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RAPID GROWTH IN MEDICALLY UNDERWRITTEN BULK ANNUITIES AS PENSIONS INSTITUTE REPORT PREDICTS CONVERGANCE BETWEEN APPROACHES

- From a standing start in 2013, 60 transactions worth over £1billion have been transacted
- From 3% (2013), medically underwritten deals accounted for over 15% of transactions by mid-2015
- “Top-slicing” largest pensioner liabilities offers particularly cost-effective risk reduction
- Underwriting using some medical and lifestyle factors predicted to be adopted by most insurers in future
- Potential new entrants into the marketplace and the convergence between approaches will maintain competition in the marketplace

13 January 2016: A new report from the Pensions Institute, part of Cass Business School, highlights the significant growth in medically underwritten bulk annuities* (MUBA). Looking to the future, it predicts that the bulk annuity market with its estimated £2trn of pension liabilities will see a convergence in pricing approaches.

The report “*The Good, the Bad and the Healthy: The medical underwriting revolution in the defined benefit de-risking market”* suggests that as the sector develops those who currently operate in the MUBA space will begin to compete for more standard bulk annuities deals while “traditional” insurers will develop the ability to use some health and medical conditions to augment existing underwriting processes.

This convergence of approaches will be led by the appetite from employee benefit consultants and trustees who have reported MUBAs generating material savings of 5% – 10% of transaction price in some circumstances.

While the use of health and medical data in the retail space is long established, it is new in the bulk annuity market having first been used in any significant way in 2013. The report highlights the significant strides made since then with deal processes becoming more standardised, streamlined and responsive as parties become more experienced. This, in turn, has meant deals can be transacted quicker, enabling prepared schemes to take advantage of market opportunities.

Looking to the future, the report also suggests that the distinction between "traditional" underwriting and specialist medical underwriting may diminish as more insurers incorporate medical and lifestyle rating factors into their underwriting process and the specialist insurers compete in "vanilla" transactions.

The report highlights that top-slicing** transactions have the potential to remove a large amount of concentrated risk from a pension scheme, which medical underwriting can help achieve at a cost-effective price.

In addition, the report concludes that convergence in pricing approaches and the potential for new entrants into the bulk annuity marketplace means that pricing will remain affordable in future. This will fuel further growth in bulk annuity volumes.

Professor David Blake, Director of the Pensions Institute, and one of the authors of the report, said: "Having originally looked at this market in 2013, *"The Good, the Bad and the Healthy"* allows us to revisit this fascinating sector to see just how far it has come. Growing from 3% of transactions under £100m to 15% by mid-2015 suggests that there is significant scope for further expansion, as we see a convergence between standard and medically underwritten approaches in the future. While this will not happen all at once, we accept that the clear distinction between sectors will not continue indefinitely and believe that medical underwriting is a process rather than a product. One that has enormous potential, provided additional financial and human capital is forthcoming."

"With new entrants bringing the potential for the development of new underwriting processes – using new risk factors and data sources – which will complement the market's existing experience, now is an exciting time to be involved in this field."

Costas Yiasoumi, Director of Defined Benefit Solutions at Partnership, said:

"Having pioneered medical underwriting in bulk annuities, we are delighted to sponsor this second Pension Institute report which clearly shows the growth and significant potential. Indeed, we are pleased to see that it has moved from being an approach for early movers to one that is increasingly being viewed as a mainstream approach for providing better value outcomes to pension schemes.

"Looking to the future, we welcome the continuing evolution and increasing usage of medical underwriting in bulk annuity pricing. The volume of medically underwritten bulk annuities written since 2013 is now approaching £1.5bn. That is a lot of pension risk secured by UK pension schemes with insurers, much of which would otherwise have remained stuck on pension scheme balance sheets. Medical underwriting has been a welcome contributor to the de-risking journey most UK pension schemes are on."

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The Pensions Institute at Cass Business School is the first and only independent academic pensions research organisation in the UK (http://www.pensions-institute.org/)

To access, The Good, The Bad and the Healthy – Medical Underwriting Revolution in the Defined Benefit De-risking market please click here - http://www.pensions-institute.org/reports/GoodBadHealthy.pdf

* = Medical underwriting in the bulk annuity space means taking scheme members' lifestyle and health information to provide a more accurate longevity prediction – and potentially lower prices.

** = Derisking a relatively small number of high-liability individuals within a scheme, thus removing the most concentrated risks and improving the effectiveness of other risk-management exercises, such as liability-driven investment.

NOTES TO EDITORS:

Report Findings:

With the majority of defined benefit (DB) schemes closed to new members and further accrual of benefits, they are effectively being wound down. This can take decades and therefore DB schemes are increasingly looking to insurance to guarantee the benefits promised and relieve sponsoring employers of the ongoing funding/management obligations.

The Pensions Institute report (sponsored by Partnership) which is launching today – *"The Good, The Bad and the Healthy: The medical underwriting revolution in the defined benefit de-risking market"* - follows on from its first report *"A Healthier Way to De-risk: The introduction of medical underwriting to the defined benefit de-risking market"* which was published in February 2013.

The report is based on interviews conducted with a wide range of individuals engaged with medically-underwritten bulk annuities, including professional pension scheme trustees, pension consultants, pension lawyers, insurers (including those that use medical underwriting, and those "traditional" insurers that do not) and reinsurers operating in the marketplace.

"The Good, The Bad and the Healthy: The medical underwriting revolution in the defined benefit de-risking market" reviewed the market (between February 2013 to November 2015) and found that:

Market Growth:

- Since February 2013, the use of medical underwriting has grown significantly with around 60 transactions and over £1bn of pension scheme liabilities have been written [to H1 2015].

- Significant increase in the proportion of bulk annuities being medically underwritten - 3% of bulk annuities (by premium) under £100m were medically underwritten in 2013, 10% in 2014 and over 15% in the first half of 2015.

- Partnership transacted the largest medically-underwritten buy-in, and a landmark top-slicing deal, in December 2014 with FTSE-listed Taylor Wimpey (£206m) which encouraged other schemes to follow. Indeed, Legal & General transacted a £230m deal in December 2015.

Pricing is Key Growth Driver:

- Industry feedback is that medically underwritten bulk annuities have often transacted 5-10% cheaper than traditionally priced bulk annuities. This is a material saving in the context of bulk annuity pricing and can mean insurance prices comparable to or even lower than the scheme liabilities on a funding basis. This is caused by the reduced uncertainty regarding the potential timing and amount of the pensions payable and the resulting reduced uncertainty in reserving and profit emergence.

- The emergence of "top-slicing" – insuring a relatively small number of high-liability individuals within a scheme, thus removing the most concentrated risks and improving the effectiveness of other risk-management exercises, such as liability-driven investment. Medical underwriting allows these top-sliced transactions to be done at a more affordable cost, since the impact of the medical underwriting is more likely to be favourable for the scheme than traditional pricing methods.

- There is significant potential for medical underwriting leading to a favourable impact on price for a pension scheme in a top-slicing transaction, since prudent assumptions are generally used to price these individuals if additional health data is not obtained.

- Other facts contribute to bulk annuity pricing, with competitive pricing offered by the specialist medical underwriters to date, driven by a combination of the underwriting itself, the investment strategy used by the insurers, their appetite to write new business and the degree of competition in the marketplace.

- The process of collecting medical information has been standardised considerably (since February 2013) due, in part, to the involvement of third-party medical data collectors, but there is scope for further standardisation. The benefit of this would be further reduced time/cost, but if the scheme fails to transaction, it could face the risk that "traditional" insurers may lock these schemes out of the market at reasonable pricing.

Sustained Future Growth Predicted:

- While Solvency II regulations may push prices up slightly, sustained growth is expected in the bulk annuity market for the foreseeable future.

- With most market participants accepting the theoretical justification of medical underwriting for top-slicing transactions, we understand a number of these deals are in the pipeline which will see an increase in their numbers in the foreseeable future.

- Most market participants interviewed believe that medical underwriting is now an established part of the bulk annuity market for smaller schemes, and will account for a substantial proportion of deals in future.

- Some are more bullish and suggested that almost all buy-ins for smaller schemes could go medically underwritten in future.

<u>Convergence of Approaches:</u>

- Looking to the future, if we have to make a prediction, we forecast that there will be a convergence between the medically-underwritten and traditional annuity markets: with medical underwriting specialists developing their offering to compete for more traditional bulk annuities and traditional insurers developing the ability to use some major health and medically related conditions to augment their existing underwriting processes.

- We would also expect that, in increasing numbers of cases, major underwriting factors will be collected post transaction. Depending on the winning insurer, this may be via a very streamlined process, such as a questionnaire even shorter than that used currently, and integrated into the current data cleansing process where marital status and addresses are also obtained and verified.

- However, this post-transaction data may not necessarily result in post-transaction premium reductions for pension schemes, but instead may result mainly in the insurers being able to gain more certainty when calculating the reserves and capital required to support the policy.

- We expect the detailed medical underwriting observed today will continue to be applied to top-sliced transactions in particular, where the high amounts of pension insured per member justify the more intensive underwriting approach.

- We also expect that increasing numbers of small schemes will be priced using medical underwriting, especially in circumstances where industry group and amount of pension in payment are likely to be poor proxies for underlying health status.

- As one insurer described it: “Medical underwriting is not a separate market. It’s a method of pricing.” We agree with this sentiment and would go further. Medical underwriting is a process, not the product.

- The product, the transfer of risk from pension schemes to the insurance sector, has enormous scope to grow in future and additional financial and human capital is essential to support that growth.

- New entrants to the marketplace will blend existing underwriting processes and develop new ones, using new risk factors based on new sources of data, in ways that cannot be foreseen at present.

ABOUT THE SPONSOR:

Partnership is a FTSE-listed specialist insurer that aims to provide better outcomes by taking into account people's health and lifestyle conditions. An expert in the field of medical underwriting, Partnership offers annuities, equity release, protection, care annuities and medically underwritten bulk annuities. For more information visit, www.partnership.co.uk