FOR ISSUE IN THE UK AND EU
FINANCIAL PROMOTION/MARKETING MATERIAL
FOR PROFESSIONAL CLIENTS AND QUALIFIED INVESTORS ONLY
NOT TO BE REPRODUCED WITHOUT PRIOR WRITTEN APPROVAL
PLEASE REFER TO ALL RISK DISCLOSURES AT THE BACK OF THIS DOCUMENT

Insight INVESTMENT

A NEW WORLD FOR UK DB SCHEMES

THOUGHTS ON INVESTMENT STRATEGY: RUNNING ON, LDI AND LONGEVITY RISK

MARCH 2026

BNY | INVESTMENTS

EXECUTIVE SUMMARY

As the landscape for UK defined benefit (DB) pension schemes continues to evolve, trustees and sponsors face an array of strategic choices amid regulatory change and economic uncertainty. We share our current thinking on how DB schemes can run on, keeping their options open, while ensuring an effective and efficient liability hedge, and focus on the potential impact of longevity risk and how to mitigate it. We hope this overview provides scope for further discussions with our clients on how to run on with confidence.

HOW TO RUN ON

- Running on your DB pension scheme can retain flexibility and keep your strategic options open, until legislation and regulatory expectations become clearer. Exciting innovation is emerging, as demonstrated by the Stagecoach/Aberdeen transaction.
- DB schemes looking to run on will typically want to ensure they have liquidity to cover their cashflow obligations, hedge their liability risks, and grow any surplus assets.
- A core allocation to contractual assets, such as high-quality corporate bonds, complemented by a hedging overlay, can establish a more resilient foundation on which schemes may then pursue surplus growth while aiming to reduce risk to members' retirement income.

LDI HEALTH CHECK

- A health check of your LDI strategy will help identify areas for improvement and will offer confidence when it comes to strategic decisions for the longer term.
- We present key questions to consider as you look to judge whether your liability hedge is robust, efficient, responsive to scheme objectives, and capable of adapting to future changes in the financial landscape.
- We also focus on areas The Pensions Regulator (TPR) has identified for further improvement in schemes' collateral management, suggesting ways to pursue increased diversification and dynamism in line with TPR expectations.

FOCUS ON LONGEVITY RISK

- The impact of longevity risk could be significant for DB schemes, whether you are running on, or planning to buy out within the next five to 10 years.
- We present a case study to illustrate the scale of the potential impact of rising life expectancy, showing how a DB scheme might need to increase its investment risk exposure materially to then stay on track for its endgame target.
- By comparison, using a longevity hedge can smooth a scheme's path to the endgame, even if you account for the cost of the hedge over time.

HOW TO RUN ON

- **Running on your DB pension scheme can retain flexibility and keep your strategic options open, until legislation and regulatory expectations become clearer and other endgame solutions emerge.**
- **DB schemes looking to run on will typically want to ensure they have liquidity to cover their cashflow obligations, hedge their liability risks, and grow any surplus assets.**
- **A core allocation to contractual assets, such as high-quality corporate bonds, complemented by a hedging overlay, can establish a more resilient foundation on which schemes may then pursue surplus growth while aiming to reduce risk to members' retirement income.**

The Pension Schemes Bill marks a step-change in how schemes may be managed, funded and run. It is already shaping long-term planning and is the next step in creating a more flexible environment for DB schemes' end-game strategies.

It comes as The Pensions Regulator has adjusted its guidance to reflect the strong funding levels of many DB schemes today. Rather than feeling pressured to pursue buy-out at the earliest practicable moment, trustees are being encouraged to consider a broader set of viable pathways for achieving the best outcome for scheme members.

Running on, at least for the time being, can help keep options open and ensure trustees are well-positioned to adapt as legislation is confirmed, regulatory clarity emerges and new endgame solutions are developed. Here we present the case for waiting and the practical implications of running on in investment terms.

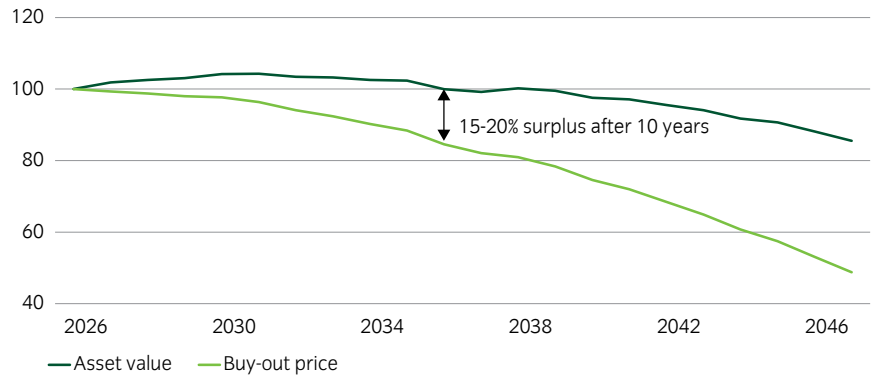
TIME IS STILL YOUR FRIEND

We have highlighted to our clients for some **time that time is your friend**.

All else being equal, the pricing of an insurance buy-out relative to gilts can be expected to fall as a scheme's membership matures over time, and a scheme's surplus can be expected to increase over time (see Figure 1).

In other words, you get paid to wait if buy-out is your ultimate endgame destination.

Figure 1: A low-risk strategy can target a growing surplus[1]



[1] For illustrative purposes only. Rebased to 100. Asset growth estimated at gilts plus 1% after costs, including an allowance for longevity hedging.

THE INVESTMENT TOOLKIT FOR RUNNING ON

A well-designed investment strategy for pension schemes begins with a clear understanding of how different components of the portfolio work together to meet member benefits securely and efficiently.

Schemes must balance the need for dependable near-term income to ensure they can afford pension payments, with the requirement to hedge long-term liability risks, all while preserving the flexibility to grow surplus assets over time.

By structuring the portfolio around these core aims – looking to meet benefits with certainty, securing liability coverage, and growing surplus assets – trustees can build an investment approach that is resilient, purposeful and aligned with their ultimate endgame objective.

1 Provide enough liquidity to meet near-term benefits with high certainty

A robust investment approach for pension schemes begins with ensuring that sufficient income is available to meet near-term benefit payments with a high degree of certainty.

The aim is to avoid any risk of having to dispose of growth assets in unfavourable market conditions simply to meet liabilities. The number of future years' cashflows that need to be secured will naturally depend on a scheme's time-horizon; for example, for a scheme targeting buy-out within five years, it may be inappropriate to invest in illiquid assets. Conversely, schemes with a longer time horizon that have secured the ability to pay near-term benefits will have more flexibility to allow time for less-liquid growth assets to generate returns.

This liquidity foundation is best achieved, in our view, by building a portfolio around a contractual core: using assets that are highly certain, contractual in nature, and maturing in line with the scheme's timeframe. This typically includes high-quality corporate bonds, asset-backed securities, secured finance assets and, where cashflows align appropriately, even private market investments that mature ahead of the required time horizon.

2 Secure the ongoing asset coverage of scheme liabilities

Alongside liquidity management, schemes must secure the ongoing asset coverage of their liabilities. This means hedging the key risks embedded in those liabilities, notably interest rate and inflation exposure. It also means mitigating longevity risk, which can be achieved through instruments such as longevity swaps.

- **See our focus on longevity risk later in this paper for more on the impact of longevity risk and innovations to make longevity hedges more accessible for DB schemes.**

Operationally, a well-designed 'collateral waterfall' plays a vital role in reducing the risk of collateral exhaustion, maintaining the stability of the hedge, and ensuring the broader portfolio remains efficient.

- **See our LDI health check section later in this paper for more on how to ensure an effective and efficient liability hedge.**

3 Grow the surplus

Many schemes hold assets in excess of those required to secure benefits and hedge liabilities. These can be treated separately as a surplus portfolio.

Unlike other assets in the portfolio, these assets are not relied upon to pay benefits and can therefore be invested more freely. The appropriate strategy for this portfolio depends on the scheme's objective for surplus utilisation.

The scheme's time horizon will influence the degree of liquidity required, risk appetite will determine the level of return sought, and whether the scheme intends to extract cashflows regularly or instead build surplus over time will shape the balance between contractual assets and more return-seeking, non-contractual opportunities.

THE IMPACT OF SURPLUS RELEASE

Surplus release has become an increasingly important strategic consideration for UK DB schemes as funding levels have strengthened, and as the Pension Schemes Bill progresses through Parliament, the details are evolving and the implications are becoming clearer.

For example, in the 2025 Budget, the government confirmed that schemes would be able to make authorised cash lump-sum payments directly to members where surplus exists. This change offers trustees a practical mechanism for sharing value in a controlled, transparent way, without the complexities historically associated with refunding surplus to sponsors or navigating restrictive tax treatments.

To illustrate the potential impact, if a scheme decides to release 1% of assets as a member "bonus", for an individual receiving a £10,000 per-annum pension this could equate to an additional £1,500 paid as a lump sum. While modest relative to overall scheme assets, such a payment could feel very significant to members. While this example is purely illustrative, we have found that noting such details has been instructive in our discussions with clients.

PORTFOLIO CONSTRUCTION IN PRACTICE

A resilient investment strategy begins, in our view, with securing the scheme's near-term benefit payments through a strong contractual core. By anchoring the portfolio in assets with predictable, contractual cashflows, sufficient to cover the first decade of liabilities, schemes can meet their obligations with high confidence while reducing exposure to adverse market conditions.

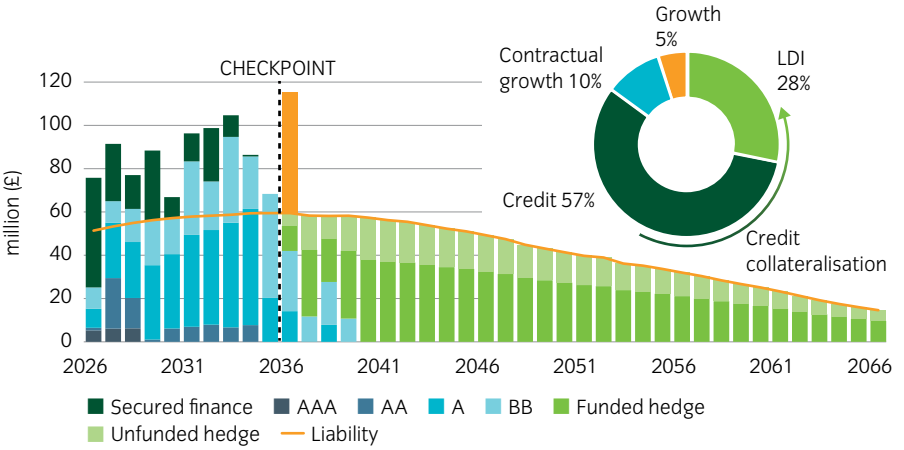
Alongside this cashflow foundation, the broader liability risks must be stabilised through an efficient liability-hedging framework which mitigates the impact of interest rate and inflation risk. Longevity risk, meanwhile, can be addressed through a longevity swap, which transfers the uncertainty around members living longer than expected.

Maintaining this framework requires careful management of collateral, where a well-structured collateral waterfall can reduce the risk of collateral exhaustion and support the ongoing stability of the hedge.

Credit collateralisation can further enhance resilience by allowing the scheme to use secure, income-producing credit assets in collateral pools, helping to avoid the need to sell return-seeking assets to meet collateral calls.

With the matching and risk-management components secured, any remaining assets can be treated as surplus, and this surplus can be put to work. Contractual assets within the surplus portfolio can generate a predictable stream of cashflows in excess of those needed to pay liabilities, supporting objectives such as surplus extraction. Non-contractual, growth-oriented assets also have a valuable role: because they are not relied upon to meet benefit payments, they can be left to compound over time. This approach reduces the risk of becoming a forced seller in stressed markets and can allow the scheme to capture long-term return potential more effectively.

Figure 2: Based on a core of contractual assets and an effective liability hedge, a DB scheme can pursue prudent surplus growth[2]



What if I want to take more risk?

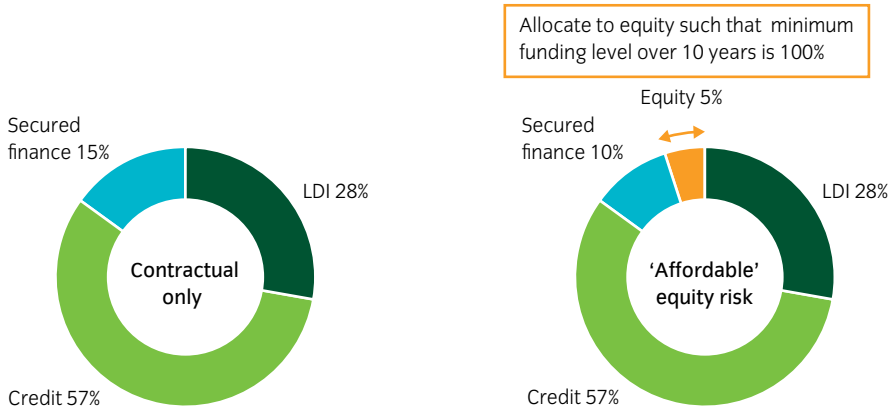
You may wish to build a contractual portfolio designed to achieve a target funding level with high certainty, even in stressed conditions.

But if you are aiming for higher returns, it is possible to build a portfolio to meet a minimum acceptable funding level with high certainty, even in stressed conditions, while also building in scope to pursue a more ambitious goal.

We present two such examples below – the first is focused only on contractual assets, while the second incorporates some equity exposure. The former has a lower potential outcome for surplus growth, with less downside risk; while the latter has a higher potential outcome, with more downside risk.

Crucially, both approaches build on a solid foundation on which risk is taken without jeopardising member benefits or increasing reliance on the sponsor's covenant.

Figure 3: It is possible to target higher surplus growth on a solid foundation without risking member benefits[3]



Projected surplus in 2036					
Median	Worst historical	-100% equity return	Median	Worst historical	-100% equity return
£101m	£86m	£86m	£158m	£40m	£0m

[2] Indicative only. Based on hypothetical assumptions for illustrative purposes only.
[3] Source: Insight as at 30 September 2025. 10-year projection. Analysis has been based on historical SPX index returns (local currency, relative to cash, history to 1937). For contractual assets the "worst historical return" uses the 80th percentile stresses for defaults, forced selling and reinvestment rates.

IMPLICATIONS OF TIGHT CREDIT SPREADS TODAY

Credit spreads are tight today relative to historical levels, raising an important strategic question for schemes: is now the moment to lock into long-dated credit, or is it preferable to retain reinvestment flexibility?

In an environment where spreads offer limited compensation for taking on additional duration risk, many schemes may value the option to revisit credit markets later, particularly if spreads widen from today's compressed levels. Retaining shorter-dated exposure can provide a degree of optionality, enabling schemes to redeploy capital under potentially more favourable conditions.

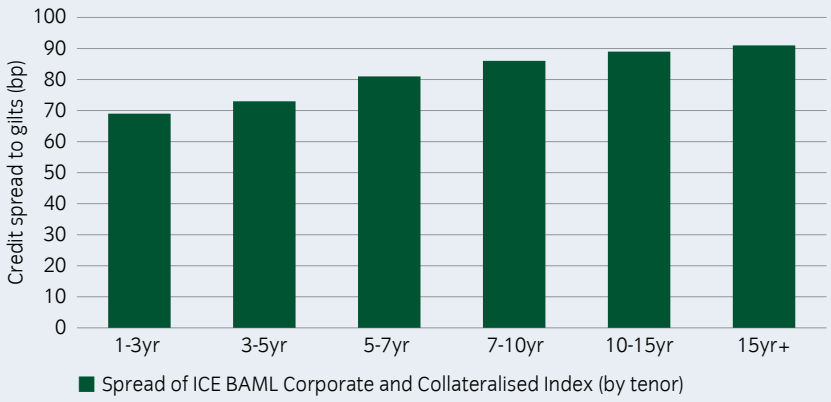
At the same time, the carry advantage of extending into long-dated credit is currently marginal. For example, the incremental spread pick-up beyond 15 years is only around 5bp more than that available in the 7 to 10-year part of the curve. In practical terms, this means schemes are not forgoing meaningful income by focusing on shorter maturities. With the long end offering little extra compensation for duration and liquidity risks, many trustees may judge the risk-return trade-off to be more attractive in the intermediate part of the curve.

Prioritising shorter maturities can also strengthen cashflow-matching capability, helping meet near-term liabilities with confidence while reducing the risk of forced sales. By anchoring a portion of the portfolio in assets that mature sooner, schemes can create valuable breathing room for the rest of the investment strategy: growth or surplus-oriented assets are given more time to deliver returns, without being relied upon to meet imminent benefit payments. This structure can improve overall resilience, especially in volatile or uncertain market conditions.

Active management of credit portfolios can also offer scope for return generation, adding value in an environment of tight credit spreads. Duration and yield curve strategies, security selection, new issue premia and market fragmentation all provide opportunities to add incremental return across fixed income markets, and could be ideal for generating and growing surplus assets over time.

Including asset-backed securities (ABS) within portfolios may also be attractive: ABS include a wide range of assets that can offer higher yields than corporate bonds with a similar credit rating.

Figure 4: Credit spreads for longer-dated credit are not much wider than those of shorter-dated credit[4]



[4] Source: Bloomberg, as at 31 January 2026.

LDI HEALTH CHECK

- A health check of your LDI strategy will help identify areas for improvement and will also offer confidence when it comes to strategic decisions.
- We present key questions to consider as you look to judge whether your liability hedge is robust, efficient, responsive to scheme objectives, and capable of adapting to future changes in the financial landscape.
- We also focus on areas The Pensions Regulator (TPR) has identified for further improvement in schemes' collateral management, suggesting ways to pursue increased diversification and dynamism in line with TPR expectations.

KEY QUESTIONS FOR DB SCHEMES TO CONSIDER

It is essential, in our view, for trustees and scheme managers to regularly assess whether their LDI framework remains fit for purpose, particularly as they consider their endgame options in light of a focus on surplus release and alternatives to buy-out.

Here we present key questions for you to ask about your LDI strategy, covering hedge design, collateral management, and the management of other risks in your portfolio. We explain more about our approach to collateral management, including the definition of Tier 1, 2 and 3 assets, later in this document.

	Topic	Key considerations
Hedge design	Hedge ratio	1. Is the aim to protect **funding level** or to protect monetary size of surplus/deficit?
	Inflation	2. Do you employ **static or dynamic** management of Limited Price Indexation (LPI) risks? If static, when were these last updated?
	Hedge management	3. Can you **improve efficiency** via discretionary management while ensuring the hedge still hedges?
	Corporate bonds	4. Can these be fully **integrated** with your LDI portfolio and help to meet cashflow, hedging, collateral, and return objectives?
Collateral management	Efficiency	5. Is there potential to **improve collateral efficiency** by increasing Tier 2 asset allocations?
	Resilience	6. Are all the available and appropriate levers (e.g. **Tier 2 assets and credit collateralisation**) in place to meet collateral calls within five days, including settlement?
	Mix of funds	7. In the context of TPR expectations, is there scope to **improve the diversification** of collateral waterfall assets (e.g. through an absolute return bond strategy) or to use a greater range of funds to tailor your **risk/liquidity mix**?
Other risk management	Longevity	8. Would **hedging longevity efficiently** help in achieving your objectives?
	Currency	9. Are **non GBP currency exposures** hedged effectively and efficiently?
	Equity	10. Could **synthetic equities or protected equities** help to boost returns in capital efficient way?

DISCRETIONARY MANAGEMENT: HOW IT CAN MAKE A DIFFERENCE TO YOUR LIABILITY HEDGE

The main objective for LDI mandates is risk reduction; however, a discretionary rather than passive approach to hedging focuses on taking high-conviction investment decisions that are designed to add long-term value, without compromising the hedge. This approach is built on the following principles.

1. **Benchmarks are important, but not perfect** – pension scheme liabilities are complex and difficult to replicate precisely with a market-based benchmark. LDI benchmarks guide asset management, as well as providing greater transparency, governance and accountability for investment decisions. However, LDI benchmarks are not exact matches for pension scheme liabilities, reflecting many underlying assumptions. Different investment experts could reasonably produce different LDI benchmarks using the same underlying information.
2. **Efficiency matters more than replication** – an LDI portfolio that closely mirrors its benchmark is not always the most efficient. Interest rate and inflation risks can be hedged using a variety of instruments, and the most cost-effective mix changes over time.
3. **Markets present opportunities, if you're positioned to act** – in markets dominated by passive LDI investors, pricing opportunities often emerge due to supply-demand imbalances or regulatory shifts. The ability to respond to these opportunities depends on the governance model, particularly the level of discretion delegated to asset managers.
4. **Discretion captures value, without compromising the hedge** – by combining the longer-term time horizon of pension schemes with the ability to act quickly on pricing opportunities often overlooked by passive LDI investors (e.g. yield curve shifts or pricing gaps between instruments), hedging costs can be reduced on an ongoing basis, while maintaining the desired hedge ratios for interest rate and inflation exposures.

Many of Insight's clients that have adopted this approach have derived meaningful funding level improvements, helping shorten their journey to their endgame or generating surplus for other purposes. **Over the long term, across Insight's discretionary LDI mandates, the average portfolio performance relative to mandate-specific liability benchmarks amounts to 0.39% per annum.**[5] For a scheme seeking to generate surplus, such outperformance as a proportion of liabilities could mean a material addition to surplus assets.

[5] As at 31 December 2025. The data captures all of Insight's full discretionary hedge management mandates with performance for relevant periods. The performance is quoted gross of management fees and net of dealing costs and relative to mandate-specific liability benchmarks. Outcomes for individual client mandates vary.

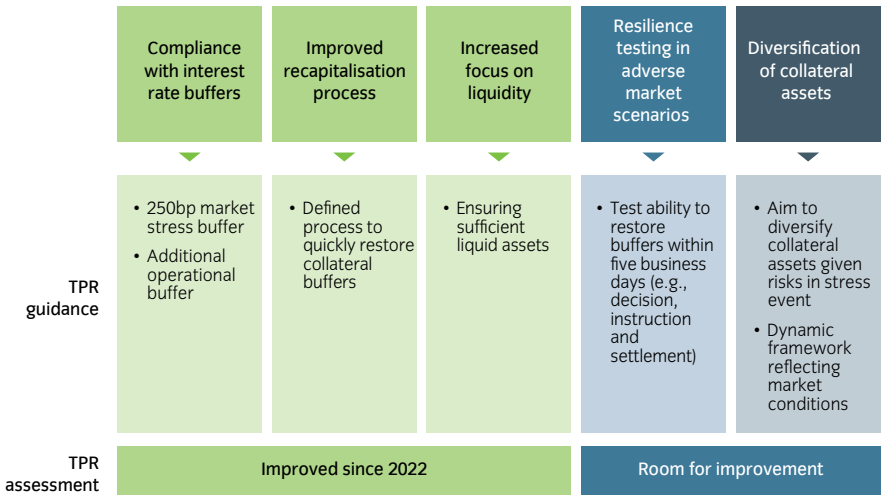
ALIGNING WITH REGULATORY EXPECTATIONS

The gilts crisis of late 2022 led The Pensions Regulator (TPR) to renew its emphasis on how well schemes are positioned to withstand periods of financial stress. As a result, trustees have been asked to demonstrate that their current arrangements are robust, and that they can be effective across a range of scenarios.

Central to the regulator's expectations is the need for schemes to **hold sufficient buffers, operate efficient recapitalisation processes** and **maintain a disciplined approach to liquidity**. These requirements reflect a shift in regulatory thinking from reactive oversight toward proactive assurance that schemes can respond quickly and decisively when market conditions deteriorate. This affects all aspects of LDI framework design, from collateral management to decision-making readiness.

While many schemes have made significant progress since 2022, the regulator has been clear that there remains room for improvement. The focus now is on operational readiness: ensuring that schemes can restore buffers quickly, diversify collateral assets appropriately, and test their processes under realistic stress scenarios.

Figure 5: UK DB schemes have made progress in aligning with TPR – but there is room to improve



Focus on collateral waterfalls

A collateral waterfall is an approach used to manage and prioritise the assets a DB uses to meet collateral calls, particularly during periods of market stress. The objective is to ensure that, when additional collateral is required, assets are sourced efficiently and without jeopardising the scheme's long-term investment strategy or liquidity position.

Insight classifies assets within a collateral waterfall in three tiers, based on their liquidity and suitability for use as collateral.

- **Tier 1** assets, such as cash and government bonds, which can be quickly deployed to meet collateral demands.
- **Tier 2** assets, including ABS or absolute return funds, to provide the liquidity required to meet TPR expectations while aiming to deliver moderate returns in excess of cash. These can offer the ability to raise cash within five business days and therefore offer the potential to reduce the impact of any forced selling, even in the event of credit spreads widening.
- **Tier 3** assets, including ABS and secured finance strategies, which can aim to generate higher returns through investment grade assets, but with reduced liquidity and higher mark-to-market risk than Tier 2 assets.

Diversification and dynamism in collateral management

The benefits of a collateral waterfalls are now widely acknowledged. However, TPR has identified the need to diversify collateral assets and adopt a dynamic approach to meeting cash calls as key areas of improvement (see box).

> **"Trustees need to be more aware of the concentration risks associated with the assets earmarked for sale during stress events. There is a risk that pension schemes attempt to sell similar types of assets at the same time which results in valuations for collateral assets falling and also the inability to find buyers. Trustees can mitigate this risk in two ways:**
>
> 1. **Trustees can consider diversifying collateral assets. This could reduce liquidity bottlenecks in specific markets and diversify sources of cash to replenish LDI assets.**
> 2. **Highly rigid cash call structures can lead to asset disposals without regard to the value of the underlying asset. Trustees, their advisors and fund managers could look to develop flexibility in the liquidity frameworks which allows for a dynamic approach to meeting cash calls where prevailing market conditions may mean that a change of approach is desirable."**
>
> Source: Market oversight: How well pension schemes are prepared for LDI risk and what trustees need to know, 18 September 2025, TPR.

To achieve these goals in practice, we are discussing the following with our clients.

- **Introducing absolute return bond strategies as part of their collateral waterfall:** We have sought to encourage our clients to consider including an absolute return bond strategy as a Tier 2 asset alongside ABS strategies.

  The critical benefit of such strategies as a diversifier within collateral waterfalls, in our view, is they are not structurally long credit exposure, with returns instead targeted through active management across credit and interest rate markets. This means such a strategy has the potential to outperform cash even when interest rates are rising and credit spreads are widening, which happened in March 2020 in the initial stages of the global pandemic and in the gilts crisis in 2022.

  Over the long term, Insight's absolute return strategy has low correlations to a range of assets to which UK pension schemes have exposures, including gilts, corporate bonds and ABS. This illustrates how introducing such a strategy alongside ABS could therefore give a pension scheme more ways to avoid being a forced seller at distressed prices when needing to top up collateral.

  The current market environment, with very tight credit spreads relative to history and high equity market valuations, is also a supportive one for strategies relying on active management rather than credit-market exposure, in our view.

  Further to this, absolute return bond strategies can have extremely strong underlying liquidity: for example, in Insight's absolute return bond strategies, over 95% of assets could typically be sold within five business days. They also typically have relatively small UK-specific exposures meaning they are less susceptible to any UK-specific future risk event.

- **Identifying parameters for dynamic management of collateral resilience:** For many clients we have implemented a dynamic approach to collateral management, which can be tailored to each individual scheme's preferences. This framework monitors the collateral resilience of Tier 1 assets on a daily basis, making an allowance for non-rate market stresses, and gives discretion for Insight to take action to maintain an appropriate balance between collateral efficiency and resilience.
  - When the adequacy of Tier 1 assets is above the upper threshold (e.g. a 4% rate rise), we can then look to top up Tier 2 assets.
  - When the adequacy of Tier 1 assets is within a 'buffer zone', above a lower threshold (e.g. a 3% rate rise) but below the upper threshold, we may take steps to increase the adequacy of Tier 1 assets.
  - When the adequacy of Tier 1 assets drops below the lower threshold, steps must be taken to increase the adequacy of Tier 1 assets.

When looking to top up Tier 1 assets, where appropriate, Insight can have discretion to use a combination of Tier 2 asset sales and credit collateralisation to mitigate forced-selling risk at distressed prices.

> The focus now is on operational readiness: ensuring that schemes can restore buffers quickly, diversify collateral assets appropriately, and test their processes under realistic stress scenarios.

FOCUS ON LONGEVITY RISK

- **The impact of longevity risk could be significant for DB schemes, particularly under run on.**
- **We present a case study to illustrate the scale of the potential impact of rising life expectancy, showing how a DB scheme might need to increase its investment risk exposure materially to then stay on track for its endgame target.**
- **By comparison, using a longevity hedge can smooth a scheme's path to the endgame, even if you account for the cost of the hedge over time.**

For DB schemes looking to run on or conduct a buy-out over the medium to long term, longevity risk is a likely focus. These schemes will typically hedge most of their liability-related interest rate and inflation risks, leaving longevity risk as the most significant risk they face.

The impact could be significant. An unexpected rise in life expectancy could have a significant impact on a scheme's finances if it chooses not to hedge longevity risk. If this happens, the scheme could need to take on considerably more investment risk to stay on track.

On the other hand, if a scheme puts a longevity swap in place from the outset, it will likely need to accept a slightly higher level of investment risk to generate the returns needed to pay for the swap – but doing so would help protect the scheme from the effects of rising life expectancy.

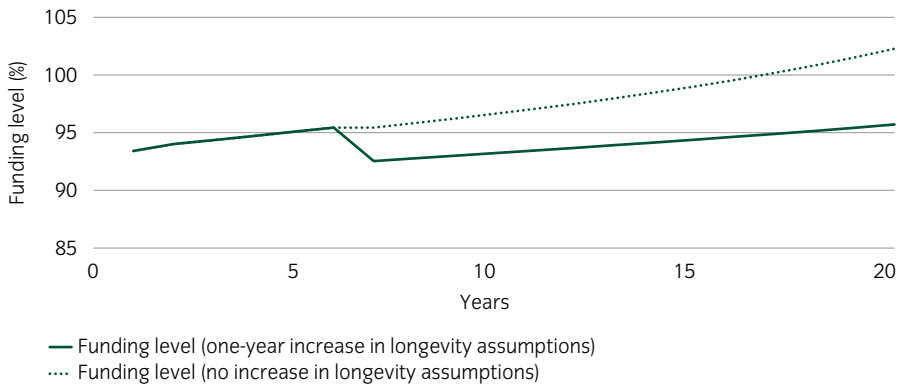
CASE STUDY: HOW RISING LIFE EXPECTANCY CAN PUSH A PENSION SCHEME OFF TRACK

If scheme members live longer than expected, a defined benefit pension scheme will need to pay out pensions for longer. A simple case study shows how this could have a significant impact on a scheme's path to the endgame.

We consider a scheme that is initially 93% funded on a buy-out basis and is targeting a full buy-out in 20 years (see Figure 6). The scheme adopts an investment strategy that is 50% gilts and 50% corporate bonds, and does not hedge longevity risk. If longevity follows the initial best-estimate assumptions, the scheme expects to be 104% funded on a buy-out basis after 20 years.

But after five years, the scheme determines that its initial life expectancy projections were one year too short (e.g. as a result of changes in forward looking longevity improvement assumptions). This change leads to an increase in liability values, with an immediate impact on scheme funding. The buy-out funding level drops from 95% to 93%.

Figure 6: Impact of a one-year increase in life expectancy on the buy-out funding-level projection[6]



If the scheme remains invested in its 50% gilts and 50% corporate bond strategy, the associated investment returns would not be sufficient to overcome the deficit. To get back on track and target a 104% buy-out funding level in year 20, the scheme would need to increase its corporate bond allocation from 50% to 75%, reducing the gilt allocation to just 25%. This would be a large increase in the level of investment risk being taken by the scheme.

In reality, the scheme might need to hold more than 25% of its assets in gilts for hedging purposes, meaning the scheme would need to move into riskier assets such as private credit or equities in order to meet its return objectives.

HEDGING LONGEVITY RISK CAN SMOOTH THE PATH TO THE ENDGAME

If the scheme had instead hedged its longevity risk at the outset, the outcome in this scenario could have been very different.

In order to illustrate this, we assume that at the outset the scheme hedged 100% of its longevity risk with a reinsurer at a risk fee of 3%. (This could be less than the buffer some schemes already incorporate within their strategies to account for longevity risk.) In simple terms, this means that:

- the scheme agrees to pay fixed[7] cashflows to the reinsurer equal to 103% of the initial best estimate cashflows for the next 50+ years, and
- in return, the reinsurer agrees to pay pensions for life to all current members of the scheme.

[6] Source: Insight Investment. For illustrative purposes only.
[7] The fixed leg cashflows are predefined, but linked to inflation in the same way as scheme benefits.

As a result of this agreement, the pension scheme is no longer affected by the realised longevity of the scheme members or changes in life expectancy assumptions. All longevity risk has been passed to the reinsurer and the scheme is only responsible for paying a series of pre-agreed cashflows.

In terms of the buy-out being targeted in 20 years' time, the longevity swap effectively means that the pension scheme is able to lock into the longevity assumptions that the buy-out insurer will use 20 years ahead of the transaction. This is because the insurer would ordinarily source its own longevity swap at the time of the buy-out, but where the scheme already has a swap in place, that swap will be 'novated'[8] to the insurer.

As a result, the insurer will calculate the buy-out premium it needs to receive by reference to the fixed leg payable under the scheme's original longevity swap. Specifically, the buy-out premium will be the monetary amount that the insurer must receive in order to pay the remaining fixed leg of the original longevity swap and generate a sufficient return on its capital.

In the context of our example pension scheme, this last point means that due to the longevity swap, the scheme would have been unaffected by the increase in buy-out premium that would otherwise have resulted from the one-year increase in life expectancy.

In Figures 7 and 8, we illustrate how the buy-out funding position of our example pension scheme develops with and without the longevity swap, in the case where 50% of the assets are invested in gilts and there is a one-year life expectancy increase in year 5.

The funding level initially progresses more quickly when there is no longevity swap (as there is no 3% risk fee to pay), but it then suffers when life expectancy increases. The funding level with the longevity swap in place does increase through time, but it does not reach the previous level of 104% after 20 years. This is because the scheme has had to pay out the 3% risk fees over the 20-year period; the risk fees represent a drag of c.20bp per annum on investment returns.

If the scheme had targeted a slightly higher level of investment return by investing 40% in gilts and 60% in corporate bonds throughout the 20-year period, the result would be as shown in Figure 8. In this scenario the buy-out funding level with the longevity swap in place reaches 103% after 20 years. This is lower than the previous target of 104%, but is arguably justifiable given that longevity risk has been removed and there should therefore be far less variability in insurer pricing at the 20-year point.

We would argue that hedging longevity risk and following a slightly higher risk investment strategy (e.g. 60% in corporate bonds rather than 50%) is likely to represent a lower-risk proposition than leaving longevity risk unhedged and facing the possibility of having to significantly re-risk the investment strategy in the event of a sudden increase in life expectancy.

Figure 7: Buy-out funding level (50% gilts)[9]

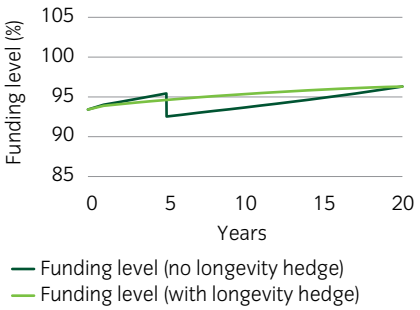
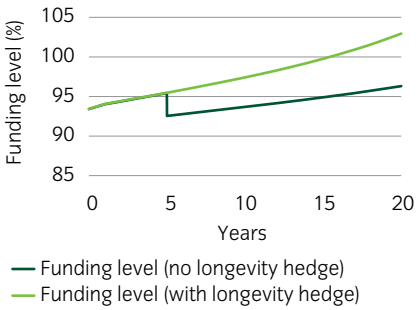


Figure 8: Buy-out funding level (40% gilts)[9]



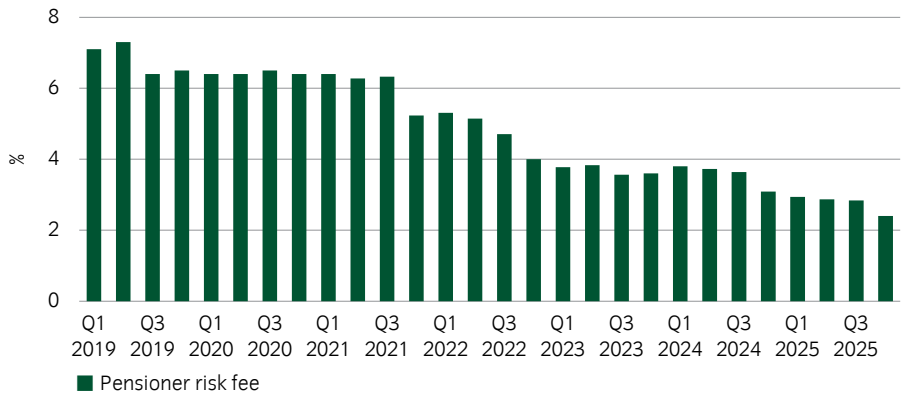
[8] Under a novation, the insurer replaces the pension scheme in the longevity swap transaction and is then responsible for paying the fixed leg to the reinsurer.
[9] Insight Investment. For illustrative purposes only.

A note on the cost of longevity hedging

The insurance premium associated with longevity hedging has fallen in recent years as a result of increased competition amongst reinsurers and a rise in interest rates (see Figure 9).

In the example above, we assumed a risk fee of 3%. This fee had dropped to 2.4% at the end of 2025, meaning the amount of additional investment risk a DB scheme would have to assume to cover the cost would also be lower than in our case study above.

Figure 9: Pensioner risk fee (% of cashflows)[10]



MAKING LONGEVITY HEDGING ACCESSIBLE

Insight has been developing an innovative approach to longevity hedging that aims to transform the way DB schemes manage their exposure to longevity risk.

Traditionally, longevity hedging solutions have been complex, time-consuming, and costly, often requiring bespoke arrangements that limit access for smaller schemes or those with less resource.

By leveraging new streamlined structures, we have developed an approach designed to make longevity risk management more accessible, enabling smaller schemes to benefit from efficient and robust protection against increasing life expectancy in their member population.

Please contact us if you would like to discuss this approach in the context of your DB scheme.

[10] Source: Hymans Robertson estimates based on data from a panel of reinsurers.

IMPORTANT INFORMATION

RISK DISCLOSURES

Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

The performance results shown, whether net or gross of investment management fees, reflect the reinvestment of dividends and/or income and other earnings. Any gross of fees performance does not include fees, taxes and charges and these can have a material detrimental effect on the performance of an investment. Taxes and costs incurred when purchasing, holding, converting or selling any investment, will impact returns. Costs may increase or decrease as a result of certain currency conversions, such as currency hedging, investment exposure to international markets, and exchange rate fluctuations.

Any target performance aims are not a guarantee, may not be achieved and a capital loss may occur. The scenarios presented are an estimate of future performance based on evidence from the past on how the value of this investment varies over time, and/or prevailing market conditions and are not an exact indicator. They are speculative in nature and are only an estimate. What you will get will vary depending on how the market performs and how long you keep the investment/product. Strategies which have a higher performance aim generally take more risk to achieve this and so have a greater potential for the returns to be significantly different than expected.

Any projections or forecasts contained herein are based upon certain assumptions considered reasonable. Projections are speculative in nature and some or all of the assumptions underlying the projections may not materialise or vary significantly from the actual results. Accordingly, the projections are only an estimate.

Portfolio holdings are subject to change, for information only and are not investment recommendations.

ASSOCIATED INVESTMENT RISKS

Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.

The issuer of a debt security may not pay income or repay capital to the bondholder when due. The return risk to a portfolio is higher where a portfolio is highly concentrated in such an issuer.

The investment manager may invest in instruments which can be difficult to sell when markets are stressed.

Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large impact on the portfolio.

A credit default swap (CDS) provides a measure of protection against defaults of debt issuers but there is no assurance their use will be effective or will have the desired result.

Investments in emerging markets can be less liquid and riskier than more developed markets and difficulties in accounting, dealing, settlement and custody may arise.

Where high yield assets are held, their low credit rating indicates a greater risk of default, which would affect the value of the portfolio.

Property assets are inherently less liquid and more difficult to sell than other assets. The valuation of physical property is a matter of the valuer's judgement rather than fact.

The specific collateral used to secure a loan may decline in value or become illiquid, which would adversely affect the loan's value. Also, many loans are not actively traded, which may impair the ability of the portfolio to realise full value in the event of the need to liquidate such assets.

Leveraged funds: as a result of market conditions, the value of the assets held by a fund may fall and result in a higher degree of leverage than is deemed appropriate by the investment manager. In order to reduce the degree of leverage, the investment manager may seek to reduce a funds' total asset exposure. Investors would need to subscribe for additional shares in order to maintain the level of sensitivity to market movements. Where such an event is unanticipated, this may result in the investors having less sensitivity to market movements than they might consider appropriate to their individual requirements until they have subscribed for additional shares.

Money market funds: an investment in a money market fund is not a guaranteed investment and it is different to an investment in deposits as the principal invested is capable of fluctuation. Whilst preservation of capital is a major component of the objective it is not guaranteed. The value of capital invested in a money market fund may fluctuate. The Fund does not rely on external support for guaranteeing its ability to sell its assets and/or meet redemptions (liquidity) or stabilising the fund's price per unit/share (Net Asset Value). Neither Insight nor any other BNYM group company will provide capital support in the event of any capital loss, which will be borne by the investor.

While efforts will be made to eliminate potential inequalities between shareholders in a pooled fund through the performance fee calculation methodology, there may be occasions where a shareholder may pay a performance fee for which they have not received a commensurate benefit.

Longevity

General information

The information within this document, and any related presentation, is intended only to provide general and preliminary information and does not address the circumstances of any particular customer. The content does not constitute professional, investment and/or financial advice, nor does any of the information herein constitute a complete statement of the matters related to this product or the relevant laws relating thereto.

Investment advice

Insight will not provide any advisory services (including the provision of "proper advice" pursuant to section 36 of the Pensions Act 1995) to customers in connection with derivative-based longevity swaps. Customers must ensure the suitability of a derivative-based longevity swap structure in relation to their particular circumstances and are required to seek their own independent tax, regulatory and legal advice in connection with the same.

Third party

Specific service providers that may be referenced within this document or during any associated presentation are intended as examples only and such references should not be taken as an endorsement or recommendation by Insight. Customers are required to conduct their own due diligence in consultation with their professional advisers prior to the selection and engagement of any such service providers and customers retain ultimate responsibility for such engagements.

Reliance

Although the material contained herein, and any information which may be given in a related presentation, was prepared on the basis of information and advice that Insight believes to be reliable, Insight is making the information available to customers without representation or warranty, express or implied, by Insight as to the accuracy or completeness of that information and without any responsibility on Insight's part to revise or update the information. The customer is required to make its own analysis and decisions with respect to a derivative-based longevity swap and the associated documents and agreements, independently and without reliance on information provided by Insight and based upon such investigation and analysis, as it deems appropriate.

Counterparty risk

The swap involves entering into an ISDA-style derivative contract with a reinsurer as the longevity risk taker. While the longevity derivative swap will be collateralised, there remains residual counterparty risk. Customers must ensure they understand the credit profile of the reinsurer counterparty.

Given the generally long-dated nature of these trades, there is an inherent risk that the reinsurer(s)' credit rating may fall significantly below the levels applicable at the inception of the longevity swap trade, potentially indicating the reinsurer(s)' inability to pay debts which, ultimately, shall lead to default under the ISDA. While the ISDA agreement will include mitigation measures - such as collateral arrangements and credit rating downgrade triggers allowing an early exit following the reinsurer(s)' credit rating downgrade – these arrangements won't completely eliminate the risk of reinsurer(s)' insolvency. In such a scenario, the customer may not only lose the benefit of the hedge and incur replacement costs but could also suffer a loss of any collateral posted to the reinsurer(s) in respect of the longevity derivative swap transaction.

Longevity derivatives

Past performance or market conditions are not indicative of future results. The value and effectiveness of a longevity derivative swap depend on a range of factors, including mortality experience, market conditions, and reinsurer counterparty creditworthiness. There can be no assurance that the product will achieve the intended risk mitigation or financial outcomes.

The proposed derivative-based longevity swap structure requires collateral to be posted on a daily basis and adjusted as the swap's value changes. This creates cash-flow demands as well as liquidity pressure and unplanned funding requirements or margin calls, especially during market volatility or stress events.

Although there's growing interest, the longevity swap market remains relatively illiquid, especially for bespoke or large contracts.

FIND OUT MORE

Institutional Business Development
enquiries@insightinvestment.com

European Business Development
europe@insightinvestment.com

Consultant Relationship Management
consultantrelations@insightinvestment.com

company/insight-investment

www.insightinvestment.com

This document is a financial promotion/marketing communication and is not investment advice.

This document is not a contractually binding document and must not be used for the purpose of an offer or solicitation in any jurisdiction or in any circumstances in which such offer or solicitation is unlawful or otherwise not permitted. This document should not be duplicated, amended or forwarded to a third party without consent from Insight Investment.

Insight does not provide tax or legal advice to its clients and all investors are strongly urged to seek professional advice regarding any potential strategy or investment.

For a full list of applicable risks, investor rights, KIID/KID risk profile, financial and non-financial investment terms and before investing, where applicable, investors should refer to the Prospectus, other offering documents, and the KIID/KID which is available in English and an official language of the jurisdictions in which the fund(s) are registered for public sale. Do not base any final investment decision on this communication alone. Please go to www.insightinvestment.com

Documents such as the KIID or KID are not applicable to Australia.

Unless otherwise stated, the source of information and any views and opinions are those of Insight Investment.

Telephone conversations may be recorded in accordance with applicable laws.

For investors in the United Kingdom (UK): Insight's Ireland domiciled UCITS funds are authorised overseas but not in the UK. The Financial Ombudsman Service is unlikely to be able to consider complaints related to the Fund, its sub-funds, its operator or its depositary where relevant. Any claims for losses relating to the operator and the depositary of the Fund are unlikely to be covered under the Financial Services Compensation Scheme. A prospective investor should consider getting financial advice before deciding to invest and should see the Fund prospectus for more information.

For clients and prospects of Insight Investment Management (Global) Limited: Issued by Insight Investment Management (Global) Limited. Registered office 160 Queen Victoria Street, London EC4V 4LA. Registered in England and Wales. Registered number 00827982. Authorised and regulated by the Financial Conduct Authority. FCA Firm reference number 119308.

For clients and prospects of Insight Investment Management (Europe) Limited: Issued by Insight Investment Management (Europe) Limited. Registered office The Shipping Office, 20-26 Sir John Rogerson's Quay, Dublin 2, D02 Y049. Registered in Ireland. Registered number 581405. Insight Investment Management (Europe) Limited is regulated by the Central Bank of Ireland. CBI reference number C154503.

© 2026 Insight Investment. All rights reserved.

16549-02-26