Medically underwritten bulk annuities (MUBAs)

Is your solvency valuation 10% too high?

Association of Consulting Actuaries, Conference, 5 February 2016

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Key messages

1 Supplying medical and lifestyle data to an insurer is likely to result in lower pricing <u>on average</u>

2 Medically underwritten bulk annuities (MUBAs) are straightforward with many cases showing that they can be completed quickly and easily

3 There are opportunities for pension actuaries - MUBAs are in the mainstream

Introduction

Actuaries estimate bulk annuity costs for various purposes

Those estimates are typically used to assist trustees and employers in planning funding, asset strategy and journey plans

Estimates are typically based on in-house assumptions derived from back-solving actual bulk annuity quotations and/or via assumptions supplied by insurers

Invariably these assumptions stem from traditionally priced bulk annuities

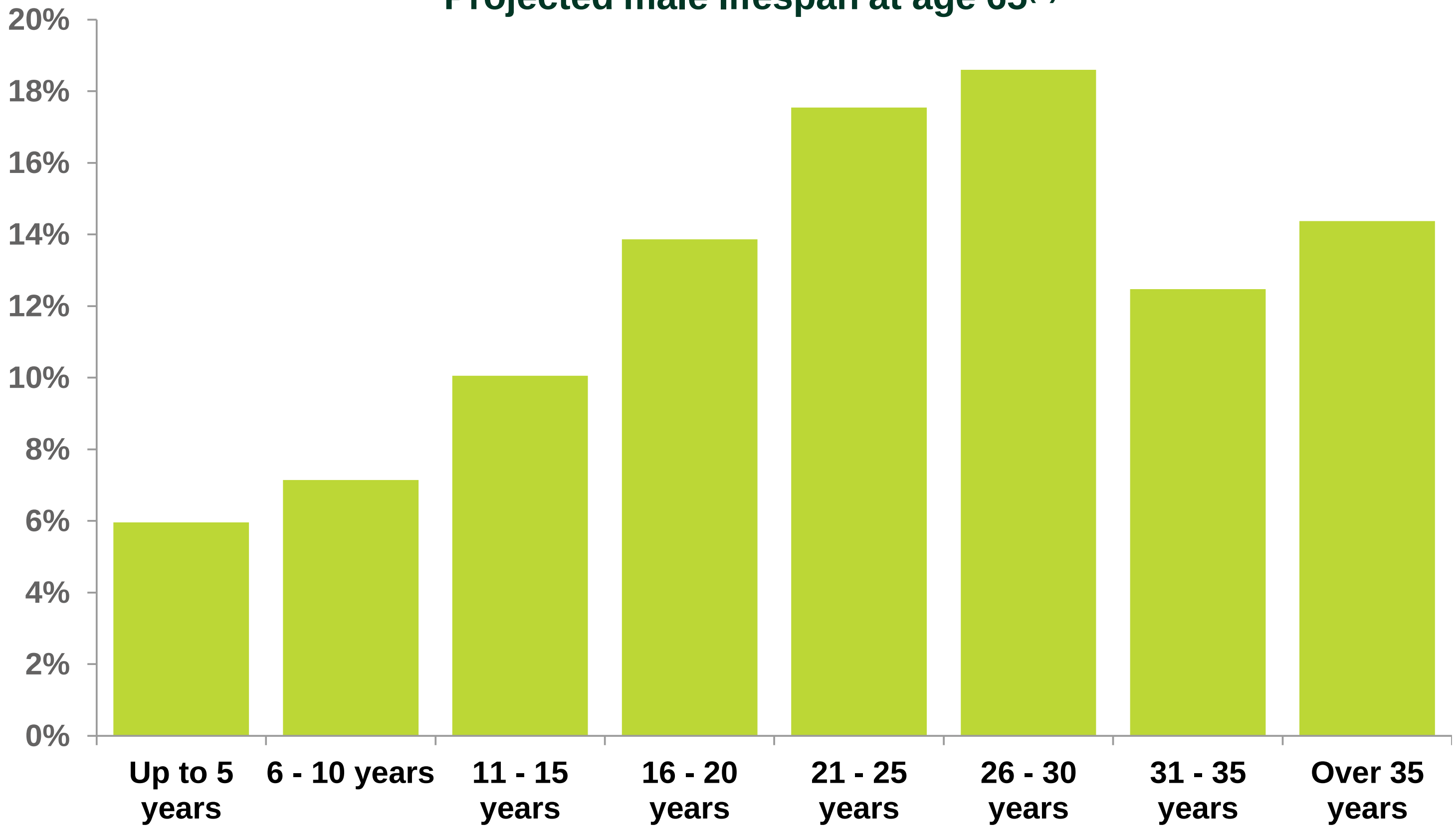
Medical underwriting is not an incremental change to bulk annuity pricing. **It is a material leap to a completely new pricing method.** It is a methodology in which (for example) medical history is more important for pricing than gender

The result is that affordability of a bulk annuity could be much closer than is currently believed

Increased data = increased confidence = less conservative = lower premium

There is huge uncertainty around how long individuals are likely to live

Projected male lifespan at age 65(1)



Individuals = uncertainty

Small numbers = uncertainty

Large numbers = less uncertainty

(1) Source: Projected lifespans are derived from the ONS 2012-based principal projection for the UK population

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What is a medically underwritten bulk annuity?

Medically underwritten bulk annuity = **Traditional bulk annuity (buy-in or buy-out)** + **Members' actual medical and lifestyle features captured in the premium**

A MUBA is practically identical to a traditional bulk annuity. The only difference is that additional underwriting information is sought

An introduction to the MUBA proposition:
Increased data = increased confidence = less conservative = lower premium

Chris would like to buy car insurance.

He goes to an insurer and simply tells them:

"*I am 55 years old, live in WC1V 2AH and have a car worth £20,000*."

The first insurer has to be cautious to protect their solvency position and profit. They assume Chris is driving a Mitsubishi Evo, has an awful claims history with nine points on his licence.

The result is a big premium.

Chris learns his lesson. He re-approaches the insurer:

"*I'm a 55 year old single actuary, who drives a Ford Focus and has a perfect driving record. For good measure here's my answer to another 250 rating factors*."

The result: more accurate premiums which are, on average, lower across all consumers

Increased data = increased confidence = less conservative = lower premium

	Traditional	Impact of medical underwriting
Bulk annuity cost	3. Capital / prudence	This is lower
	2. Other eg expenses	No change
	1. Best estimate claims i.e. pensions	On average, unchanged … … medical and lifestyle data results in a wider variation of best estimate claims between pension plans, but it is a "50/50" distribution

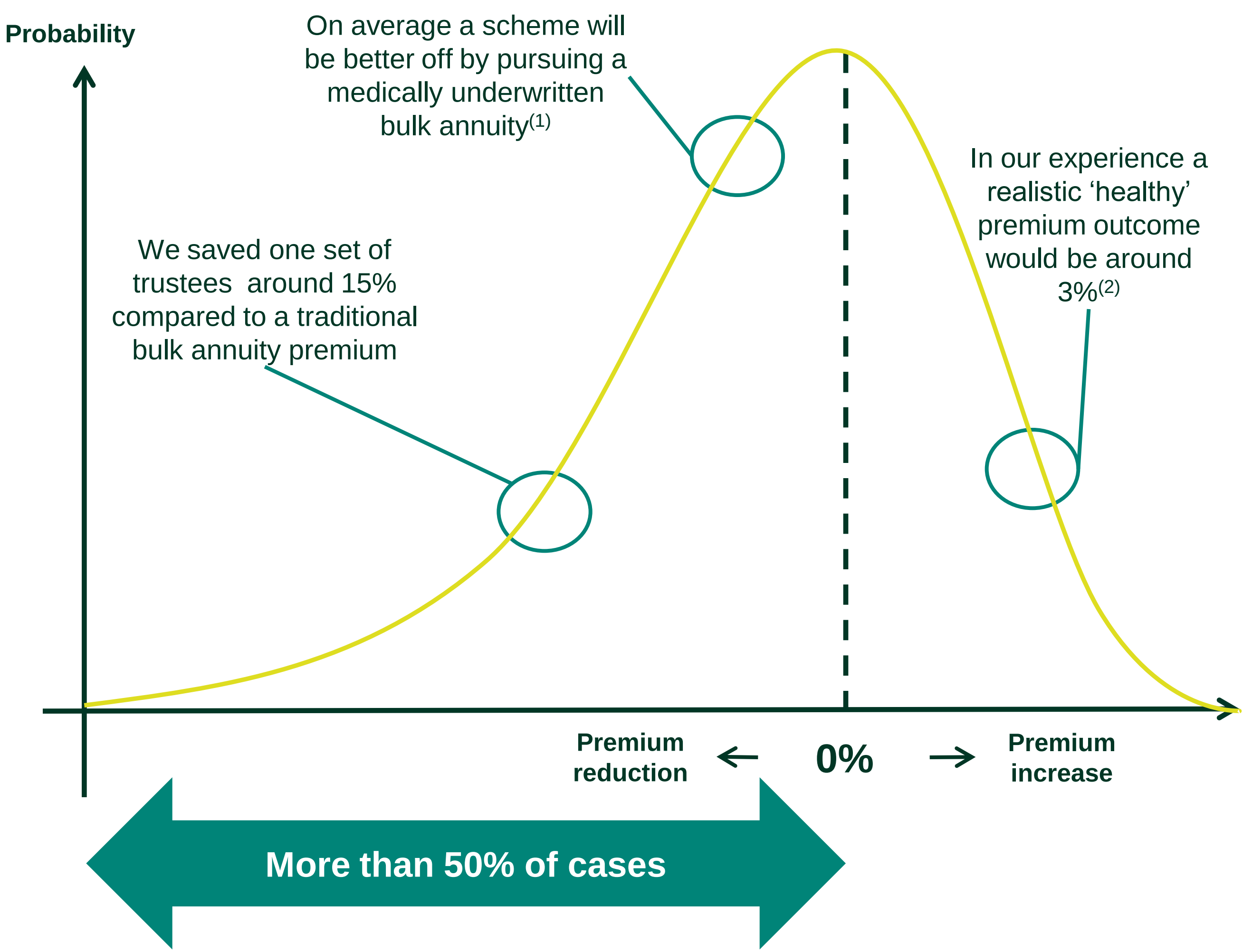
The way in which insurers set bulk annuity pricing is, of course, far more complex than illustrated here. And life expectancy is one of a few key "ingredients" to pricing

Nevertheless, there are very sound reasons to expect that medically underwritten bulk annuities should on average lead to lower pricing, except for very large pension schemes

"…savings of 5-10% due to medical underwriting…[relative to the cost of conventional underwriting]"(1) from interviewees for 'The Good, the Bad and the Healthy', Pensions Institute, January 2016

(1) Quotation taken from 'The Good, the Bad and the Healthy' Pensions Institute report by Dr Andrew Hunt and Professor David Blake

Increased data = increased confidence = less conservative = lower premium



EXPERIENCE SUPPORTS THIS[3]

"The other thing is that the pricing that is available via the medically-underwritten route is so much better than the best priced traditional insurer."
'The Good, the Bad and the Healthy'
Pensions Institute, January 2016

"Often over 5% cheaper than traditional buy-ins"
Hymans Robertson, March 2015

(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
(3) Quotations are taken from 'The Good, the Bad and the Healthy' Pensions Institute report by Dr Andrew Hunt and Professor David Blake and from Hymans Robertson's April 2015 "Medical underwritten buy-ins – market insights" publication
(4) Graph is for illustration purposes only – this is not an actual distribution

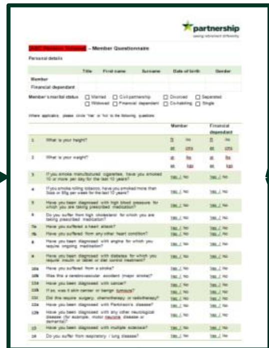
Medical underwriting in practice

40% by member

80% by liability

More than £1,500 pa

Short form issued to members



70%
Answers 'yes' to one or more question(1)

Follow up medical data might be sought

- GP Report, and/or
- Telephone interview

Underwritten, and classified as impaired

1

23% by member
45% by liability

30%
Answers 'no' to all questions

Underwritten, classified as not impaired

2

9% by member
19% by liability

60% by member

20% by liability

Less than £1,500pa

Our experience is that only c.20% of members don't respond(2)

Members with small benefit entitlements have a very limited impact on the premium and so are typically not approached for underwriting information

Insured on non-underwritten terms

3

68% by member
36% by liability

(1) Analysis as at January 2015 shows that c70% of members have one or more qualifying health or lifestyle traits that means their bulk annuity cost can be lowered
(2) Analysis as at October 2014 shows average 80% response rates to the short form on transactions completed by Partnership

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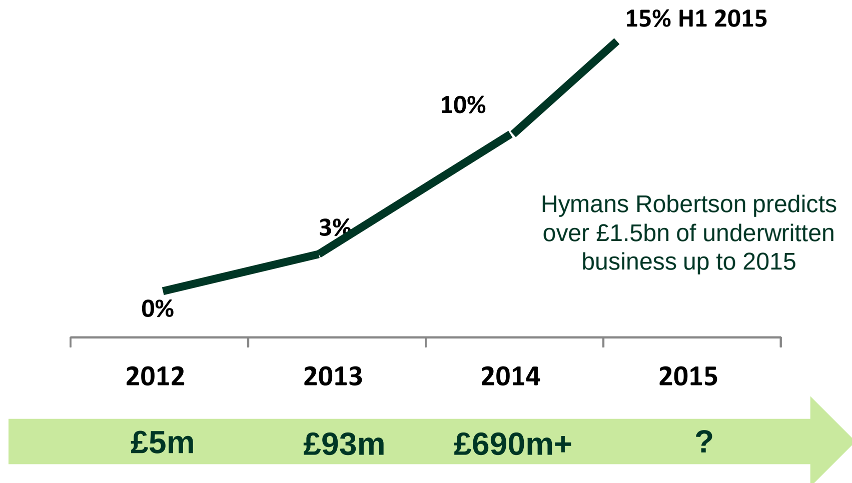
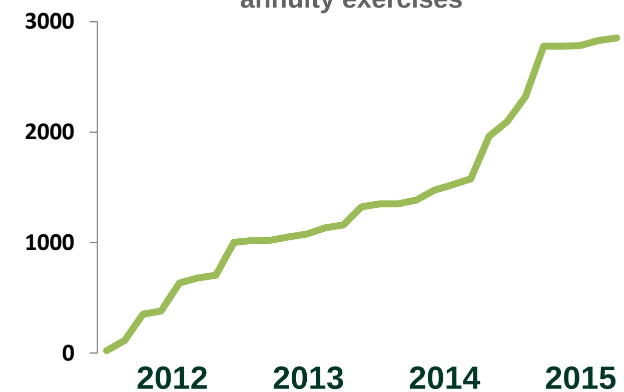
MUBAs are here to stay

- Over 10% of the sub £100m deal market was underwritten in 2014, continuing an exponential pattern of growth
- The first case over £100m was transacted in December 2014

Percentage of sub £100 million size bulk annuities that were medically underwritten



Number of lives medically underwritten to date for bulk annuity exercises



>60 underwriting exercises

>3,000 lives underwritten

Over 60 transactions to date covering upwards of £1bn of premium

Four insurers have transacted medically underwritten deals. New entrants predicted in 2016

Over 95% of processes are now undertaken via a common data collection process

93% of underwritten bulk annuities over 2013 and 2014 ended in successful insurer selection(1)

(1) Partnership internal analysis

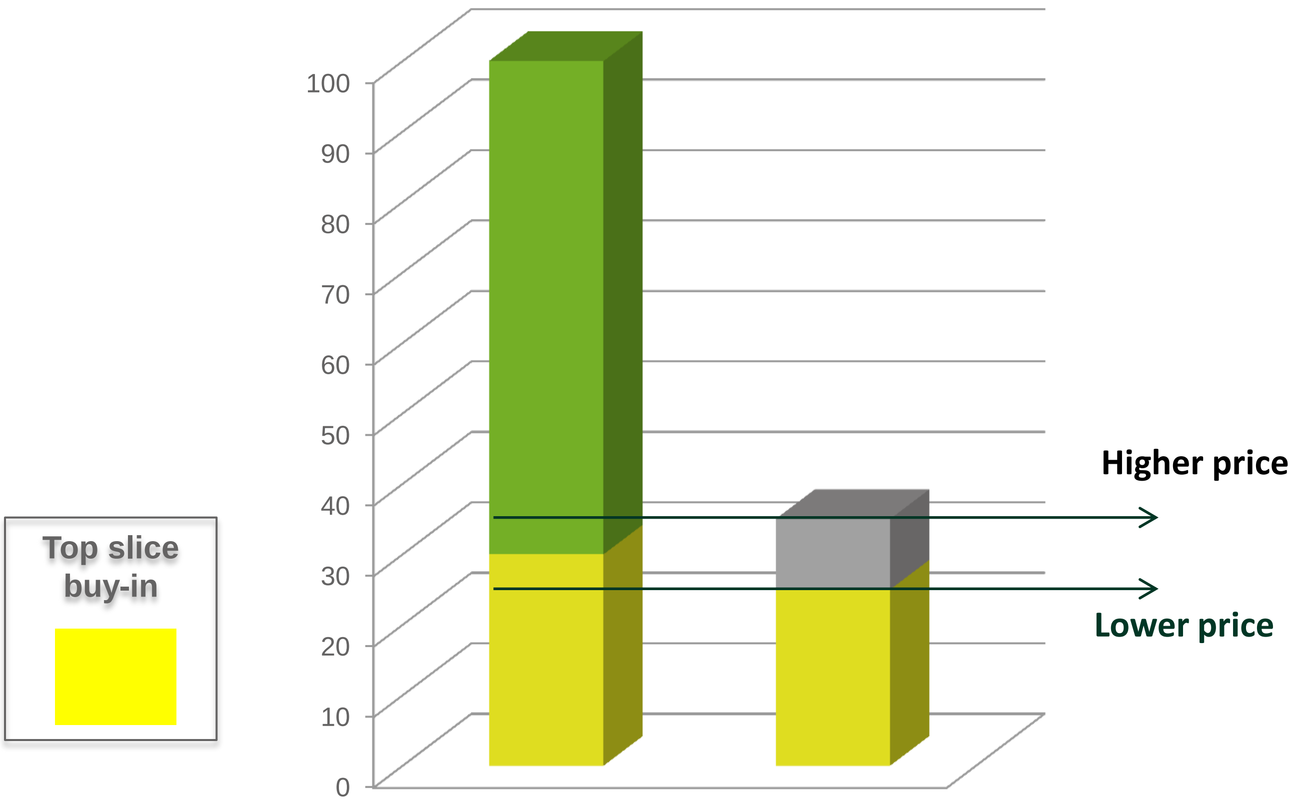
All schemes can use top slicing, even the largest

Why top slice?

1. Concentration of benefits drives risk within a scheme = tackle **a primary risk**
2. The benefits of underwriting are more pronounced = **big potential upside** with (probably) limited downside
3. Technical provision **assumptions can be prudent** for these members = release tied up funding
4. Experience shows a real possibility of **transacting below technical provisions** = tackle risk and improve funding (see next slide)
5. As data collection would be targeted to what should be highly engaged members **high response rates** can be expected

Less than £10 million ⟷ **Scheme range** ⟷ **Over £1 billion**

Improving the financial position and reducing risk



Post insurance[1]

- Scheme size reduced by 30% by insuring the largest 75 lives
- Medically underwritten annuity could save £2m or cost £3m relative to TPs
- Pension payroll insured is £1m pa out of £3m pa. Average pension size reduced from £15,000pa to £6,000pa

(1) Example figures only

Kuwait Petroleum (buy-out)

Full scheme de-risking – largest medically underwritten full scheme buy-out to date

In May 2015, Partnership were delighted to announce a £42 million medically underwritten bulk annuity with the trustees of the Kuwait Petroleum Services Company Limited Pension Scheme. This transaction is the largest full scheme medically underwritten buy-out in the UK to date.

Date	May 2015
Deal size	£42m – 34 members
Background	The trustees of the Kuwait Petroleum Pension Scheme wished to buy-out the remaining 34 members of their UK legacy scheme. With an average pension size of over £50,000, selecting an underwritten solution made clear sense. Within the group insured were three deferred pensioners who were all aged over 60.
Process	There was a competitive process with insurers quoting off health and lifestyle information collected via AON AHEAD's platform. A 90% response rate was achieved with all participating members undertaking a tele-interview and having a GP report requested where the initial underwriting form indicated an impairment.
Outcome	Partnership were selected having delivered the most competitive price following a beauty parade. The lead adviser on the deal stated that the trustees saved around 10% compared to the cost of a traditional bulk annuity policy – equivalent to a discount rate of Gilts + 90 basis points.[1]. The transaction also involved a significant in-specie asset transfer.

"This £42 million transaction clearly demonstrates the value that Partnership can deliver for trustees and their members. A saving of over £4 million against traditional pricing is a welcome addition to the tens of millions of pounds we have saved our bulk annuity clients to date."

Andrew Megson, Partnership MD of Retirement

Professional Pensions: The deal is the largest full scheme medically underwritten bulk annuity

Kuwait Petroleum scheme agrees £42.3m enhanced bulk annuity deal

PENSIONSAge The leading pensions magazine

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Aon Hewitt advise KPSCPS on bulk annuity with Partnership

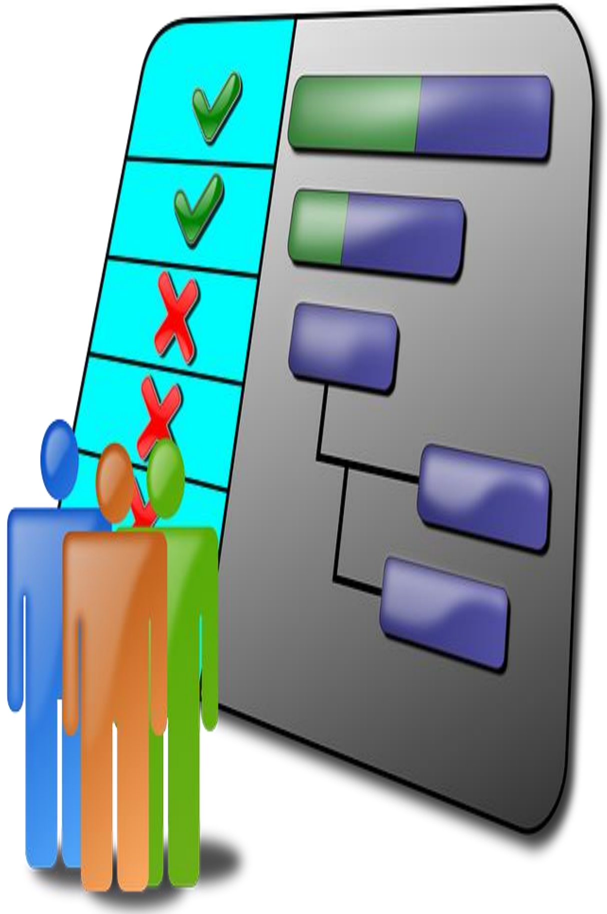
(1) Aon Hewitt's press release on the transaction and subsequent market reports

Case study (pensioner buy-in)

Fastest medically underwritten bulk annuity to date

This landmark transaction was completed in six weeks from the decision to proceed down the underwritten route. This is quicker than many traditional transactions. This demonstrates that MUBAs do not have to take much, if any, additional time and with planning and impetus, can be done very quickly.

Date	• November 2015
Scheme	• £billion+ defined benefit pension scheme with c£1bn pensioner liabilities • 1,000++ pensioners
Deal size	• £38 million – 272 members
Plan of Action	• The trustees targeted all the pensioners in a section of the scheme • They wanted a quick transaction – considered traditional and MUBA routes • A subset of higher liability lives were underwritten to benefit from MUBA pricing
Process	• Obtained indicative pricing from a few providers in the summer of 2015 • Decided – in October - that MUBA offers better value • In order to lock-in beneficial terms (based on asset availability) decided on exclusive process • Signed MoU on exclusive process late October 2015
Outcome	• Parallel work streams on underwriting, contract negotiation and pricing to minimise time taken • Signed deal end November, six weeks from decision to use the MUBA route – faster than many traditional processes



Development of the MUBA market – Pensions Institute Report January 2016

Growth

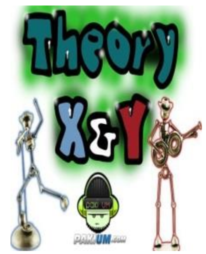
Over 60 transactions and £1.5bn of premium

From 3% of sub-£100m transactions in 2013 to 15% in H1 2015

Two deals in excess of £200m

Huge growth in top-slicing

Theory

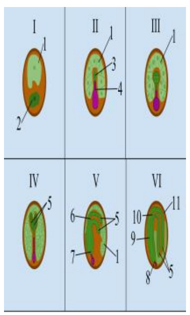


More data means less uncertainty, reduced reserves and better pricing

Enhanced impact in top-slicing as without medical data, there is a need to be conservative

Market evidence shows savings of 5-10% compared to traditional transactions

Development



Standardisation of data collection via specialist third party providers

Implications of collecting data and not proceeding with a MUBA

Prospects

Sustained growth predicted for the foreseeable future, including an increasing proportion of top-slicing

Merger and new entrants

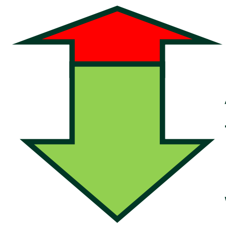
Convergence of MUBA and traditional “flavours”

To summarise – The benefits of MUBAs

Greater variation of premium

Medical underwriting doesn't rely on proxies for health status e.g. postcode and pension size

Health and lifestyle data means there is less simplification and so there is a reduced 'cross subsidies' between schemes



More accurate premiums that are lower on average

Increased data means increased confidence

A healthy scheme may pay slightly more than traditional pricing

Whilst an average scheme or scheme in poor health will probably pay less – often much less

Pensioners with large pensions

Traditional approaches to assessing longevity inevitably treat members with large benefit entitlements in top-end postcodes as "healthy"

Medical and lifestyle data means tailored pricing

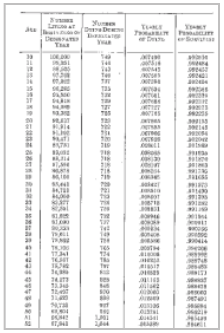
Part of a de-risking journey plan

Can insurer all pensioners or top-slice

Can spread transactions over a few years

Advantage of underwritten approach means perception of selection can be avoided – for phased deals and/or where member option exercises have been carried out

The resulting issues for pension consulting include



Technical provisions basis

Should the mortality assumption be medically underwritten and, if so, by whom?

Some schemes are known to have obtained medical data from pensioners in an attempt to refine their mortality basis

Bulk annuity cost estimates

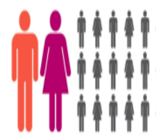
How should these be determined, given the increased range of where final pricing may fall?

Plausible range of estimates now widened by perhaps -10% to +3%?

Timing for approaching the bulk annuity market

Could some pension schemes be closer to a bulk annuity purchase that they may think?

The actuarial adviser on one of our transactions informed us that the end price was 15% lower than they'd estimated a bulk annuity would cost



Top slicing

Should top slicing be encouraged so as to bring greater stability to scheme funding?

For our ground-breaking 2014 transaction for Taylor Wimpey, 2% of pensioners represented 20% of liabilities

So, are solvency valuations 10% too high?

- There is no simple "yes"/"no" answer
- On average, the arrival of medically underwritten bulk annuities should mean solvency valuations are too high where they continue to be based on traditional bulk annuity benchmarks
- But for "healthy" schemes solvency valuations could be too low (or at least they will be should/once traditional insurers increase their pricing to reflect selection*)
- For "poor health" schemes solvency valuations could be far too high, "5-*10%*"(1)
- And note the caveat, mortality is not the only factor impacting bulk annuity pricing

* if trustees/company believe their members are healthier than what might be expected under a postcode type rating approach, now might be a good time to purchase a traditionally priced bulk annuity!

(1) 'The Good, the Bad and the Healthy', Dr Andrew Hunt & Professor David Blake, Pensions Institute, January 2016

To conclude

1 **We've explained why supplying extra data to an insurer is likely to result in lower pricing <u>on average</u>**
"… savings of 5-10% are typical …" (1)

2 **We described the use of MUBAs, illustrated with some case studies**
MUBAs are simple and efficient and can be carried out quickly

3 **MUBAs are mainstream**
In 2014 over 10% of bulk annuities in the sub £100m size sector were medically underwritten and growth continues. Opportunities may not be readily apparent using traditional techniques to estimate pricing

(1) Full quote is "Pricing continued to be materially more attractive than in the traditional market – savings of 5-10% are typical", AON Hewitt, May 2015

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Questions

Comments

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