

The Actuarial Profession
making financial sense of the future

Pensions Conference 2012
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Buying Bulk Annuity Contracts for Small Schemes

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Agenda

- Why Buy Bulk annuities?
- Annuity Premia vs Funding Reserves
- The Market
- The Practicalities

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1

Why Buy Bulk Annuities?

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2

Why buy a bulk annuity

Benefits:

- Better matches the underlying liabilities
- Removes longevity risk
- Route to wind up
- Administrative ease
- Less onerous monitoring

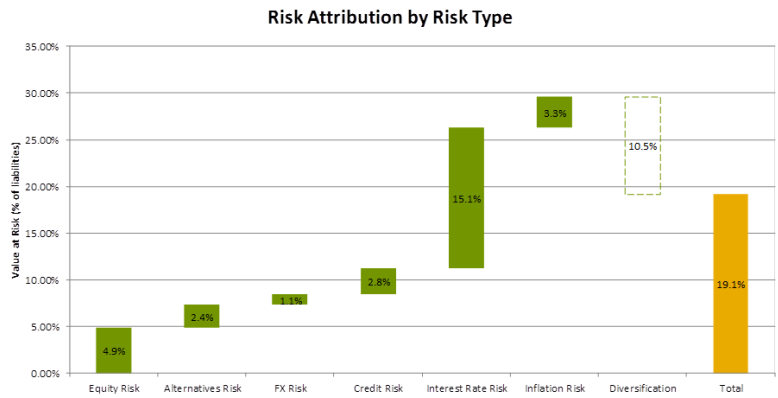
Costs:

- Funding reserve and “best estimate” cost below Annuity Premium
- Assets below Annuity Premium
- No benefit from future positive experience

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3

Risk reduction



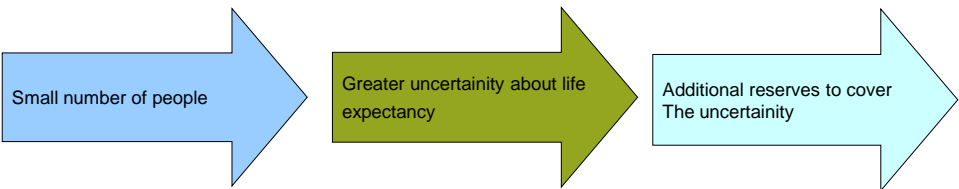
Key point - Speak to investment consultant about optimal risk reduction strategies

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4

Why size matters

Basis risk



99% confidence? (2.5% discount rate)	Numbers of members	5	50	500
	Increase in provisions	30.4%	10.3%	3.4%

Source: SIAS paper: Financial aspects of longevity risk – October 2004

Key point – small schemes have the most to gain from insuring mortality risk

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5

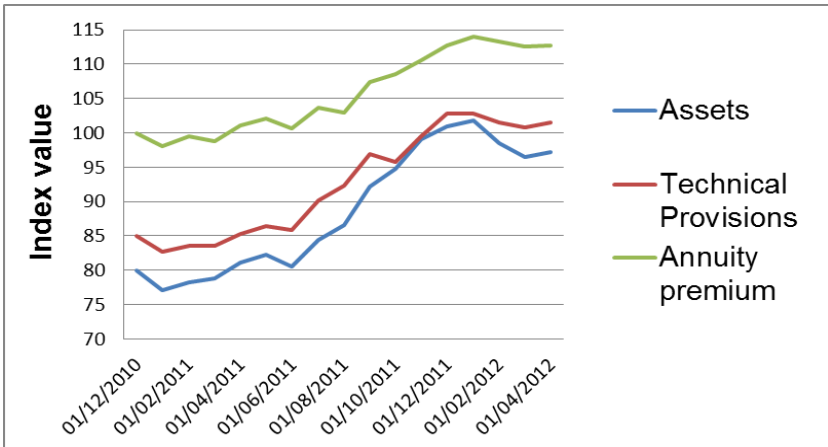
Annuity premia vs. Funding Reserves (pensioners only)

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6

Funding Reserve & Assets vs Annuity Premium

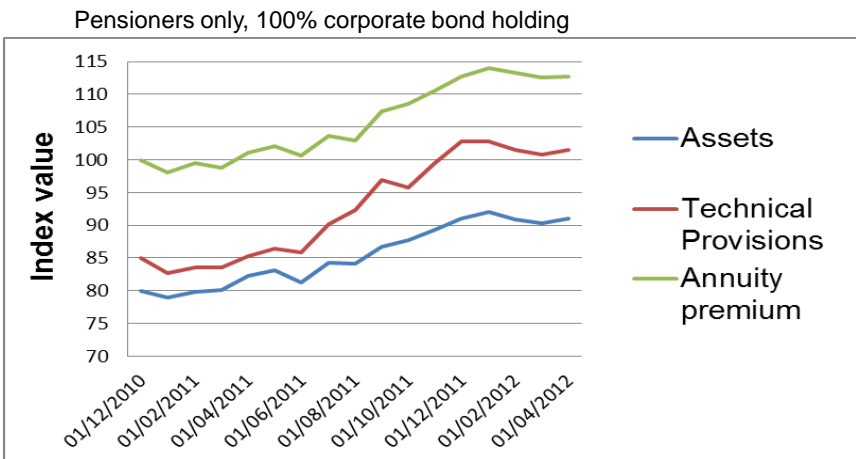
Pensioners only, 100% gilt holding



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7

Funding Reserve & Assets vs Annuity Premium



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8

Funding Reserve vs Annuity Premium

Funding

Annuity

Reserve

Premium

£10m



£11.6m

Discount rate (+ £0.4m)

Future pension increases (+ £0.2m)

Life expectancy (+ £0.4m)

Insurer expenses (+ £0.6m)

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9

Funding Reserve vs Annuity Premium

Funding		Annuity
Reserve		Premium
£10m		£11.6m

Discount rate

Gilts + 0.6% Vs. Gilts + 0.3%
+ £0.4m

Funding Reserve vs Annuity Premium

Funding		Annuity
Reserve		Premium
£10m		£11.6m

Future pension increases

- Swap rates around 0.2% above Bank of England implied rates
 - Insurers not good value on CPI (around 0.2% below RPI)
- + £0.2m**

Funding Reserve vs Annuity Premium

Funding		Annuity
Reserve		Premium
£10m		£11.6m

Life expectancy

For a male aged 65, 23 years Vs. 24 years

+ £0.4m

Allowing for basis risk could make the funding reserve highest!

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12

Funding Reserve vs Annuity Premium

Funding		Annuity
Reserve		Premium
£10m		£11.6m

Insurer expenses

£0m vs £0.6m loading by the insurer

+ £0.6m

...but 30 years running the Scheme could add £2m in advisor fees to funding reserve!

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13

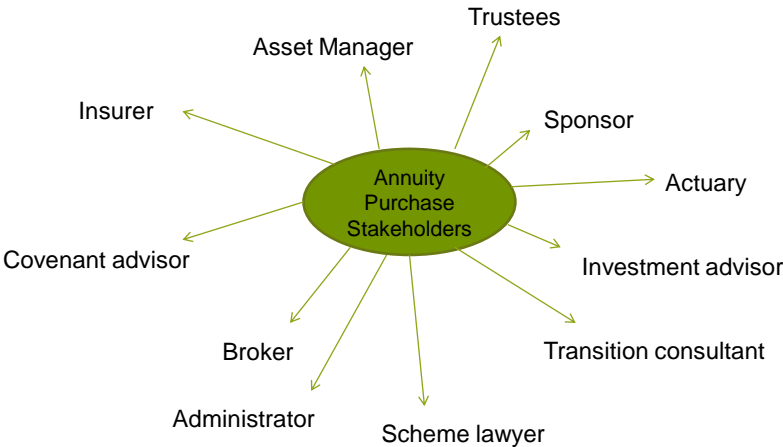
The Market

Participants in UK Buy-In/Buy-Out Market

New deals completed in Calendar Year 2011		
Insurance Provider	Size (£m)	Nº of Deals
Legal & General	1,461	82
Aviva (Norwich Union)	1,076	49
Prudential	338	2
Rothsay Life	1,045	3
Lucida	45	1
MetLife	623	23
Pension Insurance Corporation	666	11
Total	5,254	171

The Practicalities

Who gets the deal done?



Timeline of Deal Day

Date	Time	Action
1 March 2011	9:00	Formal Trustee meeting
1 March 2011	9.30	Trustee signs documents
1 March 2011	9.30	Insurer signs documents
1 March 2011	9.30	Lawyer dates the signed documents
1 March 2011	10.00	Lawyer confirms documents signed
1 March 2011	10.15	Trustee instructs disinvestment
1 March 2011	12.00	Insurer "on risk"
1 March 2011	12.00 to 16.00	Investment manager disinvests
2 March 2011	Around 13.00	Asset sale proceeds known
4 March 2011	12.00	Cash passed to the insurer

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18

Top Deal Breakers

- No clear objectives set from the outset
 - Lack of sponsor support
 - No Price objective
 - Check wider issues e.g accounting hit to sponsor
- Poor benefit specification
- Poor data
- Poor coordination between advisors, client, asset manager and insurer

LEARNING POINT: Planning ahead is essential

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19

Key Learning Points

- Risk reduction is a key objective
- An additional cost is paid for the protection
- The annuity market is still busy
- Clear objectives give successful conclusions

Non-Standard Deals

- Deferred premium
- Deferred first payment
- Medical underwriting
- Without pension increases
- PPF+ cases
- Longevity swaps (over £50m)

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