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Steering thro gh

Today's underwritten annuity market is highly competitive: each life is individually underwritten, and up to 10 companies are likely to be competing for each risk. As a result, we have the paradox of a product that is bespoke but is also now commoditised. This means good-quality pricing and risk management practices are essential and that underwriters and actuaries must work very closely together.

As the volume of sales has grown, so has the volume of data. Although that's good news, the number of deaths for holders of these products is still relatively small and, as with all lines of actuarial work, the skill is interpreting that data in the context of the evolving marketplace.

The rapid growth in sales of underwritten annuities, especially in recent years, is well documented. From 2005 to 2010, UK sales of underwritten annuities more than quadrupled, and growth since then has been around 30% per annum [1]. Although it is unlikely to continue to grow at 30% per annum indefinitely, we believe it will continue to grow – and quickly – in the foreseeable future. This is because the whole at-retirement marketplace will continue to grow, and because market developments will mean a larger proportion of retirees will apply for an underwritten annuity product.

The market's rapid expansion has attracted many insurers and reinsurers. Each will most likely have di erent pricing and underwriting structures, which will select against current players that do not refine their rating structures to the same degree of granularity. We have seen this in the market already, with many companies adopting an approach to underwriting these annuities that is reminiscent of how life insurance is rated: relatively detailed mortality loadings, customised for individual conditions and severities. This approach – in theory, at least – will attract more severely impaired lives than the traditional approach in the market of using a relatively small number of mortality tables, each reflecting a group of diseases from which an annuitant might su er.

Granular rating

As you might expect, companies are also seeking to o er enhancements to impairments not currently covered, especially for applicants with minor risk factors.

Taken in total, this suggests that to create risk pools by condition, which are stable over time and suitable for analysis, requires considerable insight and adjustment to successive cohorts of business.

A granular rating basis for this product will consist of several hundred impairment codes. Commonly, a life will have a number of impairments, and so will also be assigned multiple impairment codes. It would not be unreasonable to expect well over a thousand di erent combinations of impairments in a live portfolio. Clearly, analysing such a varied risk pool in detail has its challenges. Even with a huge number of deaths, statistical credibility will exist for only a small number of the very common combinations of impairments. As a result, the market will always need to rely on interpretations of medical studies and data by medics and underwriters to provide rating information. Relating the results of that work accurately to the base mortality cost derived by actuaries is a complex problem.

Unlike other life and health insurance marketplaces, the underwritten annuity market has had a standardised application form for all participants for many years [2]. It enables advisers to e ciently obtain multiple illustrations and quotes from providers, speeding product recommendation.

The quality of the standardised application's approach has been much improved by the recently implemented ORIGO 3.7 project. This is the new data exchange protocol for the pension annuity marketplace. It has increased the number of questions being asked, as well as the underwriting details the questions elicit, resulting in higher acceptance rates and a better understanding of each individual risk. That better comprehension of risk should

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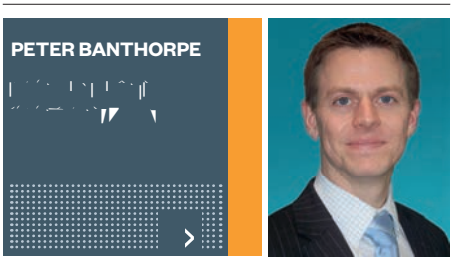
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