

Overview of UK longevity market developments



Emma McWilliam
FIA, FSA, MAAA

Philip Simpson
FIA, ASA, FSAI

The UK market for longevity risk has become increasingly dynamic and competitive over the last couple of years. Increasing numbers of players are looking to lower the risks of their life-insured annuity blocks through reinsurance or transfer. Corporate pension-scheme sponsors are seeking to off-load their volatility risk, a market opportunity of around £900 billion. In response, numerous new entrants are seeking buy-out opportunities and established players and reinsurers have changed their strategy and are actively acquiring longevity risk.

At Milliman we have worked with a number of established insurers, reinsurers, new market entrants, and investment banks to help them with both life insurance annuity transfers and corporate pension buy-outs. Our work with clients has included assisting them in the formulation of a view on longevity trends, helping them to determine prices for the acquisition of annuity or pensions business, and assistance with the provision of strategic solutions for responding to this market opportunity.

Competition is high and some attractive rates are now available in the market for off-loading longevity risk. This is exemplified by the recent Standard Life annuity deal with Canada Life, which was reported to have a £100 million embedded value release for Standard Life. Most of the transactions to date have been done by larger players such as the recent Friends Provident and Zurich Financial Services (ZFS) deals with Swiss Re. The market for longevity risk is now well established and the time is ripe for

smaller companies to actively review their longevity strategies to decide whether to take the opportunity of current competitive terms or to reconsolidate their position as writers of longevity risk.

For those sitting on the sidelines, capacity may well become an issue as writers bulk up on their longevity risk. To address capacity, investment banks are working to open up the doors to the capital markets for longevity risk; the credit crunch has accelerated these efforts. However, the gap between the differing views of longevity risk taken by insurers and capital markets still needs to close before the market truly takes off. Education of the capital markets on the underlying risk is key, and the creation of a number of mortality indices by such players around the globe as Credit Suisse, JP Morgan, Goldman Sachs, and Deutsche Boerse have helped to facilitate this. In addition, specific capital market transactions such as those by Lucida and Scor Re on the JP Morgan Life Metrics index, along with the issuance of a number



of mortality catastrophe bonds in the market by AXA, Munich Re, Scottish Re, and Swiss Re, all help to pave the way for life-insurance-linked securities.

There has also been a flurry of publications and developments to keep those working in this area busy. The actuarial profession has been active in considering future mortality improvements, and of particular interest the Continuous Mortality Investigation Bureau (CMI) recently released a library of future mortality improvement projections to help companies with setting improvement bases. This library includes a range of alternative projection methods, including cohort projections and variations thereof, P-Spline projections using assured and population lives, and Lee Carter projections. However, there are no recommendations on which basis to apply. Consequently, the key challenge for companies will be to distil the information in a practical way to determine their own view of future mortality improvements in light of medical advancements affecting major causes of death such as heart attack, cancer, and stroke.

For those active in the corporate pensions market, the CMI has also recently released the results of an experience analysis of self-administered pension (SAP) schemes covering the period 2000-2006. This analysis is vital for supporting the determination of pricing bases, including underwriting factors such as annuity amount and industry group adjustments. Previously, companies relied primarily on the Life Office Pensioners mortality tables as the reference point for setting mortality bases. But there are now newly released draft graduated-mortality tables specifically for SAP schemes as a result of the CMI's work.

The Financial Services Authority led the way in alerting insurance company CEOs to longevity risk early last year through its "Dear CEO Letter" that indicated the use of medium-cohort improvement projects with an underpin may not be sufficient for statutory reserving bases. The Board for Actuarial Standards, Accounting Standards Board, and Pensions Regulator soon after that launched reviews and released discussion and consultation papers to increase the transparency and comparability of longevity bases. Wider initiatives such as Treating Customers Fairly will also impact annuitant experience in the longer term as individuals are made fully aware of their options and alternative products in the market such as enhanced annuities. The proposals are all pushing at the boundaries to strengthen the longevity assumptions used. Indeed, for this 2008 year end, we have already seen some of the leading annuity writers such as Prudential and Legal & General strengthen their longevity reserving bases and include higher levels of underpins, but graduating these beyond age 90 to 0%.

The market as a whole is becoming more sophisticated in modelling longevity risk and understanding the long-term uncertainty and volatility risk associated with their annuity and pension portfolios. There is not a better time than now for companies to review and define their position in the market to seize the opportunity to secure a longer lifetime.

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