Secondary annuities market - Pricing and capital considerations

Gareth Mee, EY, 26th September 2016

Building a better working world

If I bought my annuity for £100, why are you only offering me £90 to cash it in?

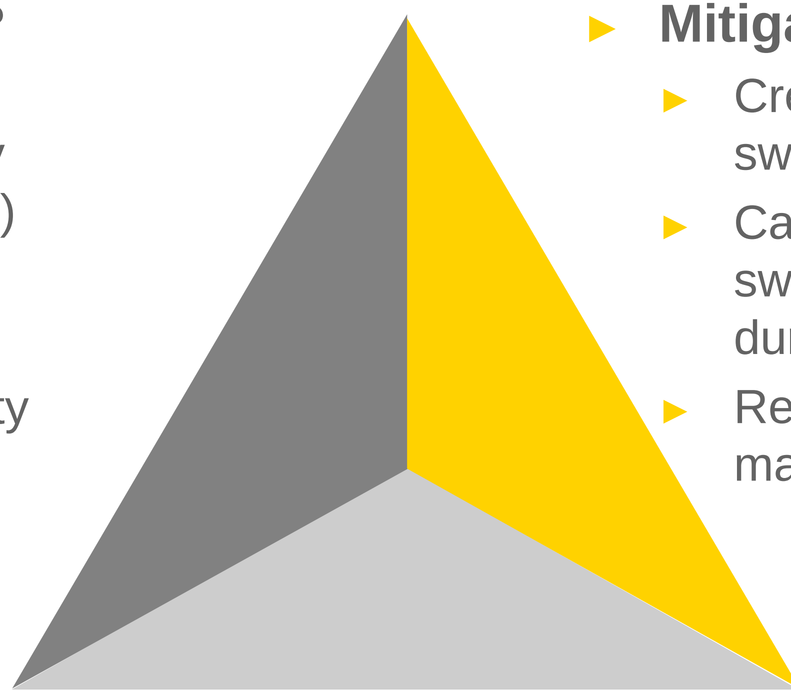
The better the question. The better the answer.
The better the world works.

Building a better working world

Pricing considerations

Factors a buyer will consider when pricing secondary annuities

- **What risks remain?**
  - Exposure to insurance company (in excess of FSCS)
  - Appetite for long dated cashflows
  - Appetite for mortality risk
  - Conduct
  - Structuring risk

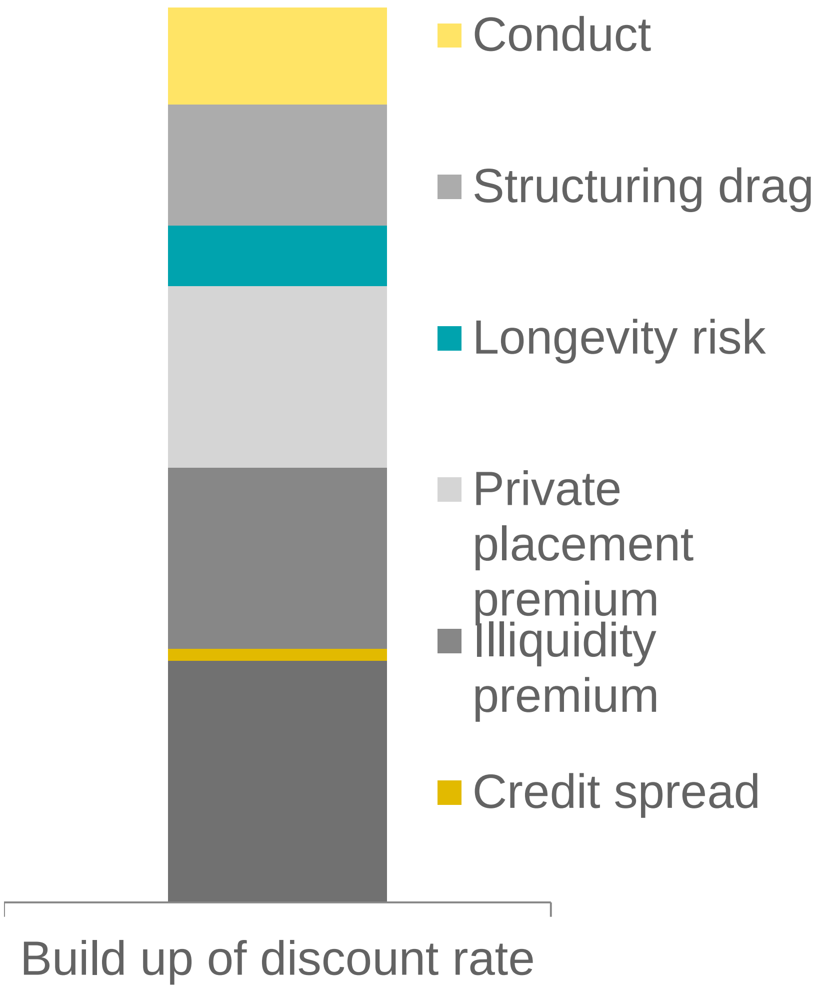


- **Mitigants**
  - Credit default swaps?
  - Cashflow / duration swaps to move duration
  - Reinsurance market?

- **Alternatives**
  - Equity release mortgages
  - Other ILS
  - Other illiquid assets

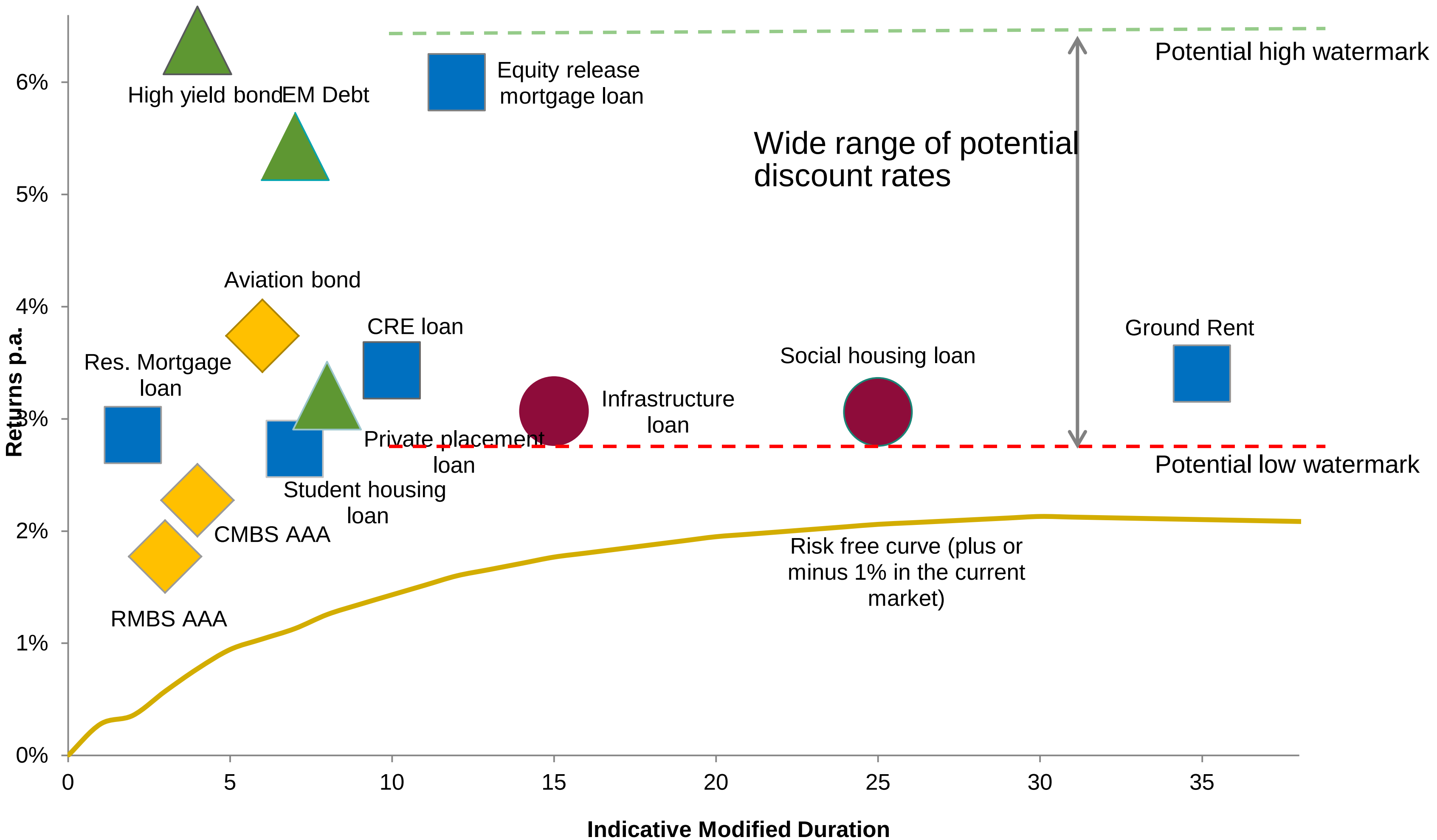
General pricing

A notional decomposition



- Expected to be immaterial credit risk due to FSCS benefit applying
- Private placement and illiquidity premium might be considered consistent with pricing for structured settlements or annuities certain.
- Longevity risk ought to be consistent with longevity swap pricing
- Third party insurers needing to restructure the assets will have a drag on the yield
- And finally, there may be conduct risk in entering into a transaction with retail consumers

Comparison with other alternatives



As of 31 March 2014, with updates to January 2015. SOURCE: Institute of Actuaries Non-Traditional Assets Working Party,

Buyback or third party considerations

Buyback

- If an insurer purchases its own policy back, it can simply cancel it. This will remove the reserves, the risk margin and the capital backing the policy. So it may simply charge the profit margin it had originally intended to earn over the lifetime of the policy.
- BUT, if this happens across the whole market, we've created a surrender option for our annuities which undermines one of the key assumptions of the matching adjustment.

Purchase by third party insurer

- A third party insurer using the asset to match annuity cashflows will need to pool the assets and restructure through an SPV
- So the annuities will have to be priced competitively compared to alternative assets which require restructure (e.g. equity release mortgages).

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Ernst & Young LLP

Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

ey.com