

## Medically Underwritten Bulk Annuities

Medical underwriting can be an attractive option to help schemes de-risk more cost effectively via either a buy-out or buy-in transaction. The developing market for medically underwritten bulk annuities now offers an alternative approach for securing benefits with an insurer. For some schemes, using additional information about the member's health can lead to significantly lower pricing compared to an insurer's traditional approach.

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### What is a medically underwritten bulk annuity?

A bulk annuity involves the Trustees of the scheme paying a premium to the insurer to purchase a policy which covers the liabilities of the members included in the transaction. This can be structured as a buy-out, where the insurer issues individual policies to the members, or as a buy-in where the policy is held by the Trustees as an asset of the scheme.

A key issue for the insurer in determining the premium is their assessment of the life expectancy of the members. Under a traditional approach, in addition to age and gender, the insurer considers indicative rating factors such as pension amount, occupation and postcode.

However, medical underwriting goes a fundamental step further, taking into account the specific health and lifestyle details of the individual members. This is analogous to the individual annuity market, where medical underwriting has been widely used for a number of years to assess life expectancies.

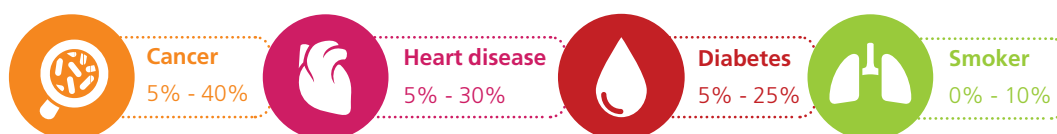
### What pricing impact can medical underwriting have?

If the medical underwriting shows the members to have lower overall life expectancies than would otherwise have been assumed by the insurers, then there will be a reduction in the premium relative to a traditional transaction. While any pricing adjustment is highly dependent on the specific details of each case, savings of up to 10% or more may be achievable.

Although the price may decrease as a result of medical underwriting it is important to be aware that the reverse is also true. If members are shown to have higher life expectancies as a result of medical underwriting, then there will be an increase in the premium relative to a traditional transaction.

Some potential savings for individual members are shown for illustration purposes in the chart below. The effect on the premium is dependent on the specific circumstances of each case, and can vary materially depending on the severity and ongoing nature of the condition.

#### Illustrative individual premium reductions for various conditions



Source: Partnership/Just Retirement

Simplified ranges shown for illustration purposes only, actual premium adjustments for individuals dependent on range of factors.

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## When could medical underwriting be suitable?

A medically underwritten approach will not be appropriate for all transactions. Some typical factors in considering whether it may be suitable include:

### Transaction size

The focus has typically been on transaction sizes of around 300/400 members or less. For example, this could be for smaller schemes, or for larger schemes where a tranche of higher liability members (e.g. those with the highest pensions) is selected – an approach known as ‘top-slicing’.

A top-slicing approach could be used for a standalone transaction, or potentially combined with a traditional exercise which covers the remaining members as part of a larger overall deal.

### Nature of transaction

Medical underwriting is suitable for transactions involving pensioners or older deferred members; there is little or no impact from medical underwriting for younger deferred members.

### Concentration of risk

Where the scheme profile shows a large proportion of the liability associated with a relatively small number of members. The higher liability members may represent a concentration of longevity risk and tend to be priced more conservatively by traditional insurers.

### Scheme knowledge

The trustees or company may be aware of health or lifestyle issues which could imply a lower than average life expectancy - especially significant if known for some of the higher liability members.

## Who are the providers?

The insurers in the medically underwritten bulk annuity market include two of the leading providers in the individual enhanced annuity market, Partnership and Just Retirement, as well as two of the traditional bulk annuity providers, Legal & General and Aviva.

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## Are there any implications of adopting a medically underwritten approach?

If medical information is requested from members then the traditional insurers may decline to quote on a non-underwritten basis for fear of being selected against. As traditional insurers do not allow for medical information, they will be concerned about being more likely to win the cases where the members are healthier than average – resulting in a higher life expectancy, and so anticipated cost, than is reflected in their standard pricing.

Where medical information has been obtained and the transaction does not proceed for some reason, if the transaction is then re-visited in the following few years, the traditional insurers may decline to quote or increase their premium accordingly. While this issue will tend to diminish over time as the medical information becomes increasingly dated, it is something to bear in mind at the outset.

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For a medically underwritten transaction which targets a specific tranche of members (e.g. ‘top slicing’ of the higher liability members), then provided these members have been chosen objectively rather than ‘cherry-picking’ those with potential health or lifestyle issues, a traditional transaction for the remaining members in the scheme should not be adversely affected.

## 2014 Budget



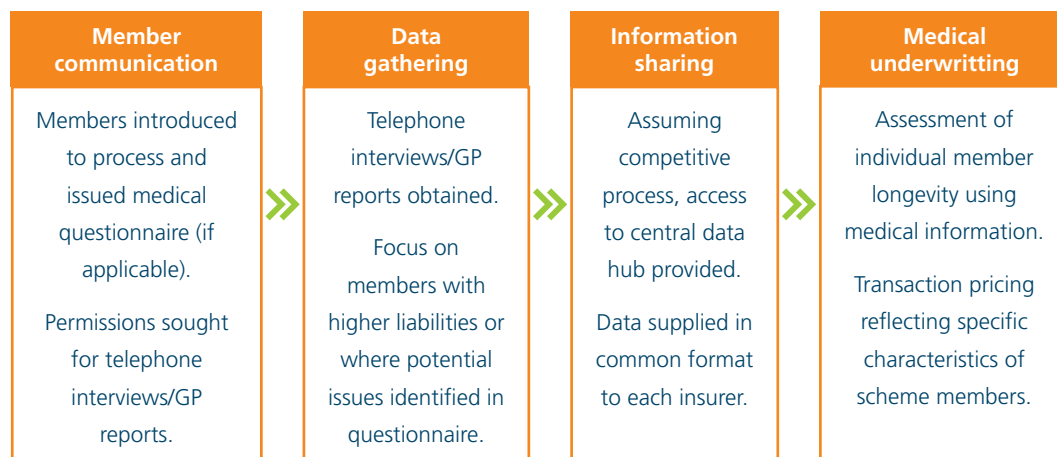
The 2014 Budget announcement removed the requirement for members of defined contribution schemes to purchase an annuity with effect from April 2015. The dramatic effect this has on the individual annuity market has led to a greater emphasis and resources being directed to the bulk annuity market by certain insurers – especially for the specialist medically underwritten providers where individual annuities played a more significant role in their overall business model.

## How does the process work?

Trustees should implement a process which seeks to both maximise the level of member engagement and recognises the potential sensitivity of the medical information being gathered. The insurers have different preferences for the way in which the medical information is collected. However, there are essentially three approaches for gathering information which can be used in combination – an initial short member questionnaire, telephone interviews and individual GP reports. The process will be targeted rather than looking to underwrite all members, for example GP reports will typically be sought for the higher liability members where the financial impact outweighs the cost.

The structure of the process will depend on whether a single insurer is involved or a competitive process is being followed with medically underwritten quotations from several insurers. For a competitive process it is possible to collate the information centrally and share this with each of the insurers through a secure online link. This can generate the desired competitive tension amongst the insurers and avoids members receiving multiple requests for information. Barnett Waddingham have experience of advising on both single insurer and competitive multi-insurer processes.

### Overview of Medical Underwriting Process



## Summary

A medically underwritten bulk annuity represents a new option for the transfer of risk which may be significantly cheaper than a traditional transaction for the trustee and sponsoring employer. The transaction could be in respect of all, or part, of the pensioner population or even the scheme as a whole. Targeting the higher liability members may also be a way of reducing any concentration of longevity risk for some schemes.

## Why Barnett Waddingham

We have close relationships and experience of working with each of the insurers who offer a medically underwritten option. Allied with our extensive experience of traditional buy-in and buy-out transactions, this means we are ideally placed to advise on this developing area of the market.

We can advise on all aspects of the process including:

- feasibility study to assess the viability of a bulk annuity transaction;
- potential suitability of a medically underwritten approach;
- support for any necessary preparatory steps;
- planning and project management of an efficient transaction process including member communications; and
- transaction structuring and price negotiations with the insurers.

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Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact Gavin Markham or Mark Paxton via the following:

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