



## What is a bulk annuity?

A bulk annuity is a policy that trustees of a defined benefit pension scheme purchase from an insurer to cover the liabilities for those members included. This can be by way of a buyout or a buy-in.

A buyout would fully extinguish the liabilities, with the insurer issuing individual policies to members; whereas for a buy-in, the trustees would purchase a policy from an insurer which would be held as an asset of the scheme. This would usually match the benefits paid from the scheme and cover all or part of the pensioner population, although it could also include deferred members.

The conventional method for pricing a bulk annuity has been for insurers to consider each member's age, sex, postcode, pension size and occupation, with the missing piece of information being their health. The insurer would then make prudent assumptions as to the impact of average population levels of impairments on the life expectancies of the members under consideration.

## Medically underwritten annuities

The market for enhanced individual annuities following medical underwriting has developed significantly over the last three years, with specialist providers emerging and driving this marketplace forward.

Statistics show that approximately 40% of members would qualify for some type of enhancement (as per Partnership Assurance). Qualifying conditions (both common and severe) include:

- › Smoking
- › High blood pressure / raised cholesterol
- › Diabetes
- › Angina / heart conditions
- › Cancer

This innovation has now been brought into the bulk annuity market, with both specialist and established providers supplying underwritten solutions for schemes. By obtaining health information from individual members, schemes could potentially reduce the cost of a buy-in or buyout, ultimately making this more affordable. Although members do not directly gain by increasing their pension income, a successful underwritten exercise could improve the funding and security of a scheme (through potentially paying a premium below a scheme's Technical Provisions measure of the liabilities and reducing funding level volatility).

## What are the benefits of a medically underwritten bulk annuity?

A medically underwritten approach should provide trustees with a more realistic view of the longevity risk held in a scheme and therefore a more accurate bulk annuity price. This may be lower than a conventional price, which could make a transaction more affordable and attractive. By completing a transaction the trustees would remove longevity, inflation and investment risks associated with the liabilities covered, which would have a positive effect on the risk profile of the scheme.

## Is there a downside?

Once a scheme has obtained medical data, trustees are obliged to share information connected with this activity with insurers. This will preclude them from obtaining quotations from some bulk annuity providers who cannot offer a medically underwritten quotation. Also, it may be that a conventional approach would have offered a more competitive price, for example if members are of better than average health. If it does turn out that members are of better health than previously assumed, this will allow the trustees and sponsor to refine their own mortality assumptions in future valuations of the scheme's liabilities.

## Who are the insurers?

Currently four insurers are actively quoting for medically underwritten bulk annuities. These insurers are:



an established insurer, active in the conventional bulk annuity market for the past few years.



a specialist enhanced annuity provider, recently entered into the bulk annuity market.



an established insurer, who were one of the first to offer conventional bulk annuity policies.



a specialist enhanced annuity provider, Partnership entered into the bulk annuity market in 2012 and completed the first medically underwritten bulk annuity in late 2012 (and a further 6 transactions up to 30 September 2013).

Just Retirement and Legal & General are able to provide quotations for deferred pensioners (over age 55) as well as pensioners, whereas Aviva and Partnership will only currently quote for pensioner members.

## Which schemes may be appropriate?

Medically underwritten bulk annuities will not be suitable for all schemes. For example, some schemes may benefit from a conventional pricing model where members are expected to be healthier than the average scheme. As trustees will be required to share any medical data with insurers, they should consider whether they believe an underwritten approach could be advantageous before embarking on a process of obtaining underwritten quotations. Points to consider would include:

- **Number of members to be included** – these exercises are generally appropriate for transactions with fewer than 300 members. This does not mean that they are restricted to smaller schemes. For example, a tranche of pensioners from a larger scheme could be considered (such as the largest pensions in payment).
- **Type of transaction** – the transactions to date have been for pensioner buy-ins, as most insurers cannot provide underwritten quotations for deferred members (although this is changing).
- **Number of ill-health early retirements** – do the trustees hold this information and, if so, have a relatively high proportion of members taken ill-health early retirement?
- **Known health or lifestyle conditions** – the trustees may be aware of any health or lifestyle conditions members have. Key individuals could be approached to discuss the project and whether they would be prepared to divulge information.
- **Concentration of risk** – schemes may have a small number of members who carry a significant and disproportionate amount of the overall liability; the trustees may have some knowledge of these members' health.
- **Conventional buy-in was not affordable** – schemes that have obtained a conventional buy-in quotation that proved to be unaffordable could consider obtaining medical information to establish whether the price would be lower via an underwritten approach.

## What could the savings be?

It has been suggested that, through underwriting, quotations could be 3% lower when compared with a conventional quotation based on average health. This will ultimately depend on the results of any underwritten exercise and, conversely, some underwritten quotations could be more expensive. However, if trustees have considered the points above and believe that members may qualify then, looking at an individual member, typically savings could be:

Individual saving relative to a traditional buy-in

	Mild lifestyle condition	Smoker	Mild impairment
<b>Male 65</b>	15%	18%	24%
<b>Female 70</b>	9%	13%	20%

Source: Partnership Assurance

## What would the process be?

Where a buy-in or buyout is under discussion, after taking into account the size of the transaction and members to be included (i.e. where a quotation is being sought for 300 or fewer members, and these are either all or predominantly pensioners) we believe that schemes should consider whether an underwritten exercise or conventional exercise would be most appropriate.

The trustees should initially consider what information they have regarding the longevity in their scheme. If there is a belief that the scheme may benefit from a medically underwritten approach, the trustees should also consider timescales, as an underwritten approach will take slightly longer since health information will need to be gathered.

Assuming a medically underwritten approach is decided upon, the next step would be to agree the method of obtaining health information to provide to the insurers. Insurers differ between their ideal methods of collecting medical information; some prefer telephone-underwriting, whereas others prefer to obtain information via a medical questionnaire and general practitioner (GP) reports, if required.

After lengthy discussions with the four insurers, JLT have established a standard process to collect medical data; we are happy to work with trustees and sponsors to tailor our approach to their requirements. The standard process, which uses a third party to obtain the medical information, would be as follows:

1. JLT would discuss the project with insurers, to establish whether each insurer would provide a quotation.
2. The third party would write out to members on behalf of the trustees with a short medical questionnaire predominantly comprising of yes / no questions. There would be an approved covering letter explaining the reason this information was being collected and the advantages of doing so. Some schemes prefer to offer vouchers or charitable donations for members who complete questionnaires, although there is not adequate evidence to confirm whether this makes any difference.
3. Members would return their questionnaire to the third party, who would then establish whether any further information was required. If so, the third party would request a targeted GP report from the member's GP. Unless the member had chosen to see the GP report before it was issued, there would be no further actions for the member.
4. The third party would provide all medical information to the insurers involved.
5. The insurers would provide quotations.

If the trustees' preference was to complete a tele-underwriting exercise, whereby members were contacted at their convenience, this would be accommodated within this process and would generally replace the targeted GP reports.

Both the third party used in this process and all the insurers involved adhere to strict data protection policies. Each member's explicit consent is sought in the initial medical questionnaire to use sensitive personal data concerning their health and lifestyle for the purpose of medical underwriting.

## Summary

Over the past few years the buy-in market has changed significantly. New insurers have entered the market, leading to increasingly sophisticated methods of calculating the cost of a buy-in, and ultimately leading to a medically underwritten proposition.

In early 2012 only one insurer was prepared to offer a medically underwritten bulk annuity; twelve months later this had extended to four. The market is evolving, and it may be that for smaller pensioner buy-ins the medically underwritten approach becomes the standard. As more schemes consider an underwritten approach, conventional bulk annuity prices may increase since the insurers will deem these as having healthier populations. Whilst the market is establishing itself, it could therefore be a suitable time to consider such an exercise.

To summarise:

- A medically underwritten bulk annuity could provide a more accurate quotation, which may decrease the price of a transaction; equally it may increase the price if members are of above average health. Therefore it is important trustees consider their scheme before obtaining health information.
- Schemes can obtain multiple underwritten quotations, leading to a competitively broked exercise. Medical data can be collected with minimal input from members. Processes are generally flexible, however trustees should consider the most appropriate method of collecting data.

## Why JLT?

The JLT Buyout Team has a long and well-established reputation for guiding clients with defined benefit pension schemes through de-risking transactions, from initial contact with insurers, to negotiating terms and the signing of contracts and placing business with all major buy-in/buyout providers. Our team have a combined experience of over 25 years of advising on bulk annuity deals and have completed in excess of 200 buy-in and buyout transactions in their current and previous roles. We have advised on total deals worth over £10bn, representing more than 20% of total market trades to December 2013. We are able to advise on a wide range of transaction types, varying in size from below £1m to in excess of £1bn, covering deal structures from conventional bulk purchase annuities to fully bespoke de-risking solutions.

Due to the specialist nature of this activity, our team's sole focus is on helping clients with these types of transactions.

This ensures we have up-to-date knowledge of the market from working with insurance providers on a daily basis and reflects JLT's commitment to this area.

We also benefit from a number of our senior leadership team having previously held prominent positions within providers from the bulk purchase annuity marketplace. This gives us an important insight, which enables our team's processes and propositions to be well aligned with insurers' own capabilities, processes and requirements.

## Contacts

If you have a question regarding the issues discussed here or any aspect of de-risking your pension scheme, please do not hesitate to speak to one of our dedicated team. The main contacts are:

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