

Medically Underwritten Bulk Annuities (MUBAs)

Is your solvency valuation 10% too high?

Executive Summary

- MUBAs have the potential to deliver better pricing on average – typical savings being 5-10% relative to a traditional bulk annuity.
- MUBAs have become more efficient over the years and can be carried out very quickly.
- MUBAs are mainstream and accounting for an increasing proportion of the market. There are currently four insurers writing MUBAs and new entrants in this space are predicted.

Solvency valuation figures and missed opportunities

Actuaries estimate solvency liabilities for a number of reasons, most commonly for triennial actuarial valuations. These estimates are invariably based on traditional annuity pricing (as such pricing constitutes the majority of bulk annuity transactions). Sometimes these figures are used as an initial indicator to decide whether to consider investigating an insured solution for de-risking some or all of the scheme's liabilities. If these figures are over-estimated this can result in missed opportunities in that some schemes may be missing out on a viable insured solution that they are not aware is attainable.

MUBAs – the potential to offer better value

Medically underwritten bulk annuities (MUBAs) arguably enable more accurate pricing of the liabilities (see below for more details) and account for an increasing proportion of bulk annuities (15% of the sub-£100m market in H1 2015¹).

A MUBA is almost identical to a traditional annuity the difference is that it utilises additional data in the form of medical and lifestyle information. A generally accepted principle is that if more information about the risk being insured is available, fewer assumptions need to be made. As insurers are required to hold prudent reserves to protect against adverse experience, any assumptions that are made inevitably err on the cautious side to some degree.

In a MUBA more information is obtained on a portion of the lives being insured. As a result of this additional data we have higher confidence in our pricing which means that the price is lower, on average.

The distribution of outcomes is not symmetrical. MUBA pricing will show a wider variation than traditional pricing. On average schemes will save relative to a traditional route – typical savings being c5-10%². This is backed up by opinions from EBCs:

¹ Partnership estimate

² From interviewees for “The Good, the Bad and the Healthy”, Pensions Institute paper by Dr Andrew Hunt and Professor David Blake

“Pricing continued to be materially more attractive than in the traditional market – savings of 5-10% are typical³;

“Often over 5% cheaper than traditional buy-ins”⁴.

However MUBAs are not always lower priced than traditionally priced bulk annuities – for example a pension scheme of individuals who have a much healthier profile that might be expected for their socio-economic group might be more expensive.

There are techniques to “triage” schemes to make some degree of informed judgement of whether a saving is likely.

MUBAs – simple, effective processes and exponential growth in popularity

Other than the small liability lives (which have an immaterial impact on the price) pensioners are sent a questionnaire comprising c15 simple questions. For those that respond, some will have a Telephone Interview with a qualified medical professional and for some a GP’s Report will be obtained (with the individuals’ consents). The high quality of member communication translates into encouraging response rates – typically 80%⁵. On average some 45% of liabilities are rated as “impaired”, 19% as “healthy” and 36% as “average”.⁶

Advisers have reported savings of 5-10% relative to a traditional bulk annuity.^(3,4)

Transactions are most common for deals sizes of under £100m, though there have been a couple of transactions to date over £200m. In the sub-£100m sector, in 2013 MUBAs accounted for some 3% of all transactions. In the first half of 2015 this was c15%. The market is growing rapidly – MUBAs are here to stay and are now mainstream. Much of the recent growth has come from large schemes using “top-slicing” – insuring the highest liability lives where the potential for variability to disproportionately affect the scheme’s (and employer’s) finances is greatest. In addition, traditional underwriting, based on income, postcode and profession is likely to lead to conservative estimates for longevity. In reality a proportion of these individuals will have some medical conditions (e.g. history of cancer in the family, high blood pressure or smoking). It doesn’t take many of these factors to result in a significant reduction in premium. The resulting uninsured portion of the scheme is then more homogeneous and behaves more predictably as it is not dominated by a few individual lives.

Whilst there are some additional processes in a MUBA (data collection), they do not have to take additional time. In fact we completed one transaction in 2015 in six weeks from the time the decision was made to use the MUBA route. There was clearly a good deal of will and impetus to get the deal done quickly and excellent project management including parallel workstreams. This shows that MUBAs can be carried out quickly and efficiently.

³ Aon-Hewitt, May 2015

⁴ Hymans Robertson, March 2015

⁵ Partnership internal analysis, October 2015

⁶ Partnership internal analysis