E5: Medically Underwritten Bulk Annuities - Background reading

Conventional bulk purchase annuities - recap

A bulk annuity is a policy that trustees of a defined benefit pension scheme purchase from an insurer to cover the liabilities for those members included. This can be by way of a buyout or a buy-in.

A buyout would fully extinguish the liabilities, with the insurer issuing individual policies to members; whereas for a buy-in, the trustees would purchase a policy from an insurer which would be held as an asset of the scheme. This would usually match the benefits paid from the scheme and cover all or part of the pensioner population, although it could also include deferred members.

The conventional method for pricing a bulk annuity has been for insurers to consider each member's age, sex, postcode, pension size and occupation, with the missing piece of information being their health. The insurer would then make prudent assumptions as to the impact of average population levels of impairments on the life expectancies of the members under consideration.

Medically underwritten annuities

The market for enhanced individual annuities following medical underwriting has developed significantly over the last three years, with specialist providers emerging and driving this marketplace forward.

Statistics show that approximately 40% of members would qualify for some type of enhancement (as per Partnership Assurance). Qualifying conditions (both common and severe) include:

- Smoking
- High blood pressure / raised cholesterol
- Diabetes
- Angina / heart conditions
- Cancer

This innovation has now been brought into the bulk annuity market, with both specialist and established providers supplying underwritten solutions for schemes. By obtaining health information from individual members, schemes could potentially reduce the cost of a buy-in or buyout, ultimately making this more affordable. Although members do not directly gain by increasing their pension income, a successful underwritten exercise could improve the funding and security of a scheme (through potentially paying a premium below a scheme's Technical Provisions measure of the liabilities and reducing funding level volatility).

What are the benefits of a medically underwritten bulk annuity?

A medically underwritten approach should provide trustees with a more realistic view of the longevity risk held in a scheme and therefore a more accurate bulk annuity price. This may be lower than a conventional price, which could make a transaction more affordable and attractive. By completing a transaction the trustees would remove longevity, inflation and investment risks associated with the liabilities covered, which would have a positive effect on the risk profile of the scheme.

Is there a downside?

Once a scheme has obtained medical data, trustees are obliged to share information connected with this activity with insurers. This will preclude them from obtaining quotations from some bulk annuity providers who cannot offer a medically underwritten quotation. Also, it may be that a conventional approach would have offered a more competitive price, for example if members are of better than average health. If it does turn out that members are of better health than previously assumed, this will allow the trustees and sponsor to refine their own mortality assumptions in future valuations of the scheme's liabilities.

Which schemes may be appropriate?

Medically underwritten bulk annuities will not be suitable for all schemes. For example, some schemes may benefit from a conventional pricing model where members are expected to be healthier than the average scheme. As trustees will be required to share any medical data with insurers, they should consider whether they believe an underwritten approach could be advantageous before embarking on a process of obtaining underwritten quotations. Points to consider would include:

- ***Number of members to be included*** – these exercises are generally appropriate for transactions with fewer than 300 members. This does not mean that they are restricted to smaller schemes. For example, a tranche of pensioners from a larger scheme could be considered (such as the largest pensions in payment).
- ***Type of transaction*** – the transactions to date have mainly been for pensioner buy-ins, as not all insurers can provide underwritten quotations for deferred members (although this is changing).
- ***Number of ill-health early retirements*** – do the trustees hold this information and, if so, have a relatively high proportion of members taken ill-health early retirement?
- ***Known health or lifestyle conditions*** – the trustees may be aware of any health or lifestyle conditions members have.
- ***Concentration of risk*** - schemes may have a small number of members who carry a significant and disproportionate amount of the overall liability; the trustees may have some knowledge of these members' health. Insurers would otherwise be expected to price these members ultra conservatively.
- ***Conventional buy-in was not affordable*** - schemes that have obtained a conventional buy-in quotation that proved to be unaffordable could consider obtaining medical information to establish whether the price would be lower via an underwritten approach.

Insurers involved

There are currently four insurers actively quoting for medically underwritten bulk annuities:

- ***Aviva and Legal & General*** - established insurers, active in the conventional bulk annuity market for the past few years.
- ***Partnership Assurance and Just Retirement*** - specialist enhanced/impaired life annuity providers from the individual annuity market, recently entered into the bulk annuity market (late 2012).

Process

Assuming a medically underwritten approach is decided upon, information on members' (and their spouses') health and lifestyles must be obtained to provide to the insurers. The remainder of the broking process is similar to that for a conventional bulk annuity exercise.

There are various possible methods for gathering the required data and different insurers have different preferences. Possibilities include:

- ***Initial data gathering*** - write to members to complete a short initial questionnaire or invite them to participate in a telephone interview.
- ***More in depth data gathering*** - obtain a full/targeted general practitioner report or conduct a detailed telephone interview.

Trustees can either choose to work with one insurer or run a multi-insurer process. For the latter, agreement must be reached between the trustees and the insurers regarding the underwriting method to be used and a third party administrator is generally required to collate the health information and ensure this is provided to all insurers at the same time.

Best practice guide

Due to the growth of this market, and with a number of new whole of market deals in progress, an industry working group has been established to develop a good practice guide for stakeholders in this area. The group, which is chaired by JLT Employee Benefits Director, Margaret Snowdon OBE, and includes representatives from four insurers, several employee benefit consultancies, an independent trustee firm and a pension law firm, expects to report in Q3 2014.

The above will give guidance to ensure consistent, safe and efficient practice in this new area of medical underwriting in relation to defined benefit scheme de-risking. It will also give stakeholders information to help them understand the solutions on offer in general terms as well as to appreciate the variety of approaches available and how these may affect outcomes.

Areas covered will include:

- Explanation of medically underwritten bulk annuities
    - Including suitability considerations, pros and cons, issues and risks.
- Broking process
    - Including preparation, data gathering and confidentiality, options and timescales.
- Case studies and illustrations.
- Potential future developments.

In the workshop we will discuss and debate some of the above areas. The session should give you a good insight into this recent market development and into the rationale behind the recommendations and information in the best practice guide once this is published.

Please come armed with questions and willing to share your own practical experiences.

If you wish to submit questions in advance please send these to the workshop chair:

Ruth Ward, JLT Employee Benefits (ruth_ward@jltgroup.com)

Further background reading:

A Healthier Way to De-risk: A Pensions Institute report for insurance companies, advisers to DB schemes, regulators, trustees, and employers

Available from: http://www.jltpcs.com/uploads/pdfs/HealthierWayToDeRisk.pdf