# Bulk annuity briefing, Quarter 1 2021

In this briefing, we consider how a bulk annuity can help manage the risk of members living longer than expected.

We also look at the latest update to the First Actuarial Bulk Annuity Index, which monitors general trends in the pricing of bulk annuity transactions relative to self-sufficiency liabilities.

## Longevity risk

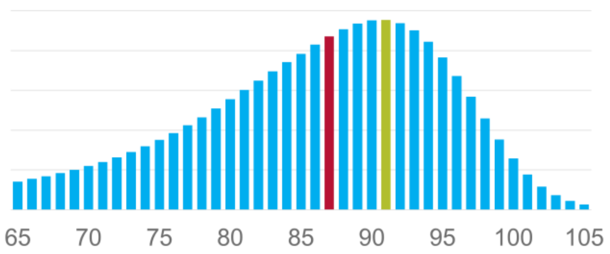
There are three different types of longevity risk:

- Base table risk: This is the risk that current mortality rates have been mis-estimated – the most dominant risk for older pensioners
- Trend risk: This is the risk that future improvements in mortality rates have been mis-estimated – the most dominant risk for younger members
- Idiosyncratic risk: This is the risk that individual members will die at a different age from that assumed – reduced by diversification for larger schemes.

Members may die sooner than expected (meaning that fewer payments need to be made and less money is needed) or they may live longer than expected (meaning that more money is needed).

## Life expectancy of an individual

Estimating individual life expectancy is not straightforward. Consider the example below:



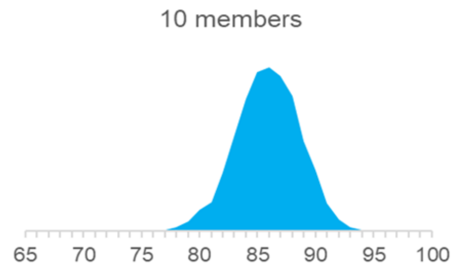

The average life expectancy for a 65 year old is 87 (the red line). However, the most common age of death (the tallest bar) is 91.

The blue lines are distributed across a number of ages, indicating a large 'spread' of possible outcomes. This means that there is a lot of uncertainty over how long they might live and therefore how much money will be needed to pay benefits.

## Life expectancy of a group

Larger pension schemes (note that an insurance company can be seen as a very large pension scheme) have less uncertainty, which means a smaller range of expected outcomes.

The following graphs show how this range, or 'spread', of average life expectancies decreases as the number of members increases.





For smaller pension schemes, the only way to remove this risk may be to buy a bulk annuity. The insurance company would then take on the risk that members will live longer than expected.

If a scheme wants to manage this risk but is not ready to buy a bulk annuity for all members, they could consider a buy-in for a portion of the membership.

## First Actuarial Bulk Annuity Index

The First Actuarial Bulk Annuity Index monitors general trends in the pricing of bulk annuity transactions relative to self-sufficiency liabilities.

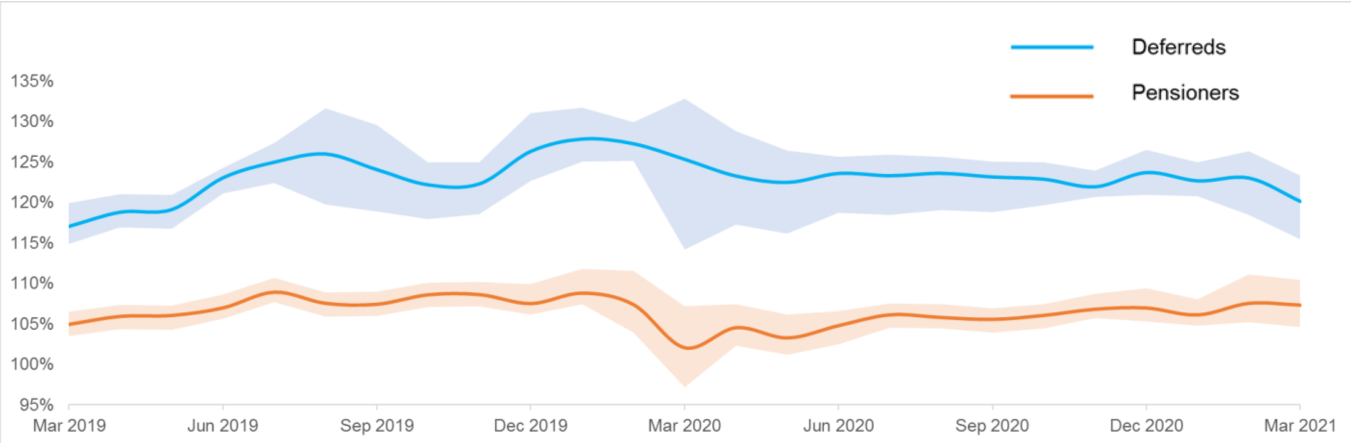
The chart below shows the average price of a £50 million bulk annuity transaction (with a mixture of fixed and inflation-linked liabilities) as a percentage of the liabilities measured on a self-sufficiency basis, using a discount rate of 0.5% pa above gilt yields.

The solid lines represent our estimate of the average price relative to self-sufficiency liabilities. The shaded area shows the range of sample pricing received, which illustrates that pricing between insurers can vary materially.

Insurers charge a higher premium for deferred members than for pensioners of the same age. This is because it is harder to predict the benefit outlay, as deferred members are entitled to exercise options around when to retire and whether to take part of their benefits as a tax-free cash lump sum.

For many schemes, the cost of a full buy-out can be prohibitive. But generally, as schemes mature and approach a self-sufficiency target, the extra funding required to reach buy-out decreases.

### First Actuarial Bulk Annuity Index (£50 million transaction) – pricing relative to self-sufficiency liabilities




Pricing has generally been attractive over the last 12 months, particularly for pensioners. Schemes that were 'buy-out ready' were able to obtain extremely attractive pricing from late March to early May 2020, on the back of the market shock caused by Covid-19.

At 31 March 2021, we estimate that the average price of a bulk annuity covering pensioners would be 7% higher than the equivalent self-sufficiency liabilities. In other words, for a scheme that was 100% funded on a typical self-sufficiency basis, we estimate that for every £10 million of liabilities, an additional £0.7m of funding would be required. However, for every £10 million of deferred liabilities, we estimate an additional £2.0m of funding would be required.

## Further information

Find out more about [First Actuarial's buy-in and buy-out services](#).

To discuss bulk annuities with us, please contact your usual First Actuarial consultant or email [enquire.buyout@firstactuarial.co.uk](mailto:enquire.buyout@firstactuarial.co.uk).