

Media Comments 2013

Osborne's Autumn Statement: Key pledges and reaction, Sarah Miloudi , News Editor, *Portfolio Adviser*, From News Dec 5 2013

Ahead of every Autumn Statement the financial press keeps its fingers crossed that the Chancellor will launch into an economic striptease – 60 minutes of exciting announcements with a big reveal saved for the end.

True to form, the journalist community was left disappointed, along with workers under 50 who will now have to wait far longer before they can collect a pension from the state. Whitehall staff were also left feeling pinched, as they will have to cope with a further £1bn-a-year cut to their budgets.

Growth projections revised up

But it wasn't all gloomy. As most commentators had thought, the OBR shunted its forecasts for growth in a pleasing direction. It said it now expects growth of 1.4% this year and 2.4% next year, double its earlier predictions, and in stark contrast to its downbeat outlook issued back in March.

Elsewhere, the Chancellor said he was pleased to report that unemployment is coming down and that inflation is in check.

“Britain's economic plan is working,” he proudly told the Parliament.

Osborne remained committed to austerity though, and warned that work still needs to be done if the deficit is to continue narrowing and the recovery to pick up steam.

He said: “[We want] a responsible recovery, where we don't pretend we can make this nation better off by writing cheques to ourselves and instead, make the hard choices.”

He also took the opportunity to take a swipe at the Labour Party, which the Chancellor said “resisted every cut and every reform” that was needed to pull the UK out of its mess.

Key announcements

Among the main announcements in the Autumn Statement, the chancellor pledged:

- The Pension age is to rise to 68 in the 2030s and to 69 in the 2040s. From next year the state pension will rise by £2.95 a week
- Libor fines will go to charity - £100m will be directed to military good causes
- The bank levy will rise to 0.155% from next year – this will raise close to £3bn in the next financial year for the government
- Foreigners who sell second homes in the UK will have to pay CGT, while the richest 1% are to pay 30% of income tax
- There will be a new tax allowance for investments in shale gas
- The Treasury is to raise £9bn over five years through tax evasion and avoidance

clampdowns – a raft of new measures is set to be unveiled

- 50,000 more people are to benefit from business start-up loans; 20,000 more apprenticeships will be on offer to youngsters
- The stamp duty on ETFs is to be scrapped
- Business rate rises will be capped at 2%; rate relief extended for 12 months
- Next year's fuel duty increase has been shelved
- Employers' National Insurance for young people is to be done away with – 1.5m people are expected to benefit, and employing someone earning £16k will become £1k less costly

The Chancellor tried to balance pledges rolled out to reduce the cost of living by scrimping elsewhere, and largely, the home team reacted fairly happily to his statement, along with some commentators, who even spoke positively in response to changes linked to the state pensionable age.

“This should not be regarded as a big deal,” said **David Blake**, Director of the Pensions Institute at Cass Business School.

“This is an inevitable consequence of the increase in life expectancy which is still continuing with no apparent sign of slowing down. Young people starting work today will not get the state pension until they are in their early 70s. But because healthy life expectancy is also increasing, being in your early 70s in 50 years' time will be like being in your early 60s today.”

In typical fashion, the opposition was much more sceptical.

In typical fashion, the opposition was much more sceptical.

Labour's Ed Balls focused on the squeeze on living standards and pointed out that the average working person was now £1,600 worse off than they were in 2010.

He also said that net lending to businesses was down versus three years ago, shrugging off the Chancellor's moves to help Britain's entrepreneurs.

Comment from economists was that the UK's fiscal consolidation still has a long way to go.

Capital Economics reacted: “The changes left the Chancellor expected to meet his primary fiscal mandate to balance the cyclically adjusted current budget in five years a year early, though he still misses the supplementary target for the debt to GDP ratio to be falling in 2015-16.”

Meanwhile, Neil Williams, chief economist for Hermes' Global Government & Inflation Bonds, said: “This is a much warmer Autumn Statement than the chancellor expected a year ago.”

Autumn Statement: State pension reaction, Manchester Evening News, 5 Dec 2013

Young people are facing the prospect of working "until they drop" under controversial plans being announced by the Government to increase the retirement age, unions said today

Young people are facing the prospect of working "until they drop" under controversial plans being announced by the Government to increase the retirement age, unions said today.

People now in their 40s will not now get the state pension until they are 68, while those in their 30s will have to wait another year until they are 69.

Mr Osborne said that the Government needs to "guarantee that the basic state pension is affordable in the future, even as people live longer and our society grows older".

He said: "The only way to do that is to ensure the pension age keeps track with life expectancy."

Mr Osborne said that people should expect to spend up to one third of their adult life in retirement.

Based on this principle, he said this would mean an increase in the state pension age to 68 in the mid-2030s and to 69 in the late 2040s. Exact dates will be set by future statutory reviews.

Mr Osborne said future taxpayers will be saved around £500bn by the changes.

He also confirmed in his speech that the state pension will increase by £2.95 a week from April.

The pensions rise from £110.15 to £113.10 is linked to September's official Consumer Prices Index inflation figure of 2.7%.

Peter Done, managing director of Manchester's Peninsula Business Services, said: "My initial reaction is that it's a slap in the face for workers. They work hard for at least 40 years of their lives and are now being told that they have to 3 or 4 more years – how morale sapping is that news for employees? The chancellor's argument is that this is in direct correlation with extended life expectancy, but for the workforce they will want to enjoy and relax in their elder years as opposed to working for longer."

"With this news it could very easily have a double effect on UK businesses. If employees do take this news negatively and get react badly about it, then productivity

will inevitably drop for companies. This will be a double edged sword, as if productivity drops then we won't get into the black as fast as George Osborne predicts."

TUC general secretary Frances O'Grady said there has been no new evidence to show that people were living any longer since the last time the Chancellor increased the state pension age.

"Yet today's young workers are being told they must work until they drop. There are already massive inequalities in the state pension, with a woman in Corby expected to receive £67,000 less than someone in East Dorset due to widening gap in life expectancy. This pension divide will get worse as a result of today's announcement.

"However many decades they work hard and contribute, tomorrow's 69-year-olds will find themselves being sent for the future version of Atos assessments if they can no longer work."

Ms O'Grady said barely half of all men are able to work beyond the current state pension age, so raising it further will simply prolong an "agonising limbo" between their last job and their state pension.

"This has nothing to do with dealing with unexpected extra pension costs but is part of a long term attack on the welfare state and the dismantling of our national insurance system."

Paul Kenny, general secretary of the GMB said: "Raising the state pension age even further will be a devastating blow for hard working people everywhere.

"Ordinary people do not want to work until they drop and common sense tells you that there just won't be the jobs around anyway.

"Many occupations, especially involving manual work, simply cannot be sustained to age 70.

"What's more, the younger generation are already jobless and debt laden, now they see a bleak retirement as well."

Mr Kenny said the move will also have "serious unforeseen consequences" for occupational pensions as many schemes are linked to the state pension age or have bridging payments up to state pension age, which would now be significantly more expensive.

But others said the rising state pension age is another step towards removing "romantic" and "unrealistic" retirement expectations as many people already face the prospect of working into their 70s.

Pension expert Ros Altmann, a former Downing Street adviser, said that the move "should not be considered a penalty on the young".

She said: "Later retirement is a realistic response to the great news that people are living longer, healthier lives and that retirement is not all it is cracked up to be.

"Romantic notions of retirement being a wonderful period of long holidays, lazy days and playing golf are simply not realistic. With just a state pension and a small amount of private savings, retirement is often a question of struggling to make ends meet.

"State pension age rises should have been introduced much earlier than now, but we have been through a period of unrealistic expectations which even led people to believe that early retirement was something to aspire to. This is totally unsustainable."

Dr Altmann pointed out that the age at which someone starts to collect their state pension is not necessarily the same as their "retirement age" and people cannot rely on the state pension alone to provide them with a comfortable lifestyle.

She said: "People will need to supplement the state pension with other income. That could be from private pensions, other savings or continuing at work part-time.

"A rising state pension age is merely a signal that people are considered to have reached an age where the state may need to support them because they can no longer work productively.

"That is not something to aspire to though. Most people will want to have more income and a period of part-time work, after full-time work, can offer a much better lifestyle than stopping work altogether and trying to live for many more years on state and private pensions."

Ed Wilson, director in PwC's pension team, said that linking the state pension age to increasing life expectancies "is likely to mean someone starting work now will have to wait to age 72, and a child born today is unlikely to receive their state pension until they reach 77".

He said many people in the younger generation "will have to accept they'll be working longer than their parents".

Around 1.9 million people have been placed into a workplace pension as part of the Government's landmark reforms which began last year amid fears that the country is heading for a retirement savings crisis if people do not start putting more money away for their later years.

So far, a higher-than-expected rate of nine in 10 people who have been automatically enrolled into a workplace pension are staying in it rather than opting out.

Tom McPhail, head of pensions research at financial services provider Hargreaves Lansdown, said that given rising life expectancies and current low levels of private pension saving, it was "unrealistic" that there would be no further rise in the state pension age.

He said: "In reality, many in work today are already unlikely to be able to afford to retire until their 70s, irrespective of when their state pension falls due."

Professor **David Blake**, director of the Pensions Institute, Cass Business School, said: "This is an inevitable consequence of the increase in life expectancy which is still continuing with no apparent sign of slowing down..."

"Because healthy life expectancy is also increasing, being in your early 70s in 50 years' time will be like being in your early 60s today."

We twentysomethings have got to get real, By Louise Farrand, *Pensions Insight*, 5 December 2013

As we are living longer, working longer is inevitable - it really is that simple, argues Louise Farrand

For my generation, news in today's Autumn Statement that we will have to work until we are seventy will come as no great surprise.

I am in my twenties, and my generation is one that has had to constantly lower its expectations. Vast hikes in tuition fees have left us with stacks of debt and when we entered the job market, we found that prospects for graduates had dried up.

Thinking of buying a house in your twenties? Forget it. The average age of a first time buyer is 30, according to research by the Halifax. No wonder, when so many of us are still paying off our student loans and struggling to break into the job market.

Many of us prioritise saving for a deposit on a house over saving into a pension, meaning my generation's retirement prospects are frankly stuffed, according to most commentators.

It's all doom and gloom, isn't it? But we twentysomethings should keep our frustration in perspective.

For one thing, pensions were never intended to support us for decades. When the state pension was first introduced in 1908, it was only given to those over 70 who passed a means test. Average life expectancy back then was only 50 – so it was really only a measure to support those who had lived unusually long lives.

By contrast, girls born today can expect to live to almost 83, and boys to 79, according to the Office of National Statistics. Given we are all leading longer, healthier lives, it is entirely proportionate to increase the age at which we can claim a state pension.



David Blake

As Professor **David Blake** of Cass Business School says: “This is an inevitable consequence of the increase in life expectancy which is still continuing with no apparent sign of slowing down. Young people starting work today will not get the state pension until they are in their early 70s.

“But because healthy life expectancy is also increasing, being in your early 70s in 50 years’ time will be like being in your early 60s today. This should not be regarded as a big deal,” Blake argues.

There is more good news. The government’s policy of auto-enrolment has already increased the number of people saving into workplace pension schemes by 1.9 million, with millions more to join as their employers reach their staging dates.

Perhaps, as cynics suggest, the focus on increasing saving into private pensions is an excuse to further erode the state pension at a later date. But the government has been overspending for years, and the reality is that the state cannot support an entire generation of pensioners.

Our generation is measuring itself against the yardstick of our parents’, one of the most – if not the most – privileged generations ever to exist in this country. Have we gone too far in expecting the same good fortune to be handed to us by the state?

If we want our interests to be reflected in mainstream politics, we have to vote”

Twentysomethings are all too often painted as the passive victims of austerity politics. Too many of us choose not to exercise the power we have as voters, while politicians scramble to pander to the powerful and politically engaged older generation which wields the 'grey vote'.

It's really quite simple: if we want our interests to be reflected in mainstream politics, we have to vote. And twentysomethings should view our longer working lives in context. We are living longer, so of course we will have to work for longer. The state pension cannot and will not prop us up in retirement.

Academic hits out at 'badly designed' DC schemes, by Iona Bain, FTadviser.com, Sep 18, 2013

An academic who has helped to draw up principles to create better defined contribution pension plans has lambasted the majority of such schemes for being "badly designed".

Professor David Blake, director of the Pensions Institute at the Cass Business School, criticised "most" DC pension plans for failing to consider factors such as a member's occupation, interruptions in career to look after children and a possible increase in their life expectancy.

He said: "Most DC pension plans are badly designed. If a DC plan were well-designed, it would be a single, integrated financial product that delivers, at reasonable cost to the plan member, a pension that provides a high degree of retirement income security."

He said that a list of 16 good practice principles in modelling plans should help to ensure that underlying schemes are more "reliable and robust".

He added: "Projections from the models can then be used to guide both plan-design and member choices."

Professor Kevin Dowd, fellow of the Pensions Institute research facility at Cass and co-author of the principles, said applying the code should make members question whether they are contributing enough in time to enjoy a comfortable retirement.

Principles

The practice principles include:

- To improve modelling member choices and characteristics.
- To be clear about plan charges.
- To include additional sources of income.
- To improve stress testing.

Adviser View

Simon Walker, director of Northumberland-based SG Wealth Management, said: “DC schemes are created with no thought whatsoever for their membership – they are being shoved into workplaces with greater concern for advisers, ensuring that employers put in minimal contributions.

“It would be a simple and straightforward job to target benefits under DC schemes. One must sit down with every single employee coming into the scheme to see what earnings might be at retirement compared to the level of contributions going in.”

The demographer’s new microscope, PROJECT M, September 2013

projectm-online.com/leading-thoughts/the-demographers-new-microscope

A new approach to predicting life expectancy could also help to price guarantees on retirement income streams, says David Blake.

In this article

- David Blake and Andrew Hunt offer a new approach for designing a mortality model from scratch.
- Current models attempt to forecast mortality by imposing a fixed structure across three key features known to influence mortality.
- “A good mortality forecasting model is critical to the commercial success of those providing these guarantees.”

When British mathematician and actuary Benjamin Gompertz presented his law of human mortality in 1825, his basic assumption was simply that a person becomes more likely to die while growing older.

This may have rung true to Gompertz, then a 46-year-old man already five years beyond the average life expectancy of his time. However, his simple linear equation neglected to factor in one of the important age-period effects of his time. Throughout the 19th century, infant and maternal mortality were strikingly high and, of those children who survived childbirth, almost half died before the age of five.

Though many contributions in the field of mortality law were made throughout the latter half of the 19th century, actuarial mortality modeling is a relatively new science. Largely forgotten over much of the 20th century, it became an existential question towards the end of the 1990s, when – at about the same time the dot-com bubble burst – actuaries discovered that the pensionable population was significantly outliving their models’ predictions.

FIXING FAULTS

Given that liabilities increase by 3% for every year a 65-year-old pensioner outlives the modeled life expectancy, the impact of lower mortality rates at higher ages was significant, with companies opting out of pension provisioning to rid themselves of legacy liabilities. “When put to the test of real-life events, existing mortality models often proved faulty, and demographers amended them with ad hoc fixes as they went along. To avoid this happening in the future, we offer a new approach for designing a mortality model from scratch,” David Blake, professor of economics at the Cass Business School in London, tells PROJECT M. Together with PhD candidate Andrew Hunt, he developed a ‘general procedure’ (GP) for constructing mortality models.

Moving away from current one-size-fits-all mortality modeling, Blake and Hunt’s new approach uses a “combination of statistical methods and expert judgment to identify sequentially every significant demographic feature in the data and give it a specific functional form.

“The GP follows individuals through time as they age. This is crucial because, as we know, life expectancy depends on year of birth,” Blake points out. “Our point was not to introduce yet another new model, but to suggest a standardized approach that could become the basis for building all country-specific models in the future.”

ACCOUNTING FOR NATIONAL DIFFERENCES

“This is crucial, since we are currently talking about the wrong type of guarantees.”

David Blake

Current models attempt to forecast mortality by imposing a fixed structure across three key features known to influence mortality: age, period and cohort (or year of birth). The GP begins by identifying all the significant age-period terms according to each country’s unique attributes. In Western countries, for instance, the mortality rate in the first six months is high and then falls off only to rise again during the teenage years when reckless behavior – particularly among males – causes the mortality rate to increase. Once this ‘accident hump’ has been crossed, the mortality rate falls again until – at around 45 – it begins its slow, fairly linear climb. The significance of the GP is its acknowledgement of national differences. Where seven age-period terms may be identified for one country, in another it might be six; the weighting of each of the terms might also be different.

For instance, when Blake and Hunt applied the GP to UK data, they identified seven age-period terms: the general level of mortality (modeled as a constant);

increasing mortality with age (modeled as an upward sloping straight line); young adult mortality, which is a humped-shaped function centered at age 25; childhood mortality (a put option); postponement of middle-age mortality to old-age mortality (a Rayleigh function); peak of the accident hump around ages 18-19 (a lognormal function); and middle-age deaths between ages 55-65 (a normal function).

IDENTIFYING COHORT EFFECTS

In comparing these results with those of the United States, they found that although the first three age-period effects were the same as those of the United Kingdom, they did not have the same relative significance.

Once all the age-period terms have been identified, any significant structure remaining in the data can be associated with the cohort effect. One of the key discoveries from implementing the GP was the risk of wrongly allocating an age-period effect to a cohort effect. Since a cohort effect “follows” each cohort as it ages, whereas an age-period effect does not, then such a misallocation leads to increasingly poor mortality-rate projections over time.

Breeding resilience

The most prominent cohort effect in datasets across the world was triggered by what became known as the Spanish flu. Ravaging populations in countries around the world from 1918 to 1920, reports on this unusually deadly influenza epidemic were not censored in Spain, creating the false illusion that the country was particularly hard hit. Worldwide, 50 million to 100 million people died. Those who survived had significantly higher life expectancy than those born a few years earlier or a few years later.

When Blake and Hunt expanded their modeling approach to countries outside the United Kingdom, their results indicated that some countries didn't have a strong cohort effect. The GP picked this up, whereas a standard age-period-cohort model applied to these countries might well estimate a statistically significant cohort effect, although the relationship would be spurious since what was being picked up was in reality another age-period effect.

For instance, whereas obesity – which has almost doubled in the United States since the early 1960s – has a cohort effect there, as described by US demographer S. Jay Olshansky, it doesn't in Japan.

“The strongest cohort effect historically recorded was triggered by the so-called Spanish flu epidemic at the end of World War I. This is still visible in datasets today. Babies that survived the pandemic were much stronger and have had

noticeably lighter mortality every year since, compared with neighboring birth cohorts.”

Blake also points to increasing numbers of women picking up the bad habits of men – smoking and drinking – as another cohort effect.

PRICING GUARANTEES

According to Blake, a mortality model generated by the GP will accurately describe features observed in the past and be easy to calibrate and explain to other stakeholders. It will also capture specific mortality features for different birth years and project them as individuals age, and provide reliable forecasts of mortality rates at specific ages for longevity risk management strategies using, say, longevity swaps. Hunt, Andrew, and David Blake, February 2013: A General Procedure for Constructing Mortality Models, Discussion Paper PI-1301, Pensions Institute (pensions-institute.org/workingpapers/wp1301.pdf).

“We believe the general procedure will help demographers to look out for certain features in a dataset, whilst recognizing that these features might occur at different times in different countries, or not at all.”

Apart from a more effective looking glass for demographers, Blake believes the GP will also be helpful in pricing guarantees on retirement income streams more accurately. “This is crucial, since we are currently talking about the wrong type of guarantees.

“Instead of accumulation-phase guarantees (such as guaranteed minimum returns), we should focus on trying to guarantee income during the decumulation phase. Since these guarantees are very far in the future, a good mortality forecasting model, specifically designed for the population of interest, is critical to the commercial success of those providing these guarantees.”

Cass Business School: Misselling fears stop auto-enrolment extension to low earners, By Samuel Dale, Money Marketing, 12 June 2013

Cass Business School professor David Blake says the Government fears a misselling scandal if it extends auto-enrolment to include all lower earners.

Speaking at a Strategic Society Centre debate on pensions contributions today, Trade Union Congress pensions policy officer Helen Nadin re-iterated calls to widen auto-enrolment qualifying and earnings bands to take contributions from the first pound of pay.

Currently auto-enrolment contributions kick in above the personal allowance level, which currently stands at £9,440 and is due to rise to £10,000 in April.

Blake said: “The reason it doesn’t happen is because the Government is concerned about misselling. It is concerned that if poor people are effectively soft compelled to join a scheme they could end up far worse off with no means tested benefits and their money becomes worthless.

“That was part of the calculation but if we can get over that it would be great to get people saving more at a lower level. There will always be those waiting to say auto-enrolment is a disaster.”

Association of British Insurers head of savings and retirement Yvonne Braun backed allowing contributions from the first pound as a “dramatic simplification”. She said any move would need to be accompanied by an advice or guidance service to stop low earners being detrimentally affected.

But Department for Work and Pensions deputy director of pensions and ageing Adrian Richards said extending auto-enrolment could increase complexity.

He said: “It is very complex and it is costly for advice at the lower end. For those employers with part-time workers on small incomes, they are not paying tax or national insurance contributions, so it adds a complexity to them that they may not want.”

Cass creates principles for DC model, Amanda White, top1000funds.com, March 27, 2013

As almost every market in the world looks to move from defined benefit to some sort of defined contribution model, academics at the Pensions Institute of the Cass Business School, City University London have developed a set of 15 principles for designing a defined contribution model. The principles, consistent with the recently published OECD guidelines, are based on more than a decade of research.

First launched in London at an event jointly hosted by the OECD, World Bank and the International Centre for Pension Management (ICPM) earlier this month, the principles cover model specification and calibration, modelling quantifiable uncertainty, member choices and characteristics, plan charges, longevity risk, the post-retirement period.

The principles also leapfrog some of the more developed defined contribution markets, such as Australia, and advocate integrating the pre- and post-retirement periods. It also models additional sources of income, such as state pensions and equity releases, and looks at modelling extraneous factors, as well as scenario analysis and stress testing, periodic updating of the model and changing assumptions.

Head of the Pensions Institute at Cass, David Blake, says a defined contribution model should project both at-retirement pension outcomes and post-retirement outcomes, and consider pre- and post-retirement periods in an integrated way. It

should also consider other sources of retirement income outside the members' pension plan in an integrated way.

He says that most defined contribution pension plans are “very badly” designed.

“A well designed plan will be designed from back to front, that is, from desired outputs to required inputs,” he says.

Speaking at the event, director of ICPM, Keith Ambachtsheer, says building an ideal retirement income system should cover three phases: pre-work, work and post-work, and in doing that answers seven questions.

1. Length of the three phases
2. Individual versus collective decisions
3. Pay as you go versus pre-funding
4. Embedded risks
5. Risk-pooling mechanisms
6. Demographic, economic and capital market prospects
7. Institutional structures.

According to the Towers Watson *Global Pension Assets Study*, defined contribution assets represent about 43 per cent of total pension assets, but are growing at a rate of about 8 per cent, compared to 4.6-per-cent growth in defined benefit.

The UK, which is the third largest market in the world and has about 40 per cent in defined contribution assets, is looking closely at its pension modelling. It is estimated that about 11 million people are at risk of an inadequate pension in the UK. Last October the government introduced automatic enrolment and backed NEST, a defined contribution fund for low-income earners.

Also speaking at the event, chairman of NEST, Lawrence Churchill, says the European Commission has identified four problems with pensions: participation, adequacy, security and sustainability.

“We can transform this in a generation if we address those four boldly, transparently and simultaneously.”

The conference also discussed the importance of communicating to members, a function more prominent in a defined contribution environment, and in particular that any communication with members should have the aim of actually influencing behaviour.

The OCED and the Chilean pension regulator have collaborated to develop a retirement-income tool for members, with which the Chilean regulator actually standardised the assumptions used by providers in communicating benefits to members – also supported by the recommendations of Cass.

Head of private pensions at the OECD, Juan Yemo, says projections have a critical role to play in communicating with members at any age.

“They help with the emotional aspect of losses, not just about volatility or risk, but behaviour when people see those losses,” he says. “This information can change behaviour.”

The Cass Business School is looking for feedback on its principles. To access the discussion paper, Good Practice Principles in Modelling Defined Contribution Pension Plans, [click here](#).

The Cass Business School’s principles of designing a defined contribution model

Principle 1: The underlying assumptions in the model should be plausible, transparent and internally consistent.

Principle 2: The model’s calibrations should be appropriately audited or challenged, and the model’s projections should be subject to back testing.

Principle 3: The model must be stochastic and be capable of dealing with quantifiable uncertainty.

Principle 4: A suitable risk metric should be specified for each output variable of interest, especially one dealing with downside risk. Examples would be the 5 per cent value-at-risk and the 90-per-cent prediction interval. These risk metrics should be illustrated graphically using appropriate charts.

Principle 5: The quantitative consequences of different sets of member choices and actions should be clearly spelled out to help the member make an informed set of decisions.

Principle 6: The model should take account of key member characteristics, such as occupation, gender, and existing assets and liabilities.

Principle 7: The model should illustrate the consequences of the member’s attitude to risk for the plan’s asset allocation decision. It should also show the consequences of changing the asset allocation, contribution rate and planned retirement date, thereby enabling the member to iterate towards the preferred combination of these key decision variables.

Principle 8: The model should take into account the full set of plan charges.

Principle 9: The model should take account of longevity risk and projected increases in life expectancy over the member’s lifetime.

Principle 10: The model should project both at-retirement pension outcomes and post-retirement outcomes. The risks associated with the following strategies should be clearly illustrated: the risk of taking a level rather than an index-linked annuity in terms of a reduced standard of living at high ages, and the risks associated with drawdown strategies in terms of taking out more from the fund initially than is justified by subsequent investment performance.

Principle 11: The model should consider the pre- and post-retirement periods in an integrated way. This is necessary to avoid undesirable outcomes at a later date – such as a big fall in the standard of living in retirement. It will also help to determine what adjustment in member choices – in terms of higher contribution rate, an increased equity weighting and later retirement – are needed to avoid this.

Principle 12: The model should consider other sources of retirement income outside the member’s own pension plan. These include the state pension and home equity release. A well-designed DC model will also help with lifetime financial planning.

Principle 13: The model should reflect reality as much as possible and allow for such extraneous factors as unemployment risk, activity rates, taxes and welfare entitlements.

Principle 14: Scenario analysis and stress testing are important. For any given scenario, one should also: make key assumptions explicit; evaluate key assumptions for plausibility; and stress-test assumptions to determine which really matter. This allows the modeller to determine the important assumptions and focus on getting them (as much as possible) ‘right’.

Principle 15: The model will need to be updated periodically and the assumptions changed. Such modifications should be carefully documented and explained in order to make sure the model retains its credibility with users

Academics publish rules for modelling pension plans, *Institutional Asset Manager*, 26/03/2013

The Pensions Institute at Cass Business School has published a set of 15 “good practice” principles for modelling defined contribution (DC) pension plans.

Based on more than a decade of research, the principles aim to help pension providers design better pension plans.

The principles cover: model specification and calibration; modelling quantifiable uncertainty; modelling member choices; modelling member characteristics, such as occupation and gender; modelling plan charges; modelling longevity risk; modelling the post-retirement period; integrating the pre- and post-retirement periods; modelling additional sources of income, such as the state pension and equity release; modelling extraneous factors, such as unemployment risk, activity rates, taxes and entitlements; scenario analysis and stress testing; periodic updating of the model and changing assumptions.

The principles are consistent with the recently published OECD guidelines for designing DC pension plans. They also meet the European Insurance and Occupational Pensions Authority’s (EIOPA) set of good practices on information provision for DC plans.

The principles are:

Principle 1: The underlying assumptions in the model should be plausible, transparent and internally consistent.

Principle 2: The model's calibrations should be appropriately audited or challenged, and the model's projections should be subject to backtesting.

Principle 3: The model must be stochastic and be capable of dealing with quantifiable uncertainty.

Principle 4: A suitable risk metric should be specified for each output variable of interest, especially one dealing with downside risk. Examples would be the five per cent value-at-risk and the 90 per cent prediction interval. These risk metrics should be illustrated graphically using appropriate charts.

Principle 5: The quantitative consequences of different sets of member choices and actions should be clearly spelled out to help the member make an informed set of decisions.

Principle 6: The model should take account of key member characteristics, such as occupation, gender, and existing assets and liabilities.

Principle 7: The model should illustrate the consequences of the member's attitude to risk for the plan's asset allocation decision. It should also show the consequences of changing the asset allocation, contribution rate and planned retirement date, thereby enabling the member to iterate towards the preferred combination of these key decision variables.

Principle 8: The model should take into account the full set of plan charges.

Principle 9: The model should take account of longevity risk and projected increases in life expectancy over the member's lifetime.

Principle 10: The model should project both at-retirement pension outcomes and post-retirement outcomes. The risks associated with the following strategies should be clearly illustrated:

- the risk of taking a level rather than an index-linked annuity in terms of a reduced standard of living at high ages,
- the risks associated with drawdown strategies in terms of taking out more from the fund initially than is justified by subsequent investment performance.

Principle 11: The model should consider the pre- and post-retirement periods in an integrated way. This is necessary to avoid undesirable outcomes at a later date – such as a big fall in the standard of living in retirement. It will also help to determine what adjustment in member choices – in terms of higher contribution rate, an increased equity weighting and later retirement – are needed to avoid this.

Principle 12: The model should consider other sources of retirement income outside the member's own pension plan. These include the state pension and home equity release. A well-designed DC model will also help with lifetime financial planning.

Principle 13: The model should reflect reality as much as possible and allow for such extraneous factors as unemployment risk, activity rates, taxes and welfare entitlements.

Principle 14: Scenario analysis and stress testing are important. For any given scenario, one should also:

- Make key assumptions explicit;
- Evaluate key assumptions for plausibility; and
- Stress test assumptions to determine which really matter and which do not. This allows the modeller to determine the important assumptions and focus on getting them (as much as possible) 'right'.

Principle 15: The model will need to be updated periodically and the assumptions changed. Such modifications should be carefully documented and explained in order to make sure the model retains its credibility with users.

Professor David Blake, director of the Pensions Institute at Cass Business School and one of the co-authors of the principles, says: "Most DC pension plans are currently very badly designed. If a DC plan was well designed, it would be a single, integrated financial product that delivers at reasonable cost to the plan member a pension that provides a high degree of retirement income security. This pension should provide an adequate replacement income for the remaining life of the plan member (and possibly also a partner) and should remove the risk that the member outlives his or her resources. A well-designed plan will therefore be designed from back to front, that is, from desired outputs to required inputs.

"The reason that most DC plans are not well designed is that they are not modelled properly. For example, they do not take account of factors such as the member's occupation, or the possibility of career breaks for child care reasons, or likely increases in life expectancy over the life of the plan member. The principles of good practice can be applied to develop more reliable and robust models. Projections from the models can then be used to more effectively guide both plan design and member choices."

The Pensions Institute is holding a consultation on the principles until 31 May.

DC modelling should take into account gender, occupation and increases in life expectancy, By Kin Ly, Pensions Age, 26/03/2013

Defined contribution (DC) pension plan modelling needs to take into account wider ‘member characteristics’ such as gender, occupation and increases in life expectancy, according to a proposed set of principles for modelling DC pension plans.

The Pensions Institute at Cass Business School is consulting on its newly devised set of 15 principles that aim to improve the modelling of defined contribution (DC) pension plans.

Most DC plans have been described by the institute as “very badly designed” because they are not “modelled properly”.

To address this, the new principles propose modelling DC plans on quantifiable uncertainty; member choices; member characteristics such as occupation and gender; plan charges; longevity risk; integrating the pre- and post-retirement periods; additional sources of income such as the state pension and equity release; extraneous factors such as unemployment risk, activity rates, taxes and entitlements; as well as covering scenario analysis and stress testing; periodic updating of the model and changing assumptions; and model specification and calibration.

Co-author of the principles and director of the Pensions Institute at Cass Business School Professor David Blake said: “Most DC pension plans are currently very badly designed. If a DC plan was well designed, it would be a single, integrated financial product that delivers at reasonable cost to the plan member a pension that provides a high degree of retirement income security. This pension should provide an adequate replacement income for the remaining life of the plan member (and possibly also a partner) and should remove the risk that the member outlives his or her resources. A well-designed plan will therefore be designed from back to front, that is, from desired outputs to required inputs.

“The reason that most DC plans are not well designed is that they are not modelled properly. For example, they do not take account of factors such as the member’s occupation, or the possibility of career breaks for child care reasons, or likely increases in life expectancy over the life of the plan member. The principles of good practice can be applied to develop more reliable and robust models. Projections from the models can then be used to more effectively guide both plan design and member choices”.

The consultation deadline is Friday 31 May. A final version of the modelling principles is due to be published in June.

DC pension plans ‘badly designed and poorly modelled’, by Tom Forrest, *The Actuary*, 26 Mar 2013

Most defined contribution pension schemes are currently ‘very badly designed’ and are not modelled properly, according to a leading academic.

Professor David Blake, director of the Pensions Institute at Cass Business School, said that DC plans often did not take account of factors such as the member’s occupation, the possibility of career breaks for child care reasons or likely increases in life expectancy.

‘If a DC plan were well designed, it would be a single, integrated financial product that delivers at reasonable cost to the plan member a pension that provides a high degree of retirement income security,’ he said.

‘This pension should provide an adequate replacement income for the remaining life of the plan member and should remove the risk that the member outlives his or her resources. A well-designed plan will therefore be designed from back to front, that is, from desired outputs to required inputs.’

Blake made the comments as the Pensions Institute published a discussion paper including a set of 15 ‘good practice’ principles for modelling DC pension plans. *Good practice principles in modelling defined contribution pension plans* is said to be the outcome of more than a decade of research.

Among the principles are that underlying assumptions should be ‘plausible, transparent and internally consistent’ and that the model’s calibrations should be appropriately audited or challenged.

The Pensions Institute is holding a consultation on the principles, which closes on 31 May, and a final version will be published in June.

Co-author of the discussion paper Professor Kevin Dowd said that applying the principles might have ‘uncomfortable implications’ for plan members.

Dowd, a fellow of the Pensions Institute, added: ‘They will often show that they will be making insufficient contributions to their pension plan or are planning to retire too early. They can therefore plan to do something about this before it is too late.’

Pensions Institute launches consultation on 'very badly designed' DC, By Jack Jones, *Professional Pensions*, 26 Mar 2013

Academics have launched a consultation to establish the best way to model defined contribution schemes which could have "uncomfortable implications for plan members".

The consultation, run by the Pensions Institute, is based around 15 principles that the institute said comply with latest OECD and European Insurance and Occupational Pensions Authority guidance.

The principles include using plausible, transparent and internally consistent assumptions, auditing and back-testing calibrations and using stochastic models to account for uncertainty.

[Click here to read the 15 principles in full.](#)

Pensions Institute director David Blake said most DC schemes were currently "very badly designed", principally because they were not modelled to reflect factors such as member occupation, career breaks or increasing longevity.

He said: "If a DC plan was well designed, it would be a single, integrated financial product that delivers, at reasonable cost, to the plan member a pension that provides a high degree of retirement income security.

"This pension should provide an adequate replacement income for the remaining life of the plan member (and possibly also a partner) and should remove the risk that the member outlives his or her resources. A well-designed plan will therefore be designed from back to front, that is, from desired outputs to required inputs."

Blake said the principles being developed could be applied to develop more reliable and robust models which could guide plan design and member choices.

But Pensions Institute fellow Kevin Dowd said: "Applying these principles may have uncomfortable implications for plan members. They will often show that they will be making insufficient contributions to their pension plan or are planning to retire too early. They can therefore plan to do something about this before it is too late."

The institute is holding a consultation on the principles until May 31. To provide feedback, contact David Blake at d.blake@city.ac.uk.

[Click here to read *Good Practice Principles in Modelling Defined Contribution Pension Plans*](#) by Kevin Dowd and David Blake.

DC plans must not employ 'misleading' return predictions, by Jonathan Williams, *IPE*, 26 Mar 2013

UK – Increasing member longevity, the consequences of changing investment decisions and realistic return predictions must form the basis of any defined contribution (DC) pension model, the UK's Pensions Institute has argued.

Academics from London's Cass Business School also said all assumptions underlying pension plans should be "plausible" and internally consistent, and should endeavour to take account of a member's other sources of income upon retirement – such as accrued state pension benefits or property ownership.

According to the Institute's latest paper, '[Good Practice Principles in Modelling Defined Contribution Pension Plans](#)', the proposed plan design would remove the risk of a member outliving his accrued assets.

Lead author Kevin Dowd, professor of economics and finance at Durham Business School, said applying the devised 15 principles could have "uncomfortable implications" for DC members.

"They will often show that they will be making insufficient contributions to their pension plan or are planning to retire too early," he said.

Co-author David Blake, director of the Pensions Institute, added that he thought most DC plans were "currently very badly designed".

"If a DC plan were well designed, it would be a single, integrated financial product that delivers at reasonable cost to the plan member a pension that provides a high degree of retirement income security," he noted.

The paper argued that the incoming Financial Conduct Authority's "deterministic" return projections were "highly problematic – and, indeed, wrong in principle".

"Such projections are highly misleading as they give no indication of the likelihoods or probabilities of achieving such returns," the paper said, referring to the FCA's approach of projecting a product's value based on three fixed return rates.

"Indeed, one can easily get situations in which the probability of achieving an annual return of 8% over an extended investment horizon is essentially zero," it added.

The paper said plan designs needed to address the "quantifiable uncertainty", and suggested that predictions offered to members should state the likelihood of achieving the predicted goal.

It further said that DC plans should take account of each member's occupation and therefore salary, gender – as women currently report lower replacement ratios upon retirement – and any existing assets members possess, such as property.

Additionally, the plan should seek to outline the impact of risk-averse investments on replacement ratio levels, the paper said.

"A good DC model will illustrate the consequences of these decisions in terms of, say, the expected replacement ratio and the 5% [value-at-risk] as a measure of the downside risk," it said.

"Knowledge of these consequences might, in turn, influence other plan decisions that the member makes, such as the contribution rate and the planned age of retirement."

Concerns over increasing longevity were also addressed, with suggestions that increasing longevity should be brought to the attention of DC members, so the increasing expense of annuities can be taken into account when targeting the ultimate size of the DC pot.

The Pensions Institute said it was open to feedback on the paper and would be holding a consultation on the matter ending 31 May.

Partnership working on 15 'enhanced' buy-ins, by Jack Jones, Professional Pensions, 21 Mar 2013

More than a dozen schemes are undertaking medically underwritten buy-ins with Partnership, after the first two 'enhanced' buy-ins were completed by the insurer last year.

Partnership head of de-risking David Harvey said approximately 50 schemes had explored the option, with 15 now conducting or having completed underwriting exercises.

The process involves gathering information on members' health to enable insurers to price bulk annuities more accurately. Just Retirement, Legal and General and Aviva are also active in this market.

The first two enhanced exercises were completed by Partnership in December and, according to a **Pensions Institute** report, underwriting in these cases cut the cost by approximately 10%.

Harvey said: "I won't say the concept has been proved beyond doubt on the basis of these two deals, but we have shown the process can work".

The 15 schemes working with Partnership range in size from just under £1m to £38m of liabilities, with 260 members in the largest scheme.

Harvey said the schemes had all or most of the following characteristics: liabilities concentrated with few members, known health issues relating to larger liabilities, no more than 300 members, a high percentage of blue collar workers, and high levels of early retirement due to ill health.

He said half the schemes that had completed underwriting exercises had response rates to the questionnaires used to gather medical information of 100%, while the lowest rate was 70%.

Harvey said approximately one third of schemes had used incentives to encourage members to fill out the questionnaires, typically Marks and Spencer vouchers worth £25 or £50.

"But there is no tangible evidence that has made any difference to response rates," he said. "In fact, not one of the schemes that got a 100% response rate offered any kind of 'thank you'."



February 26, 2013

http://ai-cio.com/The_Professors_2013.aspx

The Professors: The Ten Most Influential Academics in Institutional Investing

The Professors, *aiCIO's* first list of 2013, introduces the top 10 academics influencing this industry. These academics have significantly aided pensions, endowments, foundations, and sovereign wealth funds, as well as institutional investors who are fulfilling their obligations to stakeholders.

Keith Ambachtsheer

Director, Rotman International Centre for Pension Management, University of Toronto (Toronto, Canada) [Read more »](#)

Andrew Ang

Ann F Kaplan Professor of Business and Chair of the Finance and Economics Division, Columbia Business School (New York, New York) [Read more »](#)

Rob Bauer

Professor of Institutional Investors, Maastricht University (Maastricht, the Netherlands) [Read more »](#)

David Blake

Professor of Pension Economics at the Cass Business School, City University (London, UK)

[Read more »](#) When the next pension fund announces a longevity swap, think of David Blake. It's mostly through his efforts that this risk can now be hedged. In 2006, Blake and a team from JP Morgan began the necessary research to launch a capital market, which could be used to trade and transfer longevity risk. If it is not offloaded as easily as other types of risk today, blame regulatory restrictions on investment banks' proprietary trading desks. Blake aims to have the government issue a longevity bond—this would set the riskless term structure for longevity risk upon which the private sector could build a liquid market. As founder and head of the UK's Pensions Institute, Blake is well placed to sway opinion—but he came to the sector by accident. Looking for a PhD topic in the late 1970s under the tutelage of renowned economist Meghnad Desai, Blake found the investment behavior of every institutional investor—save pension funds—had been modeled. "The combination of long-term assets and liabilities was really interesting," he says. "No one had looked at it, so I began modeling pension fund investment behavior and examining investment performance. I then got interested in pension plan design." His focus in 2013 is a software tool to improve defined contribution plan design. Expect similar great advances.

Gordon L. Clark

Director of the Smith School of Enterprise and the Environment, University of Oxford (Oxford, UK) [Read more »](#)

Elroy Dimson

Visiting Professor of Finance, Cambridge Judge Business School & Emeritus Professor of Finance, London Business School (London, UK) [Read more »](#)

Jack Gray

Director of the Centre for Capital Market Dysfunctionalities, University of Technology, (Sydney, Australia) [Read more »](#)

Josh Lerner

Jacob H. Schiff Professor of Investment Banking, Harvard Business School (Boston, Massachusetts) [Read more »](#)

Ashby Monk

Executive Director (Global Projects Center), Stanford University (Palo Alto, California) [Read more »](#)

Antoinette Schoar

Michael Koerner '49 Professor of Entrepreneurial Finance, MIT Sloan School of Management (Cambridge, Massachusetts) [Read more »](#)

Academics launch new blueprint for building mortality models, *Institutional Asset Manager*, 15/02/2013

A new blueprint for constructing mortality models has been developed by academics at the Pensions Institute at Cass Business School, part of City University London.

The blueprint could transform the way pensions and annuity providers and governments forecast mortality rates.

Called the “general procedure”, the blueprint can be applied to any dataset to build a mortality model that fits all ages across the population.

In recent years, there has been an explosion in the number of new mortality models being developed. These models often involve ad hoc extensions to existing models that have questionable demographic significance. They also have difficulties in providing realistic forecasts of specific mortality rates.

“Rather than propose yet another new mortality model, we outline and implement a general procedure for building a mortality model from scratch,” says Professor David Blake (pictured), co-author of the research and director of the Pensions Institute.

“The general procedure is a way of constructing mortality models which are tailored to specific datasets. This means it is able to identify the idiosyncratic features of different populations which conventional ‘off-the-peg’ models are unable to do.”

When tested on UK data, the general procedure comfortably outperformed simpler models such as the Lee-Carter model. It produced more parsimonious models than those generated using a mechanical algorithm, such as principal component analysis. It also gave well specified cohort effects which are essential for reliable forecasting of mortality rates.

Existing mortality models cannot ensure that cohort effects – effects that influence the mortality experience of a specific birth cohort – are well specified as the age effects in these models are either set in advance without justification from the data, or are generated mechanically and so lack biological and demographic plausibility.

This will then cause problems when the model is used to project mortality rates into the future. The general procedure has been developed to address this issue and produce well specified mortality models.

“The procedure works by sequentially extending a simple mortality model – first with freely varying age effects which take whatever shape fits the data best and then replacing these with a simpler, parametric age function which does the same job. It uses a combination of expert judgement and a toolkit of functional forms,” says Andrew Hunt, another co-author of the study.

“This then achieves a good fit to the data with a relatively parsimonious model whose age effects can then be interpreted in light of the underlying socio-economic and demographic drivers of changing mortality rates.”

Academics launch new blueprint for building mortality models, *Actuarial Post*, <http://www.actuarialpost.co.uk/article/academics-launch-new-blueprint-for-building-mortality-models-4462.htm>

General procedure’ could transform the way mortality rates are forecast

A pioneering new blueprint for constructing mortality models has been developed by academics at the Pensions Institute at Cass Business School, part of City University London.

The blueprint could transform the way pensions and annuity providers and governments forecast mortality rates.

Called the ‘general procedure’, the blueprint can be applied to any dataset to build a mortality model that fits all ages across the population.

In recent years, there has been an explosion in the number of new mortality models being developed. These models often involve ad hoc extensions to existing models that have questionable demographic significance. They also have difficulties in providing realistic forecasts of specific mortality rates.

“Rather than propose yet another new mortality model, we outline and implement a general procedure for building a mortality model from scratch,” said co-author of the research, and Director of the Pensions Institute, Professor David Blake.

“The general procedure is a way of constructing mortality models which are tailored to specific datasets. This means it is able to identify the idiosyncratic features of different populations which conventional “off-the-peg” models are unable to do.”

When tested on UK data, the general procedure comfortably outperformed simpler models such as the Lee-Carter model. It produced more parsimonious models than those generated using a mechanical algorithm, such as principal component analysis. It also gave well specified cohort effects which are essential for reliable forecasting of mortality rates.

Existing mortality models cannot ensure that cohort effects – effects that influence the mortality experience of a specific birth cohort – are well specified as the age effects in these models are either set in advance without justification from the data, or are generated mechanically and so lack biological and demographic plausibility.

This will then cause problems when the model is used to project mortality rates into the future. The general procedure has been developed to address this issue and produce well specified mortality models.

“The procedure works by sequentially extending a simple mortality model – first with freely varying age effects which take whatever shape fits the data best and then replacing these with a simpler, parametric age function which does the same job. It uses a combination of expert judgement and a toolkit of functional forms,” **said Andrew Hunt, another co-author of the study.**

“This then achieves a good fit to the data with a relatively parsimonious model whose age effects can then be interpreted in light of the underlying socio-economic and demographic drivers of changing mortality rates.”

A General Procedure for Constructing Mortality Models, by Andrew Hunt FIA and Professor David Blake, Pensions Institute, Cass Business School, [is available here](#).

Academics develop new method for forecasting mortality rates, *IPE*, 15 February 2013

UK – Academics in London have come up with a new way of predicting how long groups of people will live, which they claim could transform the way pension funds, annuity providers and governments forecast mortality rates.

The [new blueprint for building mortality models](#) has been devised by academics at the Pensions Institute at Cass Business School, which is part of City University London.

David Blake, co-author of the research and director of the Pensions Institute, said: "Rather than propose yet another new mortality model, we outline and implement a general procedure for building a mortality model from scratch."

This 'general procedure' can be applied to any set of data to construct a mortality model to fit all ages across the population, the institute said.

The procedure is presented as addressing problems with the many new mortality models that have been developed in recent years.

These models often involve ad-hoc extensions to existing models that have "questionable demographic significance", the institute said.

On top of this, the new models have trouble giving realistic forecasts of specific mortality rates, it said.

"The general procedure is a way of constructing mortality models that are tailored to specific datasets," said Blake.

"This means it is able to identify the idiosyncratic features of different populations, which conventional off-the-peg models are unable to do."

The procedure works by sequentially extending a simple mortality model, said Andrew Hunt, also co-author of the study.

First the model is extended with freely varying age effects, which take whatever shape fits the data best, and these are then replaced with a simpler, parametric age function that does the same job, he said.

"It uses a combination of expert judgement and a toolkit of functional forms," said Hunt.

"This then achieves a good fit to the data with a relatively parsimonious model whose age effects can then be interpreted in light of the underlying socio-economic and demographic drivers of changing mortality rates."

After testing on UK data, the general procedure easily did better than simpler models such as the Lee-Carter model, the institute said.

In addition to producing more economical models than those generated using a mechanical algorithm, the procedure also gave well-specified cohort effects, which the institute said are essential for reliable forecasting of mortality rates

New mortality model blueprint could ‘transform the way pension providers forecast mortality rates’, By Kin Ly, Pensions Age, 14/02/2013

A new blueprint for building mortality models has been developed by the Pensions Institute at Cass Business School.

The new ‘general procedure’ blueprint can be applied to any dataset to build a mortality model that fits all ages across the population, and “could transform the way pensions and annuity providers forecast mortality rates”, the institute said.

The new blueprint was developed following the rise in new mortality models that often involved ad-hoc extensions to existing models thought to have “questionable demographic significance”. These models also resulted in difficulties in extracting realistic forecasts of specific mortality rates, the institute highlighted.

However tests of the new blueprint on UK data found that the general procedure outperformed simpler models such as the Lee-Carter model and produced more parsimonious models than those using a mechanical algorithm.

The tests also found that the new procedure gave well specified cohort effects which are essential for reliable forecasting of mortality rates. Pensions Institute director and co-author of the research Professor David Blake said: “Rather than propose yet another new mortality model we outline and implement a general procedure for building a mortality model from scratch.

“The general procedure is a way of constructing mortality models which are tailored to specific datasets. This means it is able to identify the idiosyncratic features of different populations which conventional ‘off-the-peg’ models are unable to do.”

Andrew Hunt co-author of the study added: “The procedure works by sequentially extending a simple mortality model – first with freely varying age effects which take whatever shape fits the data best and then replacing these with a simpler, parametric age function which does the same job. It uses a combination of expert judgement and a toolkit of functional forms.

“This then achieves a good fit to the data with a relatively parsimonious model whose age effects can then be interpreted in light of the underlying socio-economic and demographic drivers of changing mortality rates.”

Mortality Modelling – You’re Doing It Wrong, by Elizabeth Pfeuti, *aiCIO*, February 14, 2013

Longevity has become a real headache for investors with liabilities to consider, but they may be working from the wrong numbers, new research suggests.

Have you altered how you measure the longevity risk in your pension fund in recent years? Chances are you are now receiving an incorrect measure, leading academics have claimed.

The pension industry has witnessed an explosion in the number of mortality models available in recent years due, in part, to an increased focus on [longevity](#) risk by actuaries and governments, Professor David Blake and Andrew Hunt, director and fellow of the Pensions Institute at Cass Business School, have reported in a paper published today.

However, updating and creating new models may not have improved the outcome for the end users, the authors assert in the paper entitled "[A General Procedure for Constructing Mortality Models](#)".

"Despite having more terms than the older models, they still fail to capture a lot of the information present in the data," the paper asserts. "Lacking a formal procedure for interrogating the data in order to establish what structure remains to be explained, modellers too often add new terms based on theoretical models or assumptions regarding the shape of the mortality curve rather than evidence."

The authors said misinterpreted data would lead to incorrect and implausible [forecasts](#) for the end user - usually pension funds and [life insurers](#). With this in mind they had created a "General Procedure" (GP), which is driven by forensic examination of data that could be used as a basis for building a mortality model from scratch.

"Through an iterative process, the GP identifies every significant demographic feature in the data in a sequence, beginning with the most important. For each demographic feature, we need to apply expert judgement to choose a particular parametric form to represent it. To do this, we need a 'toolkit' of suitable functions."

Blake and Hunt assert that by following the GP, it is possible to construct [mortality](#) models with sufficient terms to capture accurately all the significant information present in the age, period, and cohort dimensions of the data.

The paper shows how each separate part of data should and can be examined separately before finally being related to biological and social evidence to produce a result.

"It is not a "black box" algorithm which can be deployed mechanically on various datasets, but rather requires a substantial investment of time to understand the underlying forces driving mortality within the population of interest and how these forces can be represented mathematically," the authors said.

"Far from this being a disadvantage, we would argue that our approach accords perfectly with good model building practice, which seeks to move beyond a purely algorithmic approach in order to understand better the underlying structure of the data," they concluded.

To read the entire paper click [here](#) and for Professor Blake's column on Longevity for *aiCIO*, click [here](#).

See our feature on the leading academics in institutional investment in the next [issue](#) of *aiCIO*, published at the end of this month.

‘Ground-breaking’ mortality model blueprint launched by Pensions Institute, by Jack Jones, Professional Pensions, 14 Feb 2013

A blueprint for constructing mortality models tailored to specific scheme memberships has been developed by academics at Cass Business School’s Pensions Institute.

The authors of the paper A General Procedure for Constructing Mortality Models say the method could transform the way pensions and annuity providers and governments forecast mortality rates.

The institute's director and co-author of the report David Blake said the procedure could be applied to any dataset to build a mortality model that fits all ages across the population.

These models are able to account for the idiosyncratic features of different populations, something Blake claims conventional off-the-peg models are unable to do.

"Rather than propose yet another new mortality model, we outline and implement a general procedure for building a mortality model from scratch," he said.

Fellow author Andrew Hunt said the procedure worked by sequentially extending a simple mortality model, first with freely varying age effects which take whatever shape fits the data best and then replacing these with a simpler, parametric age function which does the same job.

"It uses a combination of expert judgement and a toolkit of functional forms," he said. "This then achieves a good fit to the data with a relatively parsimonious model whose

age effects can then be interpreted in light of the underlying socio-economic and demographic drivers of changing mortality rates."

Existing mortality models cannot ensure cohort effects, - effects that influence the mortality experience of a specific birth cohort - are well specified. This is because the age effects in these models are either set in advance without justification from the data, or are generated mechanically and so lack biological and demographic plausibility.

The report's authors say the blueprint "comfortably outperformed" simpler models when tested on UK data.

To read the full report visit: <http://pensions-institute.org/workingpapers/wp1301.pdf>

The Pensions Institute reports on advances in de-risking for defined benefit pension schemes, onlystrategic.com, 6th February 2013

Trustees of UK defined benefit(DB) pension schemes could secure savings of 10% or more when they de-risk their pensioner sections, thanks to the introduction of health and lifestyle underwriting techniques in the bulk purchase annuity(BPA) market. The first major report on this innovation, published by the Pensions Institute, coincides with news of the first 'enhanced' buy-ins to be completed in a market estimated to be worth up to £380bn.

Individual underwriting could slash the cost of a buy-in relative to conventional approaches to pricing, while the entry of specialist enhanced insurers will shake up competition in the de-risking market, the report says. Importantly, as the report's analysis of the first completed deals demonstrates, individual underwriting makes possible de-risking transactions that previously had been unaffordable, taking schemes closer to a fully funded position and to a final buy-out, at a time when they are suffering from increasing liabilities due to economic conditions. Members also benefit from these transactions, which can make schemes more secure and reduce the risk of transfer to the Pension Protection Fund (PPF).

However, the report warns that in any complex market, such as DB de-risking, increased choice can lead to increased complexity. Regulators and stakeholders in the market will be keen to evaluate the different approaches to collecting health and lifestyle information from members, and also the pricing implications when individual underwriting shows the members of a scheme are likely to live longer than average assumptions would indicate. Another consideration is that the selection of an insurer that is able to address a scheme's specific member profile requires considerable expertise and this might not be readily available to smaller schemes in particular. The report recommends that stakeholders and regulators work together to establish a clear regulatory framework and a code of practice to ensure the market reaches its full potential and develops in an orderly manner.

'A healthier way to de-risk: The introduction of medical underwriting to the defined benefit de-risking market', is published by the Pensions Institute at Cass Business School. The report authors are Dr Debbie Harrison, Senior Visiting Fellow of the Pensions Institute, and David Blake, Director of the Pensions Institute and Professor

of Pensions Economics at Cass Business School. The report was sponsored by Partnership Assurance and JLT Pension Capital Strategies.

Harrison said “This is a major development in the de-risking market. Trustees and scheme sponsors depend on securing affordable buy-ins in order to reach their ultimate goal, which is to transfer all liabilities to insurance companies. The introduction of medically-underwritten buy-ins will help them to reach this goal more quickly—a development that should be welcomed by stakeholders and regulators alike.”

Will Hale, director of Corporate Partnerships at Partnership comments “Sophisticated underwriting techniques, which have made a significant impact in the individual annuity market by increasing retirement incomes for people with health or lifestyle conditions, can now provide a more cost-effective way for certain DB schemes to insure their liabilities.

We believe the proposal for industry and regulators to establish a code of practice is a welcome and significant initiative. This provides a clear framework for how schemes and their advisers consider the benefits of individual underwriting when evaluating the most effective way to insure liabilities.”

Martyn Phillips, director and head of Buyouts at JLT Pension Capital Strategies comments “Buy-ins are already a common tool for trustees looking to de-risk their DB schemes. In the same way that enhanced annuities have changed the decumulation landscape for DC pensioners through the Open Market Option, the enhanced buy-in offers DB trustees a more cost effective way to derisk. With an ever increasing pressure on costs driven by widening scheme deficits, it is important that trustees are aware of, and explore all available options”.

Insurers offer UK defined benefit pension schemes a lifeline, *Institutional Asset Manager*, 05/02/2013

Trustees of defined benefit (DB) pension schemes could secure savings of 10 per cent or more when they de-risk their pensioner sections, thanks to the introduction of health and lifestyle underwriting techniques in the bulk purchase annuity (BPA) market.

The first major report on this innovation, published today by the Pensions Institute, coincides with news of the first “enhanced” buy-ins to be completed in a market estimated to be worth up to GBP380bn.

Individual underwriting could slash the cost of a buy-in relative to conventional approaches to pricing, while the entry of specialist enhanced insurers will shake up competition in the de-risking market, the report says. Importantly, as the report’s analysis of the first completed deals demonstrates, individual underwriting makes possible de-risking transactions that previously had been unaffordable, taking schemes closer to a fully funded position and to a final buy-out, at a time when they

are suffering from increasing liabilities due to economic conditions. Members also benefit from these transactions, which can make schemes more secure and reduce the risk of transfer to the Pension Protection Fund (PPF).

- However, the report warns that in any complex market, such as DB de-risking, increased choice can lead to increased complexity. Regulators and stakeholders in the market will be keen to evaluate the different approaches to collecting health and lifestyle information from members, and also the pricing implications when individual underwriting shows the members of a scheme are likely to live longer than average assumptions would indicate. Another consideration is that the selection of an insurer that is able to address a scheme's specific member profile requires considerable expertise and this might not be readily available to smaller schemes in particular. The report recommends that stakeholders and regulators work together to establish a clear regulatory framework and a code of practice to ensure the market reaches its full potential and develops in an orderly manner. The recommendations include a call for:
 - Consistent regulation of the BPA market on the part of the Financial Services Authority (FSA) and the Pensions Regulator (tPR). The FSA and tPR memorandum of understanding on pensions issues is woefully out of date and does not address de-risking. In April 2013 the FSA hands over to the Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA), so the dual regulation of the bulk purchase annuity market becomes tripartite.
 - Consistent and reliable data for the de-risking market as a whole and the development of consistent data in the enhanced buy-in market. To achieve the latter objective would require enhanced insurers to share their qualitative and quantitative experience.
 - Insurers to develop flexibility in the way they can collect data on members' health, so that schemes can benefit from whole-of-market bidding processes and avoid having to pre-select the insurer with the most appropriate methodology, as seems to be the case at present.
 - Insurers and reinsurers to work with schemes and their advisers to develop a comprehensive disclosure process, so that all material medical underwriting facts are made available during the bidding process. This would eliminate anti-selection concerns on the part of conventional underwriters.
 - Trustees to seek expert advice about the impact of the insurer's covenant on the scheme's financial position. They should also ensure that their trustee liability insurance extends to cover their liability in relation to de-risking exercises, including enhanced buy-ins.
 - Stakeholders and regulators to produce clear guidance for trustees, sponsors and their advisers to ensure best practice is extended to the smaller schemes, which constitutes the market initially identified by medical underwriters as suitable for enhanced buy-ins.

“A healthier way to de-risk: The introduction of medical underwriting to the defined benefit de-risking market” is published today by the Pensions Institute at Cass Business School. The report authors are Dr Debbie Harrison, senior visiting fellow of the Pensions Institute, and David Blake, director of the Pensions Institute and Professor of Pensions Economics at Cass Business School. The report was sponsored by Partnership Assurance and JLT Pension Capital Strategies.

Harrison says: “This is a major development in the de-risking market. Trustees and scheme sponsors depend on securing affordable buy-ins in order to reach their ultimate goal, which is to transfer all liabilities to insurance companies. The introduction of medically-underwritten buy-ins will help them to reach this goal more quickly – a development that should be welcomed by stakeholders and regulators alike.”

Martyn Phillips, director and head of buyouts at JLT Pension Capital Strategies, says: “Buy-ins are already a common tool for trustees looking to de-risk their DB schemes. In the same way that enhanced annuities have changed the decumulation landscape for DC pensioners through the Open Market Option, the enhanced buy-in offers DB trustees a more cost effective way to derisk. With an ever increasing pressure on costs driven by widening scheme deficits, it is important that trustees are aware of, and explore all available options.”

First medically underwritten buy-ins cut cost by 10% - Pensions Institute, *Professional Pensions*, By Jack Jones, 4 Feb 2013

Partnership has completed two medically underwritten buy-ins in a development academics say could kick-start a £380bn market.

The transactions, insuring £3.5m and £1m of liabilities, are believed to be the first of their kind and were concluded in December.

A report from the Pensions Institute at Cass Business School said in the largest of these deals the medical underwriting reduced the cost of the deal by 10%.

The report, *A Healthier Way to De-risk*, said the potential size of the market was approximately £40bn at present and could hit £380bn if the process was extended to schemes with larger memberships.

JLT Pensions Capital Strategies director and head of buyouts Martyn Phillips, whose firm commissioned the research, said: "In the same way that enhanced annuities have changed the decumulation landscape for defined contribution pensioners through the open market option, the enhanced buy-in offers defined benefit trustees a more cost effective way to de-risk."

Both transactions completed so far have involved mature schemes with fewer than 20 members, advised by regional corporate financial advisers with long-standing relationships with the trustees.

The larger scheme, a small manufacturer based in the north of England, had previously explored traditional buy-ins but had been put off by the price. They transacted after receiving a quote from Partnership that was approximately 10% below the price previously quoted by other insurers.

The medical data was gathered through a questionnaire that was completed by all 18 of the scheme's members, who were all retired. Those members with the largest pensions also gave consent for Partnership to obtain a GP's report to allow them to price the deal more accurately.

Partnership director Will Hale said: "We have worked in exercises where this required an incentive but there wasn't one on offer in this case. I would compliment the trustees and advisers for the communication process and the simplicity of the message they gave members."

The transaction was concluded within two months of agreeing terms and has now been converted into a full buyout with the insurer.

The co-author of the Pensions Institute's report Debbie Harrison said the development of medical underwriting would benefit smaller schemes which had so far been underserved by the de-risking market.

She said some of these schemes could see the cost of buy-ins and buyouts fall by considerably more than the 10% seen in the first transaction.

But in light of the complex nature of the market, Harrison called for a code of conduct to be established with the support of The Pensions Regulator.

"This would help smaller schemes, their trustees and advisers understand what processes are involved and where they might need to bring in outside help," she said.

Medical underwriting 'could cut de-risking costs by over 10%', Nick Mann, *The Actuary*, February 4, 2013

Taking pensioners' health and lifestyle into account could reduce the cost of de-risking a defined benefit pension scheme by 10% or more, according to research published today by The Pensions Institute.

Medical underwriting under an enhanced bulk purchase annuity buy-in could also speed up the entire process of moving the risk associated with a pension scheme onto an insurer, the report, *A healthier way to de-risk*, explained.

By making previously unaffordable transactions possible, the practice could also increase the percentage of schemes that are able to complete a buy-in, which is an 'essential' step towards a final buy-out. Currently, only 20% of buy-in quotations result in a completed transaction, according to industry figures quoted in the report.

Members will also benefit from these transactions, which can make schemes more secure and less likely to transfer to the Pension Protection Fund at a time when

economic conditions are increasing pension liabilities and, as a result, putting more pressure on sponsors.

The start of 2013 has seen the completion of the first enhanced buy-ins taking medical issues into account, with an initial focus on smaller schemes with up to 400 pensioners. However, the report estimates the market could be worth up to £380bn if it was scaled up to cater for all sizes of scheme pensioner sections.

Dr Debbie Harrison, senior visiting fellow at The Pensions Institute, which is based at Cass Business School, said: 'This is a major development in the de-risking market. Trustees and scheme sponsors depend on securing affordable buy-ins in order to reach their ultimate goal, which is to transfer all liabilities to insurance companies.

'The introduction of medically-underwritten buy-ins will help them to reach this goal more quickly – a development that should be welcomed by stakeholders and regulators alike.'

While the enhanced bulk buy-in market is expected to grow as conventional insurers develop their own medical underwriting services or make deals with specialists, the report called for a clear regulatory framework to be set up to ensure the market reaches its full potential.

In particular, it advocated 'consistent' regulation of the bulk purchase annuity market, with the updating of the memorandum of understanding between the Financial Services Authority and The Pensions Regulator. This was last updated in 2007, prior to the development of the de-risking market.

A code of practice is also needed, with agreements between the government, regulators and stakeholders, to safeguard the interests of trustees, employers and members. This should address areas including the need for accurate data, how insurers collect medical information on scheme members and the procedures schemes adopt on the death of a member.

Insurers Offer Defined Benefit Pension Schemes a Lifeline, *The Actuarial Post*, February 4, 2013

Trustees of defined benefit (DB) pension schemes could secure savings of 10% or more when they de-risk their pensioner sections, thanks to the introduction of health and lifestyle underwriting techniques in the bulk purchase annuity (BPA) market. The first major report on this innovation, published today by the Pensions Institute, coincides with news of the first 'enhanced' buy-ins to be completed in a market estimated to be worth up to £380bn.

Individual underwriting could slash the cost of a buy-in relative to conventional approaches to pricing, while the entry of specialist enhanced insurers will shake up competition in the de-risking market, the report says. Importantly, as the report's analysis of the first completed deals demonstrates, individual underwriting makes possible de-risking transactions that previously had been unaffordable, taking schemes closer to a fully funded position and to a final buy-out, at a time when they are suffering from increasing liabilities due to economic conditions. Members also

benefit from these transactions, which can make schemes more secure and reduce the risk of transfer to the Pension Protection Fund (PPF).

However, the report warns that in any complex market, such as DB de-risking, increased choice can lead to increased complexity. Regulators and stakeholders in the market will be keen to evaluate the different approaches to collecting health and lifestyle information from members, and also the pricing implications when individual underwriting shows the members of a scheme are likely to live longer than average assumptions would indicate. Another consideration is that the selection of an insurer that is able to address a scheme's specific member profile requires considerable expertise and this might not be readily available to smaller schemes in particular. The report recommends that stakeholders and regulators work together to establish a clear regulatory framework and a code of practice to ensure the market reaches its full potential and develops in an orderly manner. The recommendations include a call for:

- Consistent regulation of the BPA market on the part of the Financial Services Authority (FSA) and the Pensions Regulator (tPR). The FSA and tPR memorandum of understanding on pensions issues is woefully out of date and does not address de-risking.
- Consistent and reliable data for the de-risking market as a whole and the development of consistent data in the enhanced buy-in market. To achieve the latter objective would require enhanced insurers to share their qualitative and quantitative experience.
- Insurers to develop flexibility in the way they can collect data on members' health, so that schemes can benefit from whole-of-market bidding processes and avoid having to pre-select the insurer with the most appropriate methodology, as seems to be the case at present.
- Insurers and reinsurers to work with schemes and their advisers to develop a comprehensive disclosure process, so that all material medical underwriting facts are made available during the bidding process. This would eliminate anti-selection concerns on the part of conventional underwriters.
- Trustees to seek expert advice about the impact of the insurer's covenant on the scheme's financial position. They should also ensure that their trustee liability insurance extends to cover their liability in relation to de-risking exercises, including enhanced buy-ins.
- Stakeholders and regulators to produce clear guidance for trustees, sponsors and their advisers to ensure best practice is extended to the smaller schemes, which constitutes the market initially identified by medical underwriters as suitable for enhanced buy-ins.

'A healthier way to de-risk: The introduction of medical underwriting to the defined benefit de-risking market', is published today by the Pensions Institute at Cass Business School. The report authors are Dr Debbie Harrison, Senior Visiting Fellow of the Pensions Institute, and David Blake, Director of the Pensions Institute and Professor of Pensions Economics at Cass Business School. The report was sponsored by Partnership Assurance and JLT Pension Capital Strategies.

Dr Debbie Harrison, Senior Visiting Fellow at The Pensions Institute said: "This is a major development in the de-risking market. Trustees and scheme sponsors depend on securing affordable buy-ins in order to reach their ultimate goal, which is to transfer all liabilities to insurance companies. The introduction of medically-

underwritten buy-ins will help them to reach this goal more quickly – a development that should be welcomed by stakeholders and regulators alike.”

Will Hale, Director of Corporate Partnerships at Partnership commented:

“Sophisticated underwriting techniques, which have made a significant impact in the individual annuity market by increasing retirement incomes for people with health or lifestyle conditions, can now provide a more cost-effective way for certain DB schemes to insure their liabilities.

“We believe the proposal for industry and regulators to establish a code of practice is a welcome and significant initiative. This provides a clear framework for how schemes and their advisers consider the benefits of individual underwriting when evaluating the most effective way to insure liabilities.”

Martyn Phillips Director and Head of Buyouts at JLT Pension Capital Strategies commented:

“Buy-ins are already a common tool for trustees looking to de-risk their DB schemes. In the same way that enhanced annuities have changed the decumulation landscape for DC pensioners through the Open Market Option, the enhanced buy-in offers DB trustees a more cost effective way to derisk. With an ever increasing pressure on costs driven by widening scheme deficits, it is important that trustees are aware of, and explore all available options

Medical underwriting in BPA market could cut costs by 10 per cent, Kin Ly, *Pensions Age, February 4, 2013*

Trustees of defined benefit (DB) pension schemes could save over 10 per cent by de-risking their pensioner sections through medical underwriting techniques in the bulk purchase annuity (BPA) market, a report by the Pensions Institute has revealed.

The report found that underwriting could slash the cost of a buy-in compared to other conventional approaches to pricing: “These and other case studies in this report demonstrate that with judicious medical underwriting an enhanced BPA can offer schemes savings of about 10 per cent – much more in certain cases – relative to the cost of conventional underwriting.”

It added that individual underwriting made de-risking transaction affordable, “taking schemes closer to a fully funded position and to a final buy-out, at a time when they are suffering from increasing liabilities due to economic conditions”.

The report featured a number of proposals, such as regulation of the BPA market to be taken on by Financial Services Authority and The Pensions Regulator, that consistent data for the enhanced buy-in market is developed and that there is flexibility in the way insurers can collect data on members’ health, so that schemes can benefit from whole-of-market bidding processes.

It also proposed that trustees seek expert advice about the impact of the insurer’s covenant on the scheme’s financial position and that stakeholders and regulators should produce clear guidance for trustees, sponsors and their advisers to ensure best practice is extended to the smaller schemes.

The authors recommended that stakeholders and regulators work together to establish a clear regulatory framework and a code of practice, to ensure that the market reaches its full potential.

The Pensions Institute senior visiting fellow Dr Debbie Harrison said: "This is a major development in the de-risking market. Trustees and scheme sponsors depend on securing affordable buy-ins in order to reach their ultimate goal, which is to transfer all liabilities to insurance companies. The introduction of medically-underwritten buy-ins will help them to reach this goal more quickly – a development that should be welcomed by stakeholders and regulators alike."

According to the report, the enhanced bulk buy-in market currently focuses on smaller schemes with up to 400 pensioners. There are more than 5,000 schemes in this market, representing about 350,000 pensioners in aggregate and assets under management (AUM) of about £40 billion. This represents just over 10 per cent of the AUM in relation to pensioner sections in the total market, indicating that if the enhanced bulk buy-in can be developed to cater for all sizes of pensioner sections, the market would represent AUM of about £380 billion.

Medically underwritten buy-ins could save DB schemes 10%, *Pension Funds Online*, February 4, 2013

Savings of 10% or more could be secured by trustees of defined benefit (DB) schemes when they de-risk, due to the introduction of health and lifestyle techniques in the bulk purchase annuity (BPA) market, a report says.

The findings, which have been published by the Pensions Institute, coincide with what is believed to be the first 'enhanced' buy-in transactions, conducted by Partnership Assurance in December 2012, in a market that experts believe could be worth up to £380bn.

According to the report which uses the completed deals as case studies, individual underwriting makes possible de-risking transactions that previously had been unaffordable, taking schemes closer to a fully funded position and to a final buy-out.

"This is a major development in the de-risking market," said Dr Debbie Harrison, co-author of the Pensions Institute's report.

She added: "Trustees and schemes sponsors depend on securing affordable buy-ins in order to reach their ultimate goal, which is to transfer all liabilities to insurance companies. The introduction of medically-underwritten buy-ins will help them to reach this goal more quickly- a development that should be welcomed by stakeholders and regulators alike."

At the unveiling of the report at Cass Business School, Dr Harrison said that the current focus for enhanced bulk buy-ins is smaller schemes with up to 400 pensioners.

Based on data in the Pensions Regulator and Pension Protection Fund's Purple Book 2012, there are more than 5,000 schemes in this market, representing about 350,000 pensioners and £40bn assets under management.

"Buy-ins are already a common tool for trustees looking to de-risk their DB schemes. In the same way that enhanced annuities have changed the decumulation landscape for DC pensioners through the Open Market Option, the enhanced buy-in offers DB trustees a more cost effective way to de-risk" said Martyn Phillips, JLT Pensions Capital Strategies director and head of buyouts.

He continued: "With an ever increasing pressure on costs driven by widening scheme deficits, it is important that trustees are aware of, and explore available options."

Due to the complexity of the market, the report also recommends that a clear regulatory framework and a code of practice needs to be established, and that there needs to be consistent and reliable data for the de-risking market as a whole and the development of consistent data in the enhanced buy-in market.

"We believe the proposal for industry and regulators to establish a code of practice is a welcome and significant initiative. This provides a clear framework for how schemes and their advisers consider the benefits of individual underwriting when evaluating the most effective way to insure liabilities," said Will Hale, director of corporate partnerships at Partnerships.

Enhanced buy-in market could grow to £380bn, *Pensions World*, 4 February 2013

Trustees of defined benefit (DB) pension schemes could secure savings of 10% or more when they de-risk their pensioner sections, through health and lifestyle underwriting techniques in the bulk purchase annuity (BPA) market. A report '[A healthier way to de-risk: The introduction of medical underwriting to the defined benefit de-risking market](#)' by Dr Debbie Harrison, senior visiting fellow of the Pensions Institute, and David Blake, director of the Pensions Institute and professor of pensions economics at Cass Business School coincides with news of the first 'enhanced' buy-ins to be completed in a market estimated to be worth up to £380bn.

Individual underwriting could slash the cost of a buy-in relative to conventional approaches to pricing, while the entry of specialist enhanced insurers will shake up competition in the de-risking market, the report says. Importantly, as the report's analysis of the first completed deals demonstrates, individual underwriting makes possible de-risking transactions that previously had been unaffordable, taking schemes closer to a fully funded position and to a final buy-out, at a time when they are suffering from increasing liabilities due to economic conditions.

Members also benefit from these transactions, which can make schemes more secure and reduce the risk of transfer to the Pension Protection Fund (PPF).

However, the report warns that in any complex market, such as DB de-risking, increased choice can lead to increased complexity. Regulators and stakeholders in the

market will be keen to evaluate the different approaches to collecting health and lifestyle information from members, and also the pricing implications when individual underwriting shows the members of a scheme are likely to live longer than average assumptions would indicate. Another consideration is that the selection of an insurer that is able to address a scheme's specific member profile requires considerable expertise and this might not be readily available to smaller schemes in particular.

The report recommends that stakeholders and regulators work together to establish a clear regulatory framework and a code of practice to ensure the market reaches its full potential and develops in an orderly manner. The recommendations include a call for:

- Consistent regulation of the BPA market on the part of the Financial Services Authority (FSA) and the Pensions Regulator (TPR). The FSA and TPR memorandum of understanding on pensions issues is woefully out of date and does not address de-risking.
- Consistent and reliable data for the de-risking market as a whole and the development of consistent data in the enhanced buy-in market. To achieve the latter objective would require enhanced insurers to share their qualitative and quantitative experience.
- Insurers to develop flexibility in the way they can collect data on members' health, so that schemes can benefit from whole-of-market bidding processes and avoid having to pre-select the insurer with the most appropriate methodology, as seems to be the case at present.
- Insurers and reinsurers to work with schemes and their advisers to develop a comprehensive disclosure process, so that all material medical underwriting facts are made available during the bidding process. This would eliminate anti-selection concerns on the part of conventional underwriters.
- Trustees to seek expert advice about the impact of the insurer's covenant on the scheme's financial position. They should also ensure that their trustee liability insurance extends to cover their liability in relation to de-risking exercises, including enhanced buy-ins.
- Stakeholders and regulators to produce clear guidance for trustees, sponsors and their advisers to ensure best practice is extended to the smaller schemes, which constitutes the market initially identified by medical underwriters as suitable for enhanced buy-ins.

Dr Debbie Harrison, said: "This is a major development in the de-risking market. Trustees and scheme sponsors depend on securing affordable buy-ins in order to reach their ultimate goal, which is to transfer all liabilities to insurance companies. The introduction of medically-underwritten buy-ins will help them to reach this goal more quickly – a development that should be welcomed by stakeholders and regulators alike."

Will Hale, director of corporate partnerships at Partnership, commented: "Sophisticated underwriting techniques, which have made a significant impact in the individual annuity market by increasing retirement incomes for people with health or lifestyle conditions, can now provide a more cost-effective way for certain DB schemes to insure their liabilities.

“We believe the proposal for industry and regulators to establish a code of practice is a welcome and significant initiative. This provides a clear framework for how schemes and their advisers consider the benefits of individual underwriting when evaluating the most effective way to insure liabilities.”

Martyn Phillips, director and head of buyouts at JLT Pension Capital Strategies, added: “Buy-ins are already a common tool for trustees looking to de-risk their DB schemes. In the same way that enhanced annuities have changed the decumulation landscape for DC pensioners through the Open Market Option, the enhanced buy-in offers DB trustees a more cost effective way to derisk. With an ever increasing pressure on costs driven by widening scheme deficits, it is important that trustees are aware of, and explore all available options.”

Insurers Offer Defined Benefit Pension Schemes a Lifeline, *Economic Voice*, February 4th, 2013

Trustees of defined benefit (DB) pension schemes could secure savings of 10% or more when they de-risk their pensioner sections, thanks to the introduction of health and lifestyle underwriting techniques in the bulk purchase annuity (BPA) market. The first major report on this innovation, published today by the Pensions Institute, coincides with news of the first ‘enhanced’ buy-ins to be completed in a market estimated to be worth up to £380bn.

Individual underwriting could slash the cost of a buy-in relative to conventional approaches to pricing, while the entry of specialist enhanced insurers will shake up competition in the de-risking market, the report says. Importantly, as the report’s analysis of the first completed deals demonstrates, individual underwriting makes possible de-risking transactions that previously had been unaffordable, taking schemes closer to a fully funded position and to a final buy-out, at a time when they are suffering from increasing liabilities due to economic conditions. Members also benefit from these transactions, which can make schemes more secure and reduce the risk of transfer to the Pension Protection Fund (PPF).

However, the report warns that in any complex market, such as DB de-risking, increased choice can lead to increased complexity. Regulators and stakeholders in the market will be keen to evaluate the different approaches to collecting health and lifestyle information from members, and also the pricing implications when individual underwriting shows the members of a scheme are likely to live longer than average assumptions would indicate. Another consideration is that the selection of an insurer that is able to address a scheme’s specific member profile requires considerable expertise and this might not be readily available to smaller schemes in particular. The report recommends that stakeholders and regulators work together to establish a clear regulatory framework and a code of practice to ensure the market reaches its full potential and develops in an orderly manner. The recommendations include a call for:

Consistent regulation of the BPA market on the part of the Financial Services Authority (FSA) and the Pensions Regulator (tPR). The FSA and tPR memorandum of understanding on pensions issues is woefully out of date and does not address de-risking.

- Consistent and reliable data for the de-risking market as a whole and the development of consistent data in the enhanced buy-in market. To achieve the latter objective would require enhanced insurers to share their qualitative and quantitative experience.
- Insurers to develop flexibility in the way they can collect data on members' health, so that schemes can benefit from whole-of-market bidding processes and avoid having to pre-select the insurer with the most appropriate methodology, as seems to be the case at present.
- Insurers and reinsurers to work with schemes and their advisers to develop a comprehensive disclosure process, so that all material medical underwriting facts are made available during the bidding process. This would eliminate anti-selection concerns on the part of conventional underwriters.
- Trustees to seek expert advice about the impact of the insurer's covenant on the scheme's financial position. They should also ensure that their trustee liability insurance extends to cover their liability in relation to de-risking exercises, including enhanced buy-ins.
- Stakeholders and regulators to produce clear guidance for trustees, sponsors and their advisers to ensure best practice is extended to the smaller schemes, which constitutes the market initially identified by medical underwriters as suitable for enhanced buy-ins.

'A healthier way to de-risk': The introduction of medical underwriting to the defined benefit de-risking market', is published today by the Pensions Institute at Cass Business School. The report authors are Dr Debbie Harrison, Senior Visiting Fellow of the Pensions Institute, and David Blake, Director of the Pensions Institute and Professor of Pensions Economics at Cass Business School. The report was sponsored by Partnership Assurance and JLT Pension Capital Strategies.

Dr Debbie Harrison, Senior Visiting Fellow at The Pensions Institute said: "This is a major development in the de-risking market. Trustees and scheme sponsors depend on securing affordable buy-ins in order to reach their ultimate goal, which is to transfer all liabilities to insurance companies. The introduction of medically-underwritten buy-ins will help them to reach this goal more quickly – a development that should be welcomed by stakeholders and regulators alike."

Will Hale, Director of Corporate Partnerships at Partnership commented: "Sophisticated underwriting techniques, which have made a significant impact in the individual annuity market by increasing retirement incomes for people with health or lifestyle conditions, can now provide a more cost-effective way for certain DB schemes to insure their liabilities.

"We believe the proposal for industry and regulators to establish a code of practice is a welcome and significant initiative. This provides a clear framework for how schemes and their advisers consider the benefits of individual underwriting when evaluating the most effective way to insure liabilities."

Martyn Phillips Director and Head of Buyouts at JLT Pension Capital Strategies commented: "Buy-ins are already a common tool for trustees looking to de-risk their DB schemes. In the same way that enhanced annuities have changed the decumulation landscape for DC pensioners through the Open Market Option, the enhanced buy-in

offers DB trustees a more cost effective way to derisk. With an ever increasing pressure on costs driven by widening scheme deficits, it is important that trustees are aware of, and explore all available options.”