Sovereign Annuities

From Promise to Reality

Hard numbers on the choices Irish trustees are really making

Shane O'Farrell FSAI, FIA
Executive Manager (Risk and Longevity)
Irish Life Corporate Business
1st Oct 2013

Irish Life
CORPORATE BUSINESS

History of Sovereign Annuities

- Sovereign Annuities are annuities with payment linked to the performance of underlying EU government bonds
- Concept of these ”cheaper” annuities linked to Irish government yields first floated early 2010 by the IAPF and Society of Actuaries
- Based on proposals with a number of parallel objectives:
  1. to tackle Defined Benefit (DB) funding
  2. retain pension funds within the State
  3. indirectly address priority rule?
- After much, much technical work with Pensions Board-finally certifications in current standard format came late 2012
- New choice for trustees (on buy-in or buy-out basis)
- Various disclosure and due diligence requirements on trustees (under either scenario)

Irish Life
CORPORATE BUSINESS

Background to the numbers

- Irish Life certified in late December 2012-total of 3 providers in the market competing actively
- Since then maintained full records of all market tenders and their final outcomes
- Confident in these numbers we have caught all material (approx €2m+) bulk annuity deals that have closed
- The results show a very large increase in level of annuity buy-outs from scheme wind-ups and re-structuring
- Not surprising given the decline in DB on-going for last few years and re-introduced funding standard
- But how much of the annuity buy-outs have been on a Sovereign basis? Were the products seen as too risky and exotic and challenging? Or were they seen as reasonable and valid choices under tough conditions?

Irish Life
CORPORATE BUSINESS

The vote result……

Irish Life
CORPORATE BUSINESS

The vote result……

Irish Life
CORPORATE BUSINESS

The Dominance of Sovereign Annuities

The answer is: a lot!

Total buy-outs in 2013 (to end Q3) are three times the total 2012 level

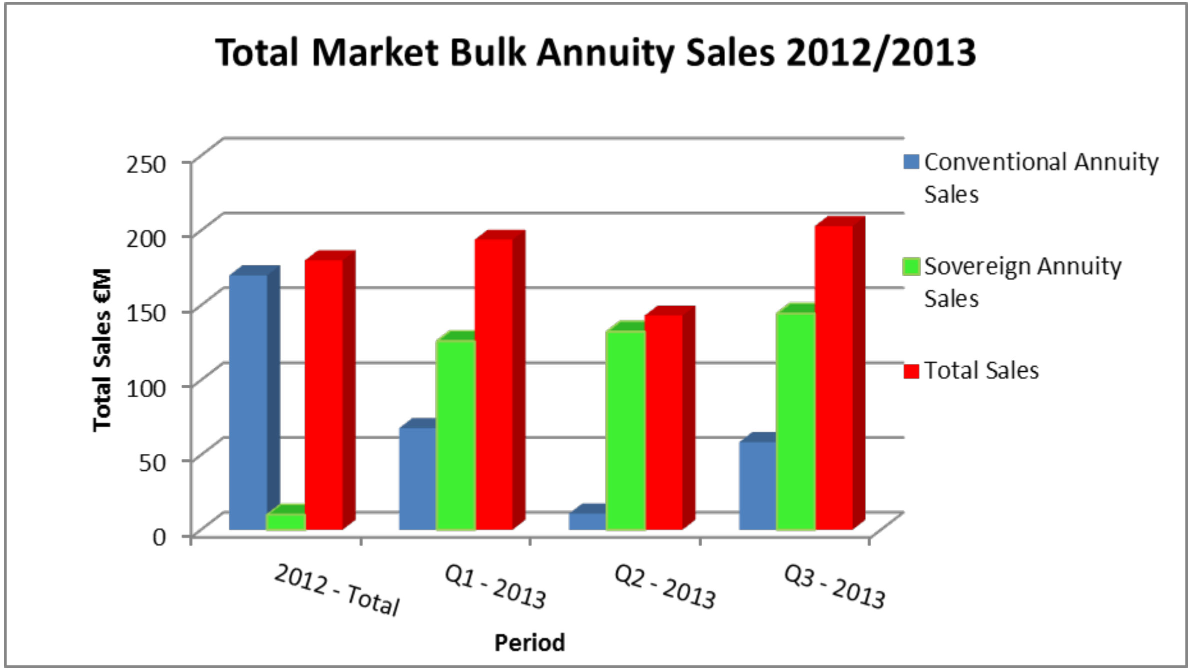
There has been over €540M of bulk annuity business transacted in the Irish market so far this year (to end Q3) over 30 separate schemes

Approx. 75% of this money has bought Sovereign Annuities (SAs): total purchases of €400m over 17 different schemes

Approx. 1,500 pensioners now in receipt of Sovereign Annuity (from all 3 providers)

Approx. €70m has been saved on annuity costs

2012 and 2013 Compared



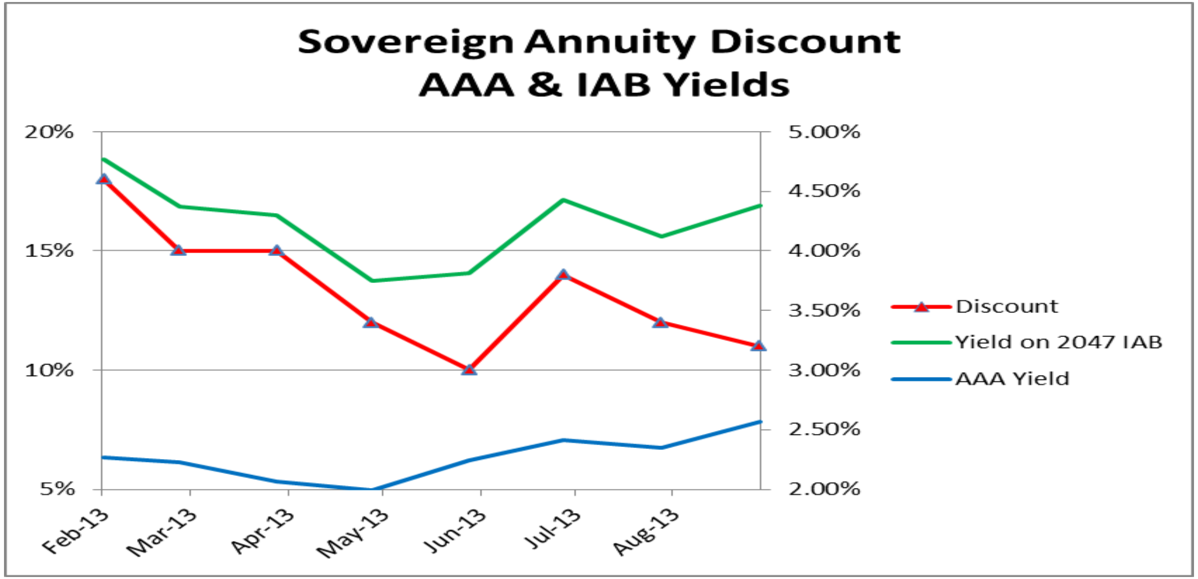
SAs are now the primary method of scheme de-risking

Reasons for the success?

- Each trustee and scheme will have their own unique story
- A view SAs are fairer way to allocate funds to Active and Deferreds under a material deficit
- Much improved Irish bond position (whilst cutting the price discount) made the default risks lower and the concept an easier communication to pensioners
- Hybrid products allowed a gradual familiarisation-these were the starter product- but established the principle
- Once a few cases had closed, increased sense that precedent was set and main trustees bodies were comfortable

Irish Life
CORPORATE BUSINESS

Recent Pricing Trends



- Most recent pricing only (since daily NTMA quotes available)
- Initial 2047 IABs at 5.92% in Aug 2012: now 4.25% current

Irish Life
CORPORATE BUSINESS

From hybrid to pure Sovereign

- Initial transactions had a hybrid product with a conventional underpin (eg first €6k of pension as conventional annuity with SA for excess): balanced compromise and diversify risk
- As many trustees became more comfortable with SAs (and as Irish yields declined) 100% SAs became more common
- All more recent cases have been on 100% basis: reduced pricing discount means hybrid offers less and less (and simpler communication to pensioners)

Product Type	Q1 – 2013	Q2 - 2013	Q3 - 2013	Overall
Sovereign	€64	€129	€144	€338
Conventional	€26	€8	€59	€92
Hybrid Product	€104	€6	-	€110
Total	€194	€143	€203	€540

Irish Life
CORPORATE BUSINESS

Typical scheme situations

- To date, all schemes using any form of Sovereign Annuity bulk annuity purchase are doing so on a buy-out basis
- Generally schemes are winding-up but there have been some buy-out purchases for on-going DB plans (heavily re-structured with Section 50 in place)
- Bigger the deficit means more likely to use SAs (and to higher 100% degree)
- No Sovereign Annuity buy-in to date-but still possible if trustees so choose
- Some direct scheme Irish Amortising Bonds (IABs) purchases for investment reasons-limited solvency relief and out of scope of our data

Observations on member communications

- Very varied process by trustees

- Best exercise was a large scale communication including large member meetings with trustees, Irish Life (as the chosen provider from the tender) and independent consultant explaining the concept to pensioners

- Whilst we'd recommend this, others have taken a less comprehensive approach and has resulted in higher level (but manageable volume) of post-sale queries

- Pensioners equally concerned about practical changes like next payment date and taxation implications of changes-important to address

- General pensioner reaction has been calm

Irish Life
CORPORATE BUSINESS

Where to now?

- Clear there will continue to be large scale DB wind-ups and restructuring leading to high volumes of buy-outs
- Will SAs continue as the preferred method?
- In absence of any change to a “fairer” priority rule, trustees may continue to see SAs as essential in poorly funded schemes
- One view is that if Irish bonds improve the price gap makes the extra complexity questionable value?
- Counter is that they simply become the accepted norm-even a small reduction is worth the saving?
- Likely to depend on each scheme’s funding ratio and impact the savings make on that ratio

Irish Life
CORPORATE BUSINESS

Thank You

- Questions?

Irish Life
CORPORATE BUSINESS