



Institute
and Faculty
of Actuaries

Annuities: challenging times ?

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Opening Comment (and small print)

I would like to extend my thanks to those from whom I have borrowed material and in particular to Daniel Hurley of KPMG who has assisted in the formulation of this presentation but who was unable to speak today.

Nevertheless the views expressed in this presentation are those of the speaker alone, and not representative of any current or former employer (despite what it says on the brochure !).

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

Annuities – Challenging Times

AGENDA

The Environment for Annuities in the UK

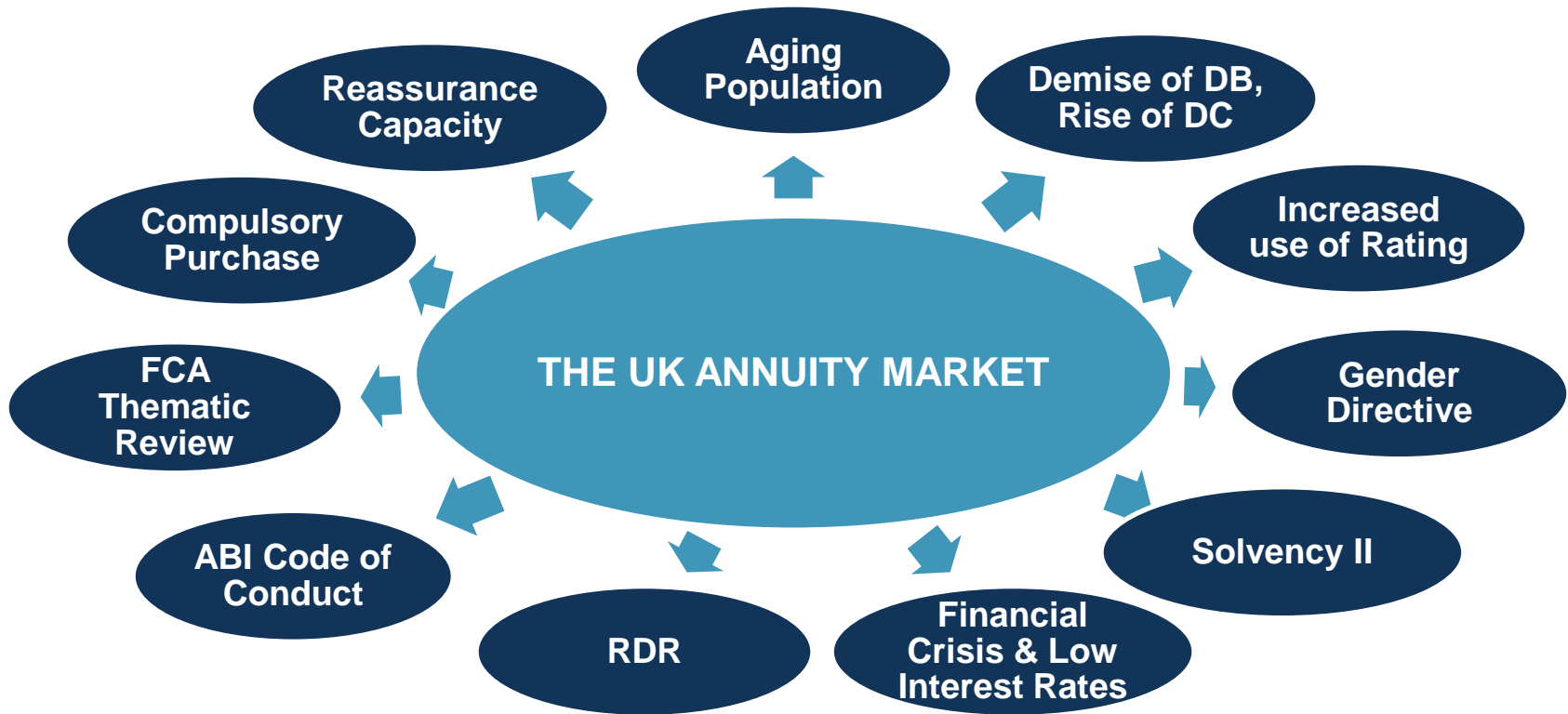
The FCA Review – What and Why ?

The Challenge of Comparing Price

The Challenge of Assessing Profitability

The Future for the UK Annuity Market ?

Environment for UK Annuities (1)

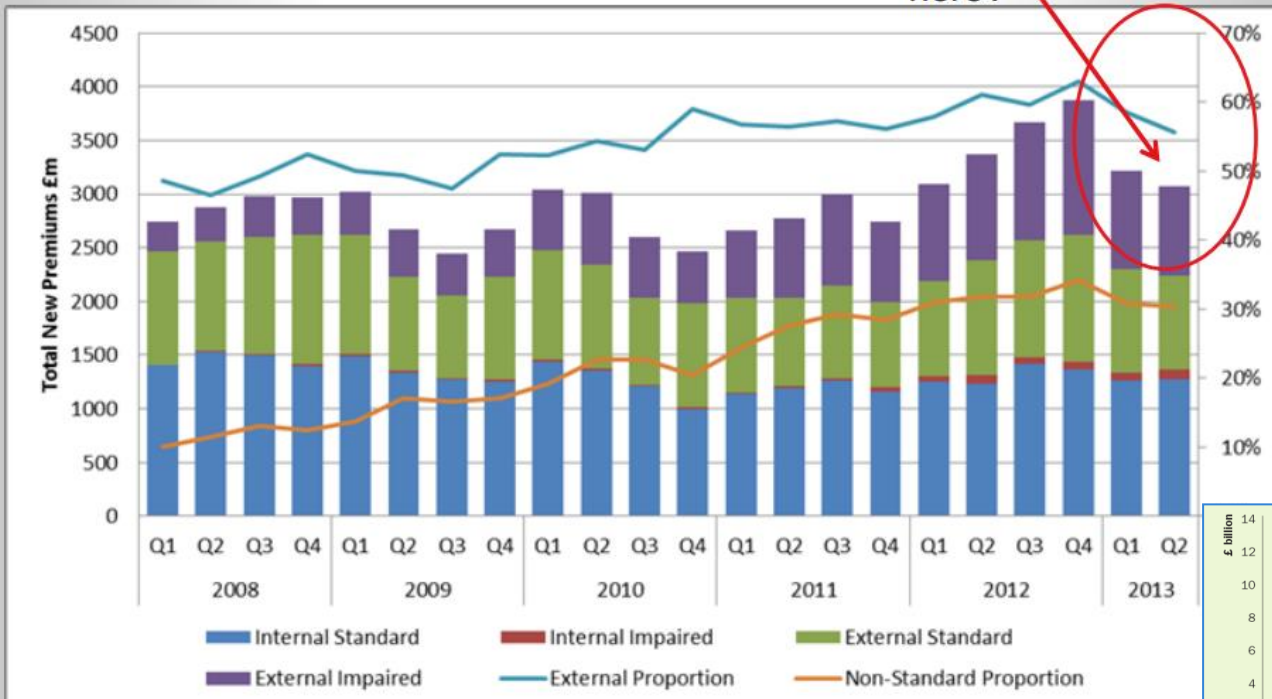


Environment for UK Annuities (2)



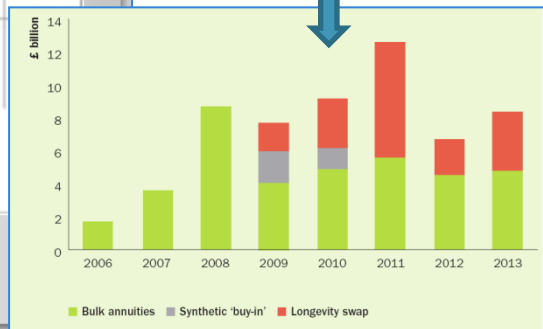
Markets – a tough start to 2013

What's going on here?

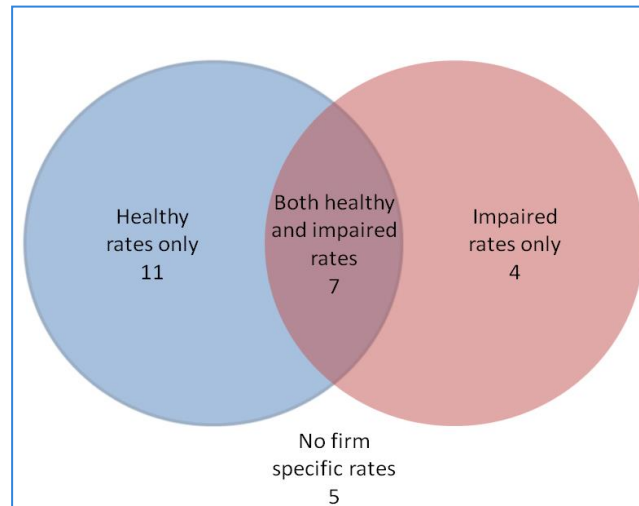
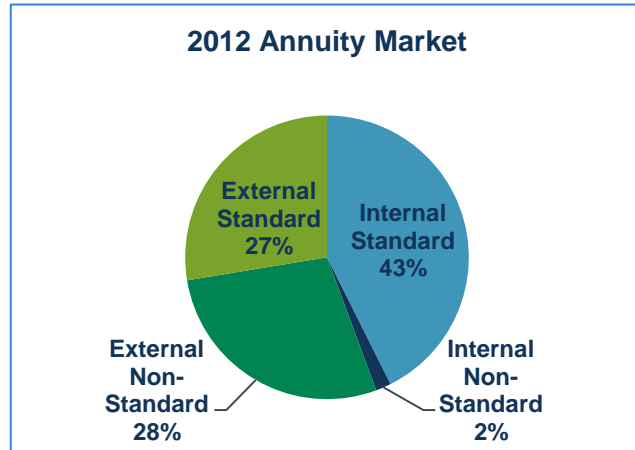


Source : ABI new individual annuity data

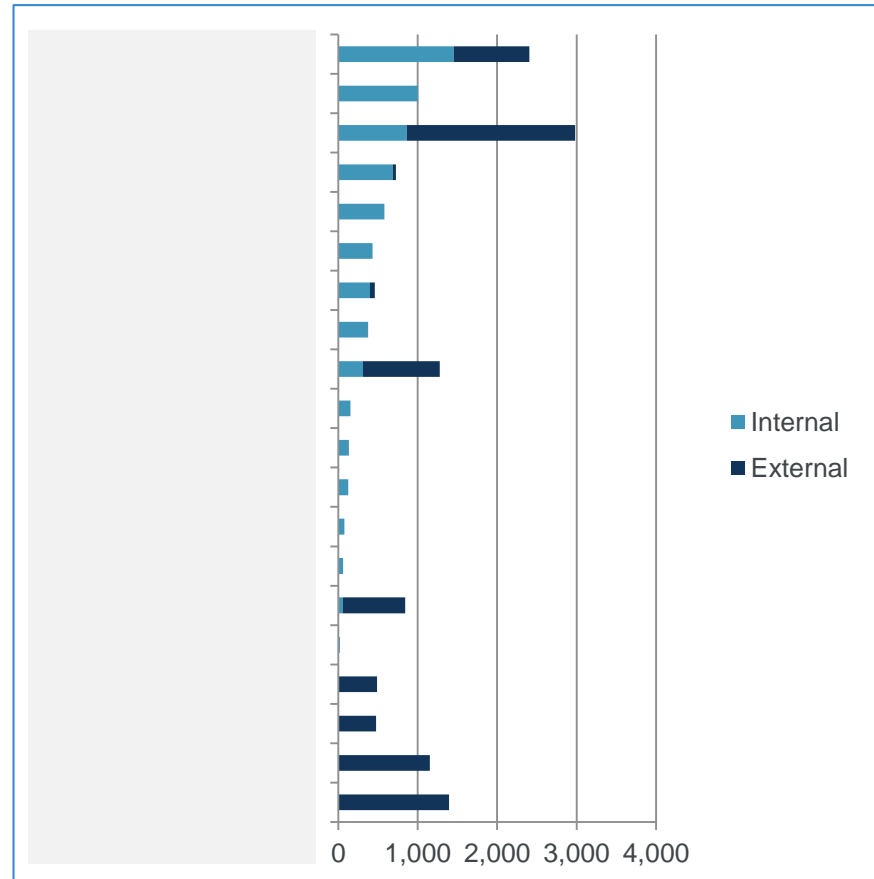
Bulk Annuity Market



2012 UK Annuity Market



2012 Business Written (£m SP)



The FCA's Thematic Review

Why ? ... Unconvinced the Industry is Doing Enough ?

Regulatory Change (1) – OMO Reform

There has been a long journey to the current position:

- Sep 2002** FSA requires OMO to be included in wake-up pack
- 2007** Treasury/DWP sets up an OMO Review group to review the market
- April 2008** Outcome of the FSA thematic review on OMOs
- 2009** ORIGO's Options pensions introduced to speed up the transfer process
- 2011** The Government threatens to consider legislative options to improve OMO rates
- Mar 2012** The ABI compulsory Code of Conduct is launched with a deadline of 1st March 2013 for compliance

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Yet still ...

- **Over 50% staying with vesting pension provider**
- **Only 2% “enhanced” cf 60% omo**
- **20% disparity in price**
- **Inertia driven sales requires positive action**

How ?

Price

Profitability

Process

FCA Price Comparison - Challenges

Annuity Quotes Survey – Whole Market

16 Single Life + 1 Joint Life, 1 post code, no gender

- 2 ages, 4 annuity levels, 2 health (non / smoker)



Challenges

Not all insurers use the same rating factors and / or loadings.

Some insurers do not use post code rating.

Those that do use different source models.

Not all insurers have the same business mix.

Socio-economic mix, Gender mix.

Insurers have differing investment strategies and risk appetites

Credit markets, negative bases, mortgage returns will vary over time.

ABI Quotation Survey

Annuity Quotes Survey – Whole Market

6 Single Life + 6 Joint Life - 1 age, 1 small annuity,

- 3 unhealthy types (stroke, smoker, lung disease) – all from London

- 3 locations – for healthy individual:

“Death rates of characters in soap operas on British television: is a government health warning required?”
British Medical Journal



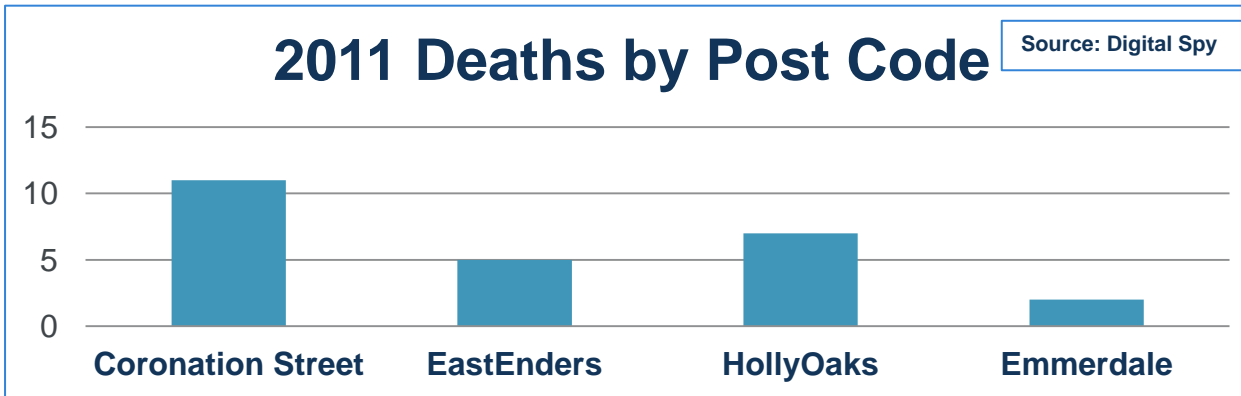
Manchester City



London Borough



Leafy Suburb

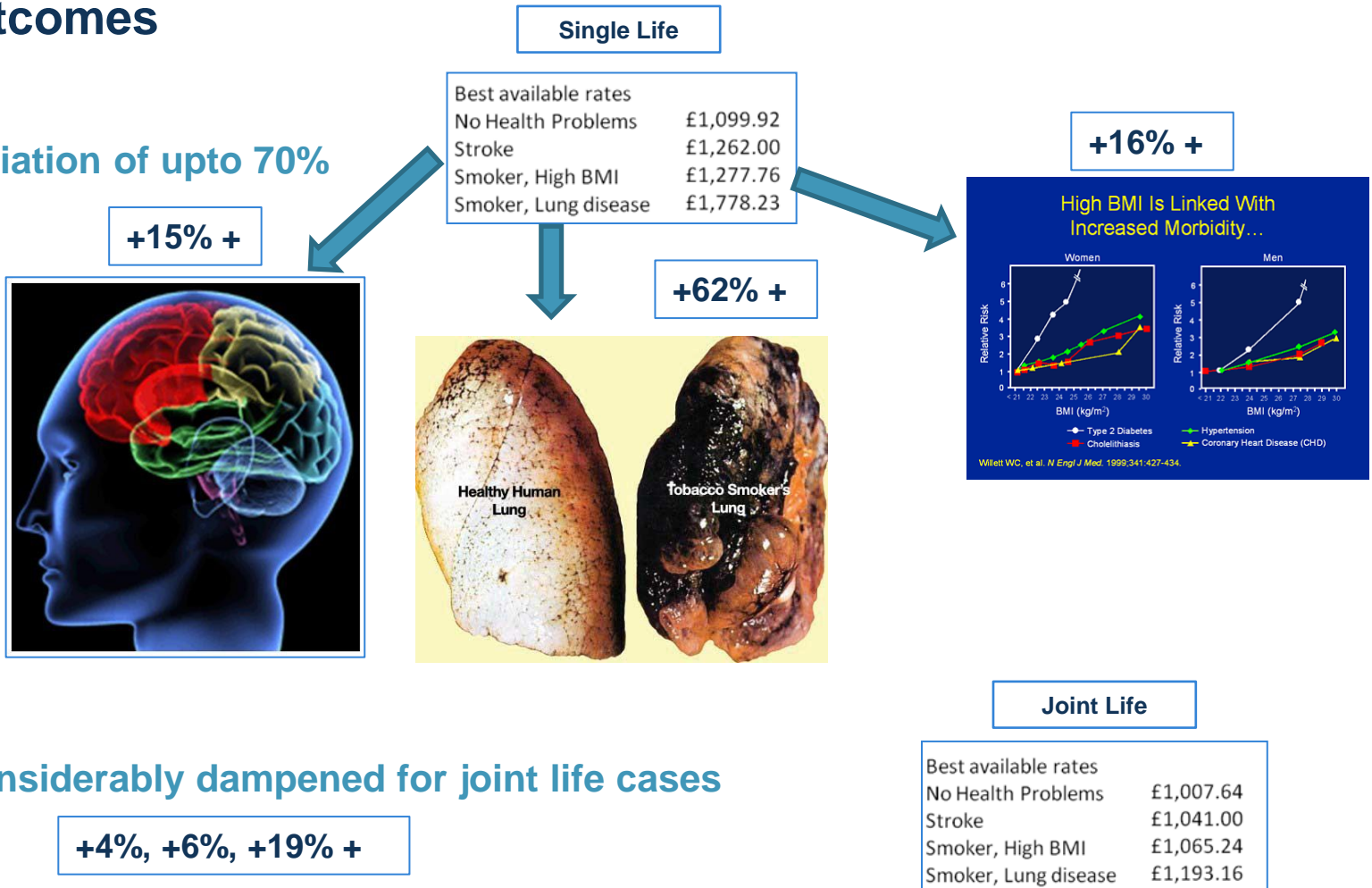


Yorkshire

ABI Quotation Survey - Learnings

July Outcomes

Health variation of upto 70%



Impact considerably dampened for joint life cases

ABI Quotation Survey - Learnings

Significant Price Range

- upto 30%

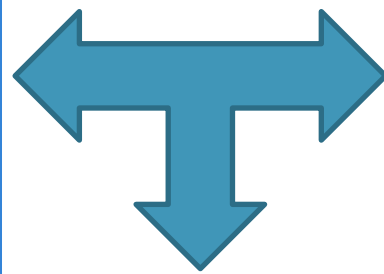
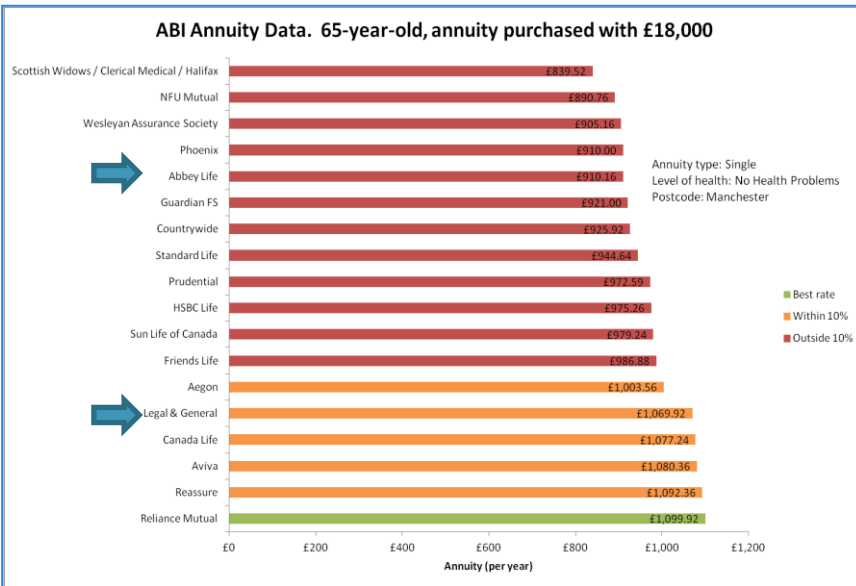
Some outliers but...

Top 5 v Last 5 >> 10%-15%

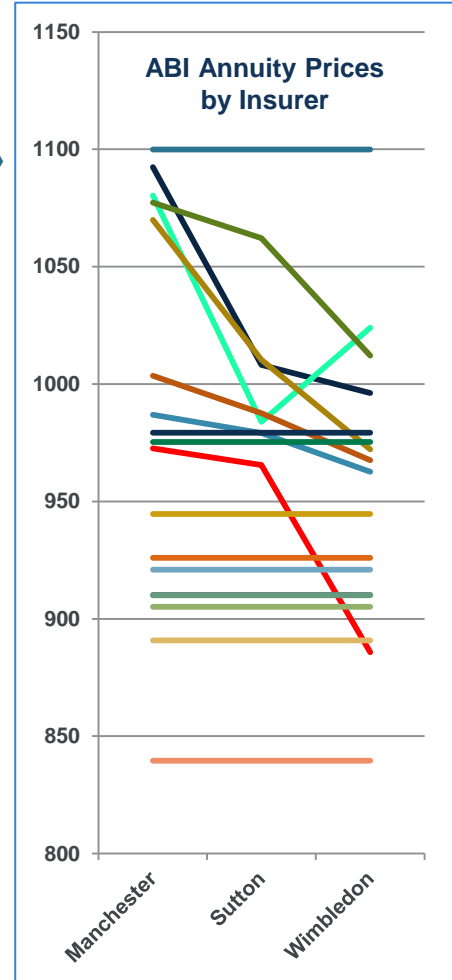
8 / 18 Varied by Post Code

Post Code Differential between 2.5% and 9.0%

Selection Risk Alert !

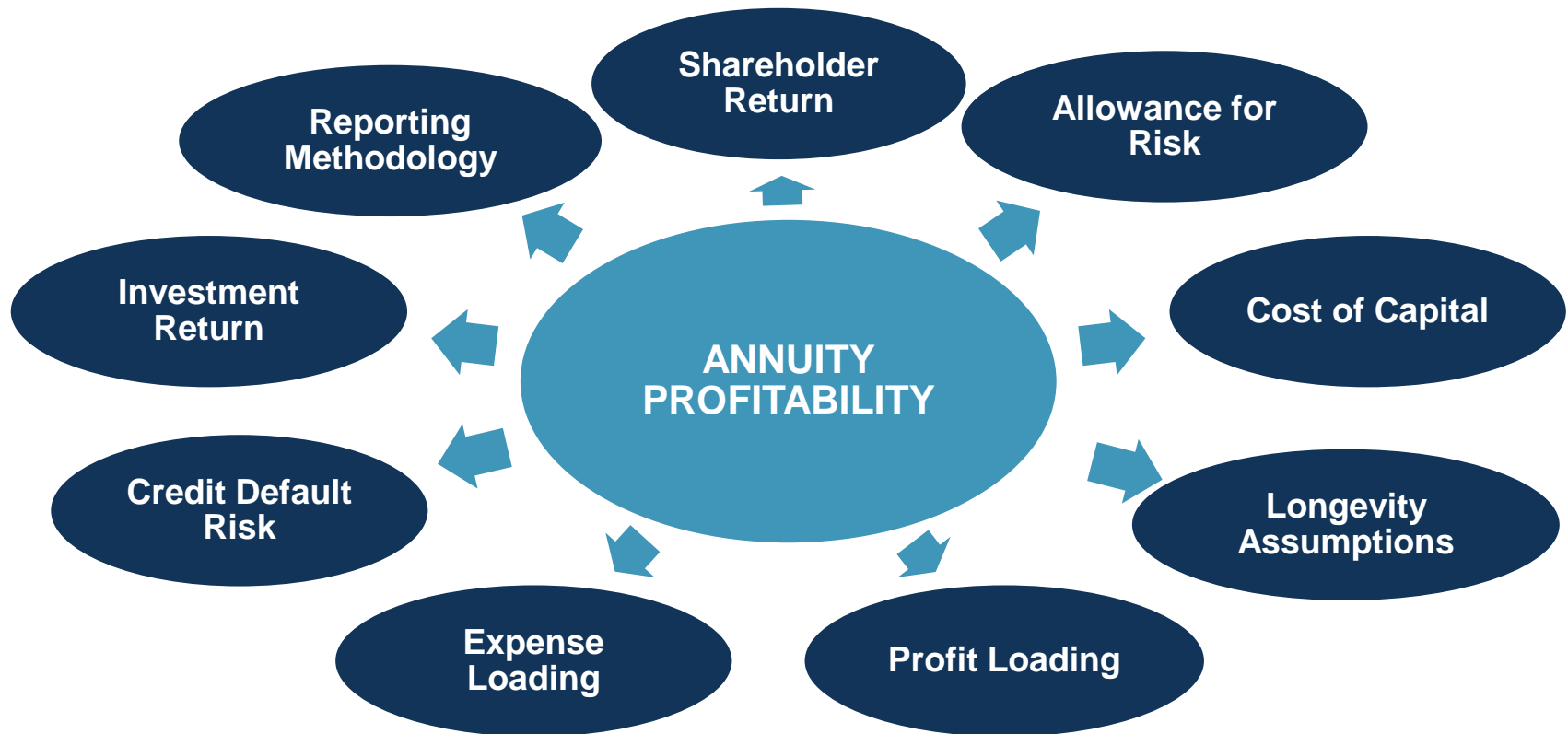


Response ?
Price changes !
For the best...?



Source: ABI, KPMG

Challenges for the FCA – Profitability ?



Longevity Assumptions

Socio Economic Underwriting Risk

Traditionally Pooled Experience => Post Code

Individual Health Underwriting Risk

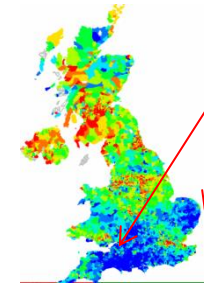
Underwriting manuals but limited experience over 60. Also Moral Hazard.

Anti-Selection Risk from Healthy Lives

Own experience hugely dependant on practices of other insurers.

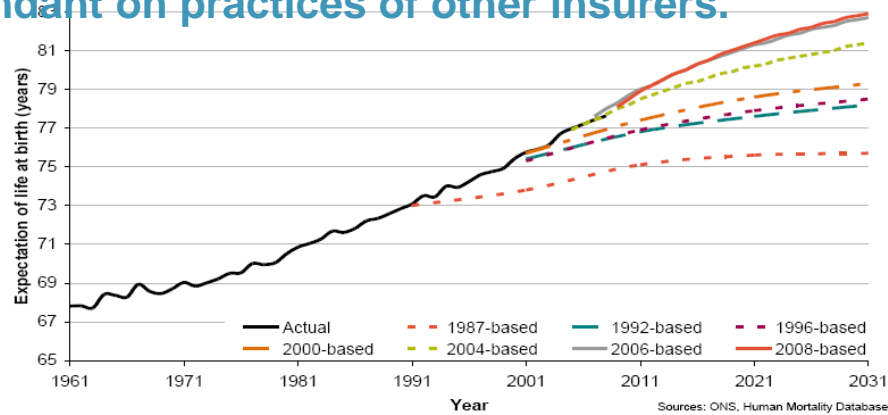
Future Improvements

Industry repeatedly wrong.



“Somerset and Suffolk towns top life-expectancy list for older people.” The GUARDIAN

“Violent death rates in The Archers higher than national average” The MIRROR



How do insurers' price for these significant shareholder risks ?

Investment Returns

Traditional Investment in Credit

Who should the risk premium belong to ?

Who should the liquidity premium belong to ?

Which period is an appropriate measure ?

How do you price for being unlucky ?

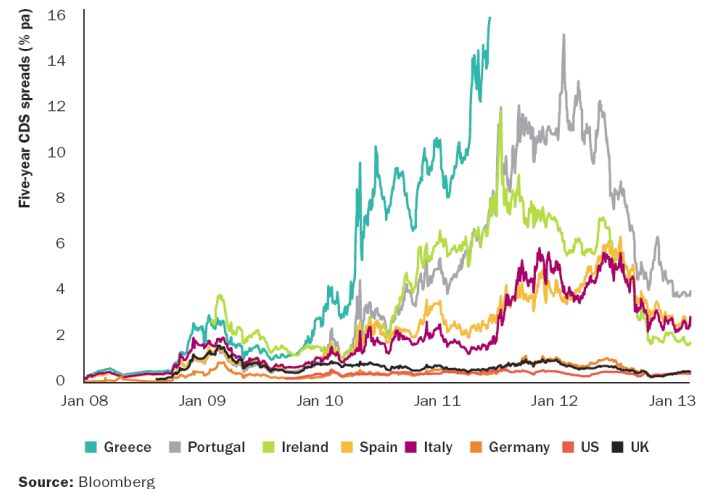
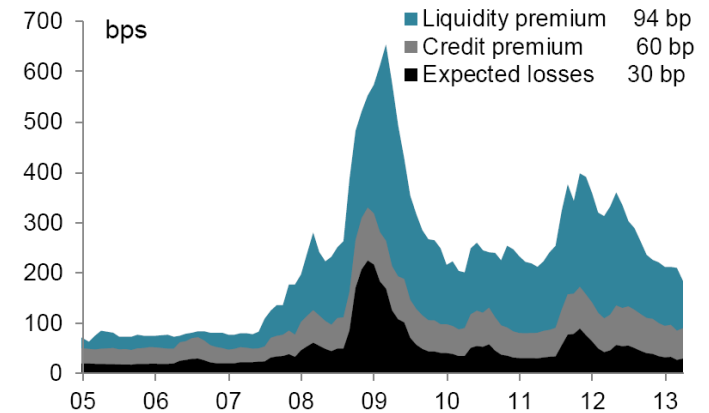
Alternative Strategies ?

How to allow for risks ?

Solvency II

Investment profiles may become impossible ?

Can you rely on achieving current returns ?



Should insurers retain more risk premium for taking credit risk ?

Cost of Capital



Historically Probably Understated Cost of Capital ?

Pillar one requirement, Pillar 2 includes diversification, MCEV

Solvency II is still unclear

What is / has been an appropriate assumption for level of capital ?

Economic Capital

Seems far more logical, but how do you deal with:

- Diversification ? Can you rely on it ?
- What level of security ? Reg Min = 1 in 200 ? Desired rating = AA ?
- What return on capital ? Risk free ?

Have insurers factored in the full cost of capital ?

Drawing Together Risk and Return

Expense Loadings

Appropriate Contribution to Overheads ? Care over zero sum game ?

Brand Capital ?

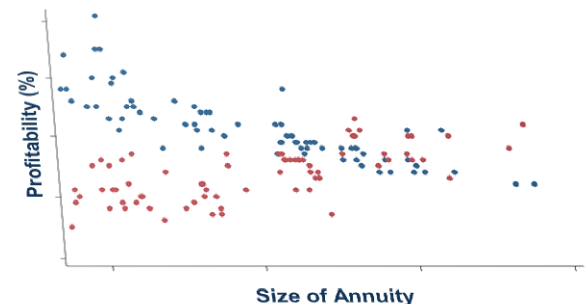
Competition theory suggests Brand is a form of Capital that requires a return.

Profit, Risk and Return

Should risks be allowed for in assumptions or in return ?

Should this reflect diversification benefit with other risks ?

A key benchmark would be the level of profit for a near risk free approach using 100% gilt investment, and 100% reinsurance to a strong counterparty.



The Future for UK Annuities ?

Market Demand

Perhaps males and healthy pensioners will defer annuitisation ?

But still ultimately Growing Market, Huge Opportunity

Insurers

Passive approach to retiring customers not option.

Rating is out there – adapt or die ...

Does the cross subsidy from unhealthy to healthy have to end ?

Regulators

Can we simplify the rules or product ?

Solvency II will become clear !!

Price Comparison Here to Stay





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