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Medically underwritten bulk annuities

Michael Anderson
Hymans Robertson

Andy Morley
Partnership Assurance

8 May 2015

What is a medically underwritten bulk annuity?

- Bulk annuities (buy-ins) have been used for managing risk within defined benefit pension schemes for some time.
- A more recent innovation has been to incorporate specific health and lifestyle factors into pricing, via surveying the select group of members to be covered by the policy.
- There are upper limits in terms of the number of members to be covered under this approach, due to practical reasons (currently c 300). Most transactions to date have focused on significantly less lives.
- As the market has matured, the size of transactions has increased £206m in liabilities.

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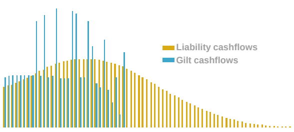
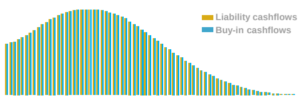
Buy-ins – the ultimate risk reduction





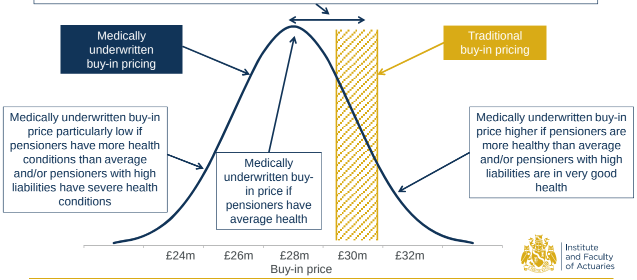
Protection against:	Gilts	Buy-in
Interest rates	Some	✓
Inflation	Some	✓
Longevity	✗	✓
Proportioned married and ages of spouses	✗	✓
Default risk	✓	Insurance reserves, FSCS

Concentration of risk

- Typically, 50% of a DB pension scheme's liability is made up from only 10% of the members. This dynamic creates a significant concentration of risk:
  - the experience of this small group of members will drive pension scheme's finances
  - in particular, significant longevity risk
- A medically underwritten buy-in is a very effective way of tackling this concentration of risk.
- For these reasons, well over 50% of the transactions that have completed to date have focused on the highest individual liability members ("top slicing").

Medically underwritten buy-in pricing

For the time being, the price of a medically underwritten buy-in is likely to be lower than the price of a tradition buy-in, even if pensioners have average health, partly due to the strong appetite from the medically underwritten buy-in providers to build market share and the resulting strong competition



What are the benefits to pension schemes?

- Chiefly improved pricing compared to traditional buy-ins, particularly for small groups of high liability members or small schemes (covering all members).
- In addition, the fact that it's a new market, means there has been a significant early mover advantage for those pension schemes that have.
- Efficient way of managing concentration risk and mitigating longevity risk.

In our experience, medically underwritten buy-in prices are at least 5% cheaper than a traditional buy-in

Medically underwritten buy-in providers

Provider	Background	Buy-in deals to date
partnership	• UK's second largest provider of medically underwritten annuities to DC members (£466m of individual annuity revenue for FY 2014) • Entered bulk annuity market for DB schemes in 2012	• 22 medically underwritten buy-ins • Covering c£354m of liabilities
justretirement	• UK's largest provider of medically underwritten annuities to DC members (£1,200m of individual annuity revenue for FY 2013/14) • Entered bulk annuity market for DB schemes in 2013	• 24 medically underwritten buy-ins • Covering c£447m of liabilities
Legal & General	• Multi-line insurer and longest established insurer in traditional buy-in market – covering all transaction sizes • Experience of enhanced annuities for DC members and now quoting on medically underwritten buy-ins	• No medically underwritten buy-ins • 53 buy-ins covering £5.98bn of liabilities in 2014
AVIVA	• Multi-line insurer and established insurer in traditional buy-in market • Experience of enhanced annuities for DC members and now quoting on medically underwritten buy-ins	• No medically underwritten buy-ins • 60 buy-ins covering £874m of liabilities in 2014

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How health information is obtained

1. Letter to pensioners
- 15 short questions;
- permission for a telephone conversation; and
- permission to obtain a GP report.

2. Obtaining more detail on any health conditions

For members who give permission:
- telephone pensioners;
- further reassure; and
- GP reports obtained.

3. Information shared with insurers
- Third party who has gathered medical information shares this with insurance companies who are quoting.

4. Underwriting
- Insurance companies use health information to establish view of pensioners' life expectancy and determine their buy-in quotation accordingly.

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- For a competitive tendering process a third party is required to avoid members being bombarded by information requests from different insurers.
- Using a specialist third party also assists control of member communications and managing data protection risks.
- MorganAsh is very active in this space at present, although there are several other providers looking to enter the market.
- Nature of the process is constrained by the need to meet differing requirements of annuity providers (so that they will all participate in the process)

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Common misconceptions

1. All members need to be approached → A subset typically approached – those with most impact on premium
2. This is a niche market for small schemes → Medical underwriting can deliver value for all sizes
3. There is no way to create competitive tension → Deals usually transacted via competitive tender
4. Underwriting slows things down → Underwriting adds only 2 to 4 weeks to overall timescales
5. It's uncertain how high the premium could go if "healthy" → We can provide a premium for a 'realistic healthy' outcome
6. Members will not respond → The average response rate is in fact over 80%
7. Members need to be telephone interviewed → A short form and GPR works just as well
8. Underwriting adds to costs → Cost is small vs potential saving in bulk annuity price

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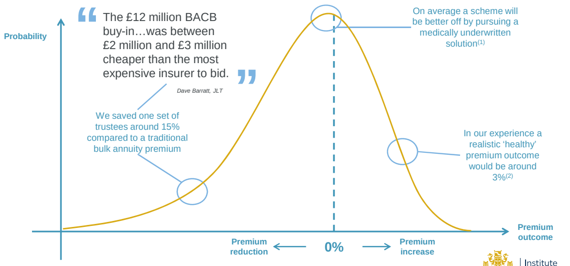
Many significantly better off, but importantly on average better off

Many schemes will be significantly better off via a medically underwritten solution, with the average scheme being better off



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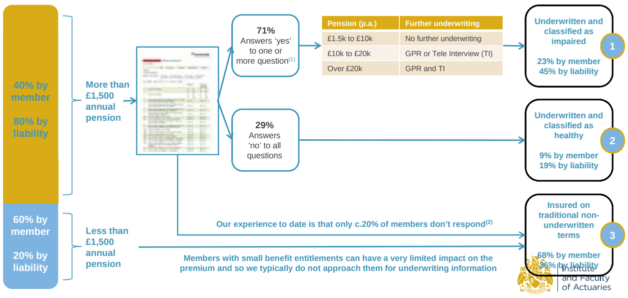
(1) Increased data means increased confidence which means we can be less conservative and hold less capital
(2) Based on Partnership analysis of realistic scenarios following medical underwriting as at September 2014

A well designed underwriting process places members in one of the three categories

Our investment in underwriting and processing technology means we can medically underwrite members with pensions as small as £1,500 p.a. For pensions below £10,000 p.a. we don’t even need a GP report or Tele Interview to give full credit for medical conditions



Pension (p.a.)	Further underwriting
£1.5k to £10k	No further underwriting
£10k to £20k	GPR or Tele Interview (TI)
Over £20k	GPR and TI

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(1) Analysis as at January 2015 shows that 71% of members have one or more qualifying health or lifestyle traits that means their annuity cost can be lowered.
(2) Analysis as at October 2014 also shows response rates on average of 80% to the short form on the deals we have completed (70% more widely)

Case study – Taylor Wimpey Pension Scheme

Top slicing – largest medically underwritten bulk annuity to date

This landmark transaction, the largest ever medically underwritten bulk annuity in the UK, significantly raises the threshold of deal and pension scheme sizes that had previously been assumed to be suitable for medical underwriting.

Date	December 2014
Deal size	£206 million – 99 members
Background	The Trustees were looking to de-risk the liabilities of the 99 largest pensioners and their contingent spouses from their multi-billion pound pension scheme. The average pension size was well in excess of £50,000 per annum, meaning a significant concentration of risk.
Process	It was a top slicing deal in which the client went straight down the medically underwritten route, quickly recognising the value over a traditional process from outset. There were four insurers involved in a competitive process and a high response rate was achieved from members.
Outcome	The pensioners did not have an untypical distribution of health conditions for a top end socio-economic group of members – i.e. they were not particularly healthy or unhealthy. This demonstrated the power of medical underwriting – by just knowing for a fact they are broadly average allowed us to deliver a much more competitive price than a traditional deal. Partnership won based on a combination of price, security and ability to deliver. The deal transacted quickly, having moved from exclusivity to trading in just 10 business days, including a complex in specie asset transfer. Our unique underwriting intellectual property can deliver bulk annuities costing less than technical provisions and significantly lower than a traditional bulk annuity. For this deal the Trustees transacted at a figure £9.4m below their technical provisions and, as technical provisions are typically set below estimated bulk annuity cost, the implication is that medical underwriting saved considerably more than £9.4m against the estimated cost of a traditional bulk annuity.

“This £206 million top-slicing transaction is a perfect example of how Partnership is able to bring the advantages of our unique intellectual property and underwriting expertise to trustees, corporates and pension scheme members within the growing UK defined benefit market”
Steve Groves, Partnership CEO

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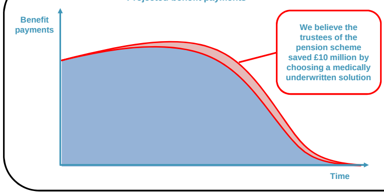
Case study – Taylor Wimpey Pension Scheme

**A highly competitive process coupled with a good underwriting result delivered a great financial outcome for the trustees.
Solid preparation and planning on our part gave them comfort that they would access that outcome in an organised and quick way.**

Projected benefit payments[1]



Granular health and well being information on the membership was used rather than relying solely on proxies for health.

Some lives were impaired.

But even for those in 'average' health we now had individual underwriting data which ensured we better understood our risk exposure.

The trustees therefore paid a 'fair' price, avoiding a premium which included a 'safety blanket' of profit for the insurer

- Solid preparation and transition readiness shining through
- A tightly managed and executed asset changeover
- A game changer for the bulk annuity de-risking market

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(1) For illustration purposes only

Medically underwritten illustrations

The table below sets out ten illustrative medical underwriting illustrations for our example member, Tony.

Whilst these illustrations are generic (and so in no way tailored to a specific scheme) they do reflect in full our approach to assessing longevity.

	Tony
Sex	Male
Age	65
Annual pension	£30k
Increases	RPI (min 0%, max 5%)
Dependant	3 years younger 50% benefit

Premium adjustment versus a non-underwritten premium[1]		Tony	
		Mild	Severe
1	Smoker	-1%	-4%
2	Heart attack	-4%	-19%
3	Cancer	-1%	-38%
4	Stroke	0%	-24%
5	High blood pressure	-1%	-4%
6	Diabetes	-3%	-22%
7	Liver disease	-9%	-25%
8	Angina	-2%	-17%
9	Lung disease	-8%	-29%
10	Healthy	3%	

Health and lifestyle conditions present in combination would usually warrant a larger premium reduction

These examples are simplified and only for illustration purposes. In reality the impact of medically underwriting could fall outside the ranges provided above

There is an asymmetric distribution of outcomes.

An all healthy outcome is relatively close to traditional pricing.

Conversely a premium reduction can be significant in nature.

A 'mild' lung disease could involve asthma with recurrent chest infections and occasional steroids

A 'severe' cancer could be a recent colon cancer diagnosis with ongoing treatment

A 'healthy' life is an individual who having completed our medical underwriting process was deemed to have no impairments or lifestyle factors which would adversely affect their health

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(1) Based on Partnership's current pricing methodology, illustrations correct as at July 2014

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Questions

Comments

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

The views expressed in this presentation are those of the presenters.

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