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# Friends Life With-Profits Annuity De-risking (WPAD)

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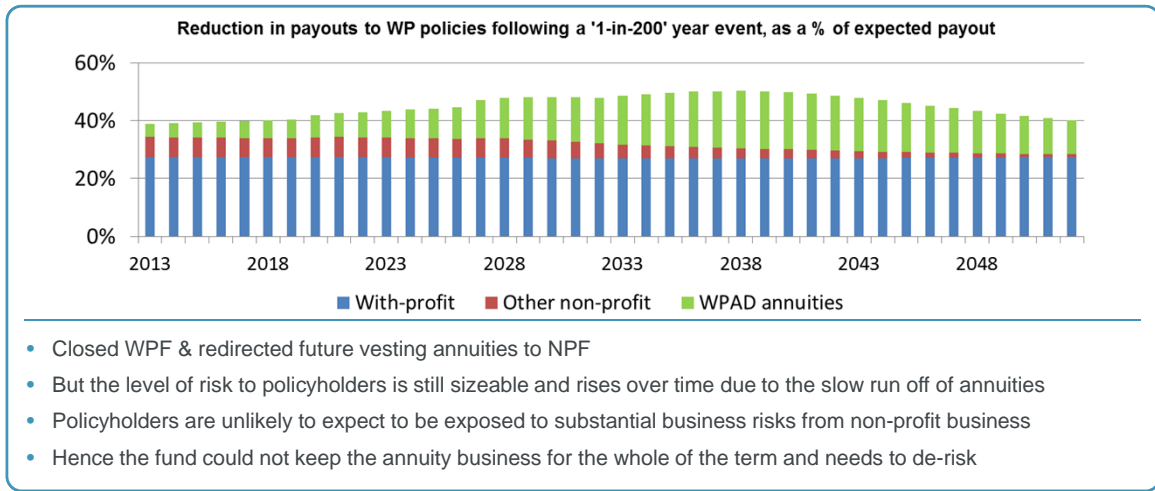


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Sponsorship  
 Thought leadership  
 Progress  
 Community  
 Sessional Meetings  
 Education  
 Working parties  
 Volunteering  
 Research  
 Shaping the future  
 Networking  
 Professional support  
 Enterprise and risk  
 Learned society  
 Opportunity  
 International profile  
 Journals  
 Support

## Background – Impact of WPF holding annuities



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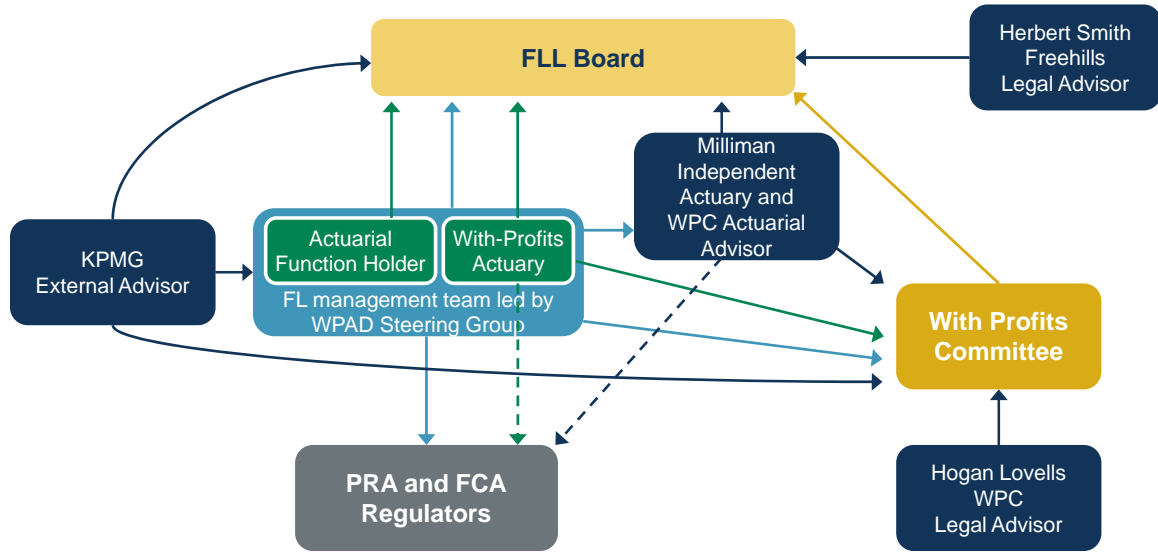
## Options for WPAD and why internal reallocation



- Internal reallocation to the non-profit fund completely removes the non-profit risks from the WPFs and does not involve the non-profit policies being moved to a completely different company
- Needs willing shareholder

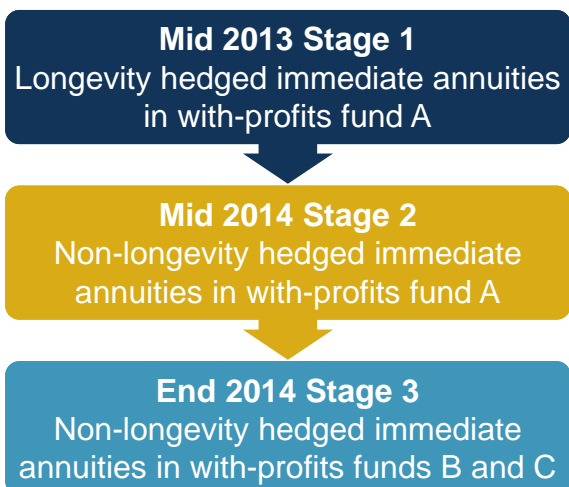
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## Governance rules



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## Stages of the WPAD



To fully de-risk the with-profits funds, all the following non-profit annuity business should be reallocated:

- Existing immediate annuities
- Existing deferred annuities
- New non-profit annuities arising from future new vestings

De-risking of the deferred annuities and new vestings were carved out of the original scope into a separate redirection project

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## KPMG's role as the External Advisor to derive a range of market tested prices

KPMG acted as the External Advisor for Friends Life for the reallocation to:

Determine ranges of prices at which the Friends Life could reasonably carry out a reallocation of the annuities to the non-profit fund



Provide information on how the range of prices will vary with market conditions



In respect of new vestings, advise on suitable long term pricing approaches under which new vestings could be allocated to the non-profit fund or otherwise removed from the with-profits funds



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## Range of prices - components

- For the existing annuity business, we determine two ranges:

### Financial Basis

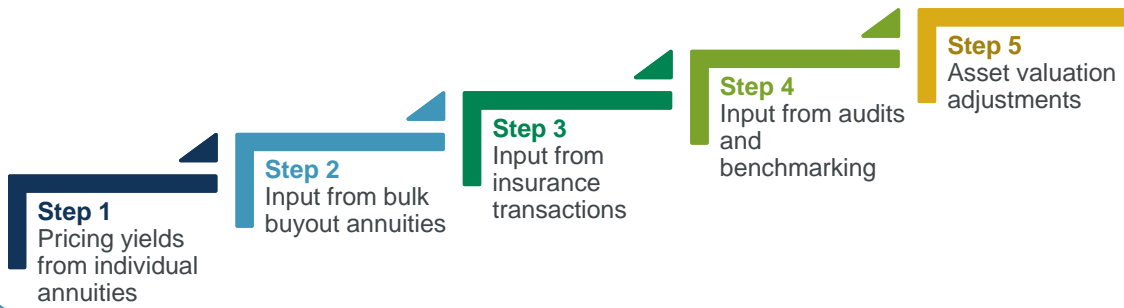
- For the financial range, we determine a range of spreads to the swap curve which can be used to discount the best estimate annuity cashflows to determine a reallocation price.

### Mortality Basis

- For the mortality range, we determine a range of best estimate mortality assumptions based on our independent review of the relevant mortality experience. These can be used to project forward the best estimate annuity cashflows mentioned above.

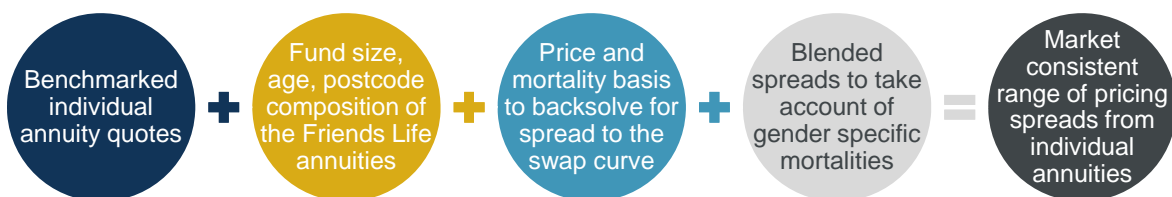
## Financial Basis

A 5-step process for the proposed Financial Basis is used:



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## Step 1: Pricing yields from individual annuities



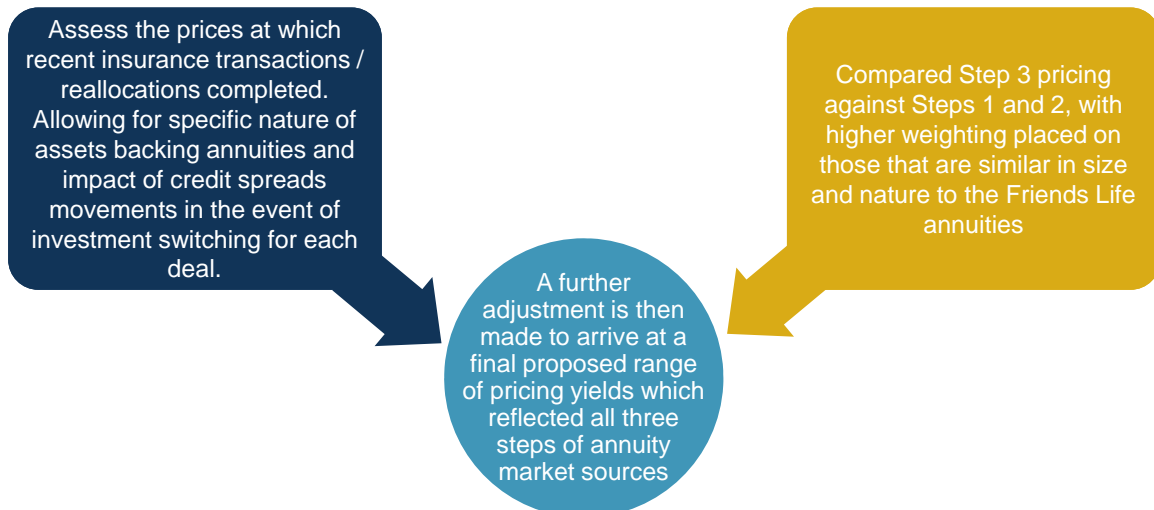
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## Step 2: Input from bulk buyout annuities



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## Step 3: Input from insurance transactions



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## Step 4: Input from audits and benchmarking

### Step 5: Asset valuation adjustments

#### Step 4: Inputs from audits and benchmarking

- Information gathered from audits and benchmarking of realistic mortality and improvements bases were considered
- Links to Proposed Mortality Basis (next slide)

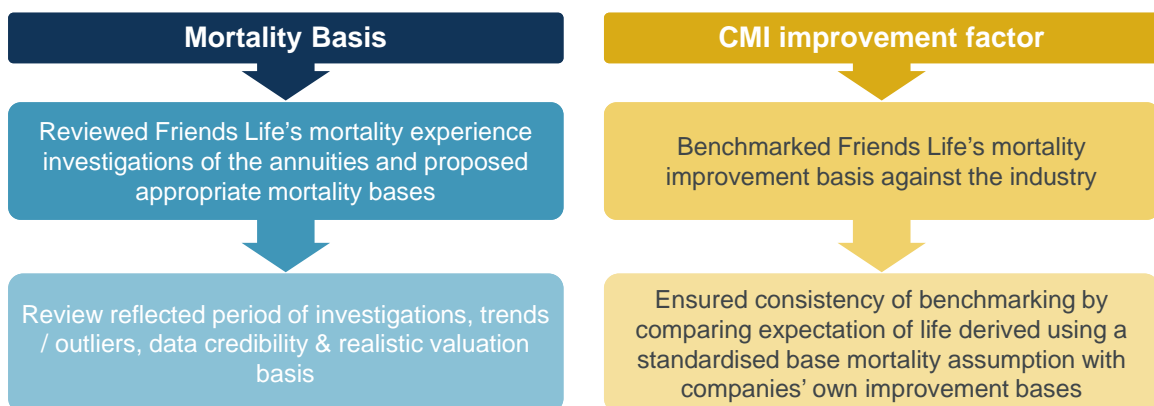
#### Step 5: Asset valuation adjustments

- Reviewed with our banking practice the valuation methodology of the assets backing the annuities, focusing on non-mark to market assets which are difficult to value
- All assets to be transferred are generally valued at bid values. Recommended adjustment for assets valued on a non-bid basis
- Assets dependent on input from external asset managers required Friends Life to engage with the asset managers on judgemental aspects of asset valuation

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## Mortality Basis

The proposed Mortality Basis determined a range of realistic mortality bases (% mortality table and mortality improvement factors) for the reallocated annuities



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## Impact of the March 2014 Chancellor's Budget on the Financial Basis

- The Chancellor's 2014 Budget released in March 2014 has had some impact on the developments of the individual and bulk annuity markets since then
- Evidence of downsizing of the individual annuity market and some improvement in bulk annuity quotations since the Budget. Not easy to know whether this is due to the Budget or companies having available particular assets of which to offer better terms. But sufficient and consistent market comment means impact of the Budget should be allowed for at the time in 2014
- Individual OMO market quotes have on average become more competitive since January 2014. This increased competitiveness is not universal, as some companies' prices have become less competitive since January 2014. This may be a result of the uncertainties in the market as a result of the March 2014 Budget, with companies taking different strategies during the transitional period

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## Determining the actual price

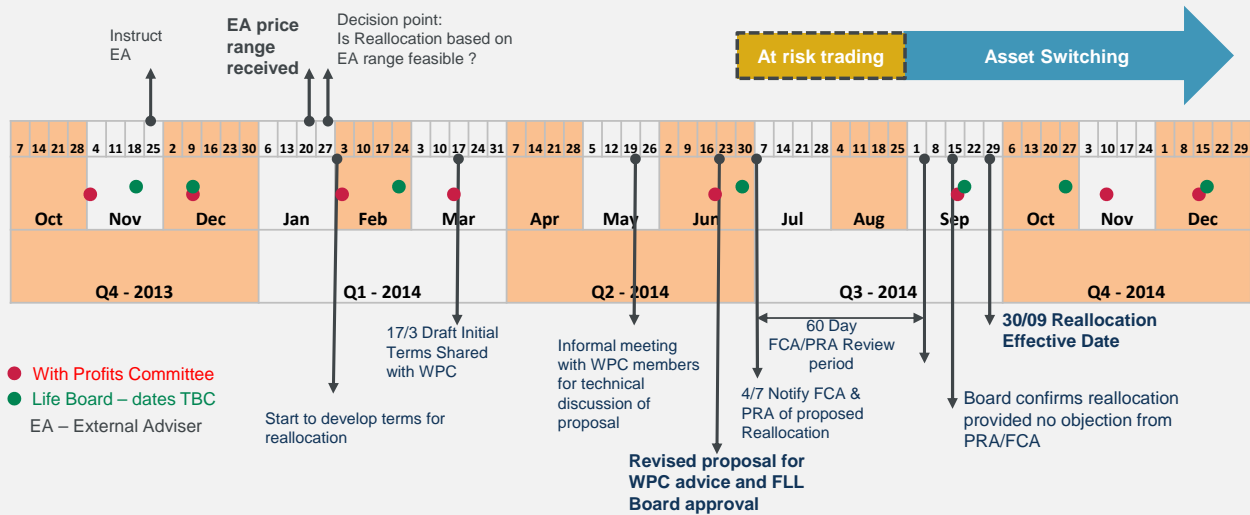
- Stage 1 risk free.....
- Stage 2 / 3 shareholder:
  - return on economic capital
  - acceptable impacts on other metrics
- Real best estimate assumptions
  - Investment strategy / returns, allowance for special assets
  - Longevity – more portfolio specific, future improvements
  - Other, e.g. historic age ratings, any spouse cases, LPI....
- Acceptability:
  - price range position versus other T&Cs
  - supplementary benchmarking of price/impacts versus new business and public market information
  - Independent Actuary
  - PRA/FCA/WPC Actuarial Advisor, "commercial tension"



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## Example timeline



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## Investment considerations

Which assets to accept?



What price for illiquid assets?



Asset transition issue:

- Particular issue for Stage 1 as c£2bn liabilities but low risk assets
- Period on risk – time to switch + governance lead time



Asset transition solutions:

- Price / range roll forward
- WPF ring-fence => start early but not at WPF risk
- Keep some assets
- Asset manager purchases
- Warehousing / matched sales
- Transition managers
- Monitoring



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## Implementation

- Impact of implementation considerations on transaction?
  - Policies in scope (suspended policies? material pricing uncertainties?)
  - BAU limitations
- Repointing policies – admin systems versus downstream
- Data cleanse
- Death reviews
- Outsourcer engagement
- Improvements in BAU reporting
- Lower burn-through risk => capital support reductions
- “Fairness review” of premium (due to Budget changes)



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## Conclusions

- WPAD Stages 1 to 3 were implemented successfully and enabled the WPC / WPA / Board of Friends Life to reallocate the business the NPF, at a fair price from both policyholder and shareholder perspectives
- The with-profit funds are now in a much cleaner position as a result of not having the non-profit immediate annuity risks in them
- KPMG have successfully used the same process of annuity de-risking with two other companies



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**Questions**



**Comments**

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