy
- Balance sheet asset allocation
- Counterparty exposures

OWNERSHIP STRUCTURE AND ABILITY TO RAISE CAPITAL

- Who are Ultimate Owners
- Owners Solvency and Financial Strength position
- Owners long-term commitment to market
- Use of reinsurance and fronting arrangements
- Quality of existing Capital
- Ability to raise new Capital
- Availability of management actions to raise Capital
- Stress testing of access to Capital

EXPERIENCE, REPUTATION AND ONGOING SERVICE CAPABILITY

- Local market experience
- Brand awareness
- Long term commitment to local market
- Unanticipated contract terms
- Ongoing service for Trustees
- Service for scheme members
- Member experience
- Cost of change

IRISH LIFE ASSURANCE

Irish Life was founded in 1939 and is one of Ireland's leading financial services companies. Irish Life has over one million customers in Ireland and is the largest insurer in Ireland (by market share).

IRISH LIFE HAD A HEADLINE SOLVENCY II COVERAGE RATIO OF 176% AT THE END OF 2020*

This ratio remains comfortably above the regulatory requirement and is ahead of its peers in this market. Over the last four years, Irish Life have maintained a Solvency II Coverage Ratio of at least 160%. All of Irish Life's Eligible Own Funds is comprised of the highest quality unrestricted Tier 1 capital.

"Overall, considering the YE2019 financial position, ILA appears to perform very well over a number of factors examined including strong headline solvency position, investment grade credit rating and access to capital through its parent."

Lincoln Pensions

IRISH LIFE HAS A STAND-ALONE INSURER FINANCIAL STRENGTH CREDIT RATING OF AA (FITCH)

Irish Life has over 40,000 Irish pension annuity customers* and serve these customers using an in house administration system. Irish Life run one of the largest payrolls in the State and have a dedicated locally based servicing team who deal solely with pensioner annuity customers.

Irish Life is part of the Great West Lifeco Group, one of the world's leading life assurance organisations. Great-West Lifeco has operations in Canada, the United States and Europe. The Group has over 31 million customers and 24,000 employees worldwide.

Great West Lifeco (through the The Canada Life Assurance Company) has an Insurer Financial Strength rating of AA (Fitch).

Fitch views Great West Lifeco as an insurer with very strong capitalization, strong competitive position in the Canadian market, stable core insurance earnings, low-risk investment profile and conservative liability profile.



FURTHER CONTACT

To find out more about our research and see what this analysis means for your scheme please contact:



Shane Prendergast FIA FSAI
Executive Pricing Manager
Irish Life

Email: shane.prendergast@irishlife.ie

*The information shown in the update is based on Irish Life data. Information correct as at April 2021.

CONTACT US

Irish Life Assurance plc, trading as Irish Life is regulated by the Central Bank of Ireland

In the interest of customer service we will monitor calls.

Irish Life Assurance plc, Registered in Ireland Number 152576, VAT number 9F55923G.

Irish Life, Lower Abbey Street, Dublin 1, Ireland. T: 01 704 2000 • F 01 704 1905

