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Pension Risk Bulletin

Great outcomes start with good data!

LifeWorks publishes original content that provides insights for pension plan sponsors and pension plan administrators on the topic of pension risk.

Our goal is to draw upon our research and our experience to advance the conversation on a spectrum of topics related to pension risk management and transfer.

The year 2021 is likely to see unprecedented annuity business volumes in the Canadian market, thanks to a general improvement in pension plan financial conditions. With increasing group annuity demand from sponsors and plan administrators, and a limited supply of insurer capacity, plan sponsors should ask themselves how to make their transaction stand out from the rest. There are many data-related elements that insurers consider, notably data quality, availability and completeness.

Key Points

- Annuity purchase data tells the evolving story of the plan's experience and its demographic profile. This is in contrast to pension administration- and actuarial valuation-quality data, which are data snapshots at a point in time;
- Transforming your pension administration data into annuity purchase data influences insurer pricing and their willingness to participate in a quotation process;
- Good data management and governance should start now as it not only pays off for risk transfer transactions but also in on-going plan management.

Let's start by debunking some myths about pension plan data:

Myth 1 – Administration data or actuarial valuation data are sufficient

Administration data, valuation data and group annuity purchase data have different purposes and do not share the same level of completeness and accuracy.

Administration data is often collected through the plan sponsor in order to provide members their entitlements. It usually is collected at hire date, updated yearly to reflect benefit sensitive information and upon life events, i.e. termination, retirement, death. The most important thing about administration data is that it accurately reflects, at a given point in time, a member's benefit entitlement and their status (active, deferred vested or annuitant or other). Once a member becomes inactive, the opportunities to update the member's data become limited and data noise such as inaccurate spousal information while the member is alive, can arise and don't impact the accuracy of the benefit amount. Moreover, loss of historical data, which is key for annuity purchase, may occur if the plan sponsor migrates pension administration systems or providers over the years. Upon system or provider migration, non-digitized historical information often ends up in a box in the archives collecting dust. This is especially true for older members who may have retired before most administration providers digitalized information on file.

Valuation data is a subset of the administration data at a specific date. It is used for benefit valuation purposes to establish the appropriate contribution requirements for the plan and is usually updated once every three years or once a year depending on the valuation calendar. Data cleansing is limited to the data fields crucial to determining the required contributions. For instance, the salary history of an annuitant is usually irrelevant for valuation purposes but is highly informative for the insurer's underwriting process.

Annuity purchase data could be defined as a mixture of current and historical pension administration data, ideally along with socio-economic data. It typically contains enough information to reconstitute a member's historical benefit entitlement as well as to reconcile historical data or status changes. Importantly, the data needs to be as transparent and consistent as possible so insurers feel they have a representative picture of the most recent several years, and can assess how the member's entitlements will evolve in the future. Annuity purchase data should be telling a story to insurers. It should accurately reflect past experience and it should have enough information for insurers to project the population into the future.

Myth 2 – Premium adjustment clauses substitute data cleansing and data validation

Data risk is not a risk that insurers are willing to take on or are in the business for. The annuity purchase process can be lengthy, and the annuity data becomes dated in the process. Small adjustments mainly attributable to life events such as deaths or retirements are expected, while adjustments due to data mistakes (e.g., wrong date of birth, gender, spousal information, pension amounts, etc.) should not be expected to occur frequently and should be minimized. To avoid taking on unwanted data risk and to reflect adjustments in the final price, insurers incorporate price adjustment clauses into their policies. They typically reserve the right to reprice the transaction using a then-in-effect pricing basis rather than the original competitive basis if adjustments are greater than a certain threshold of the original price. This can lead to less-than-optimal pricing. Insurers also hold additional margins if they expect a large premium adjustment due to unclean data, since premium adjustments entail liquidating investments or holding cash reserves.

Myth 3 – It's not worth preparing mortality data, insurers won't use it

In the spirit of providing high-quality annuity purchase data to insurers, mortality data (i.e., plan member and spousal historical deaths), should be communicated to insurers to refine their mortality assumptions. In the absence of such data, insurers make assumptions that are typically conservative. Even if your data reveals that your population lives longer than average, one should expect that insurers would have already reflected those characteristics in their conservative pricing such that there is nothing to gain from not providing the data. Providing mortality data can however reduce the uncertainty margin that insurers would otherwise hold. Insurers use plan-specific mortality data, combine it with their own historical experience, and triangulate with external data vendors and other sources of information to perform look-back and prospective modelling. When all analyses point towards a mortality pattern, their risk management teams become more agreeable to reflecting the plan-specific data in their assumptions. Even if not fully credible, insurers may still apply a certain credibility factor that can often tip the scales to the plan sponsor's advantage in terms of pricing.

For large transactions, the benefits of gathering, preparing, cleansing, and validating the historical data far outweighs the cost. Not only will the effort most likely result in lower pricing margins but, all other things being equal, insurers will be much more agreeable to pursue your annuity purchase opportunity.

So why is data so important?

Insurers are not in the business of underwriting data risk. Data risk caused by omissions, incomplete or inaccurate information is not usually covered by insurers in a group annuity purchase. Some degree of data risk can be assumed by insurers if the documentation gathered is sufficient to meet their internal risk management standards before contracting on the obligations. Pension data still drives insurers' group annuity pricing in several ways and its quality not only impacts insurers' underlying assumptions, but also has a ripple effect on other assumption:

1. **Demographic assumptions:** Plan data is a lever that plan sponsors have some control over when it comes to insurer pricing. It can be used to influence insurers' views on the plan's mortality profile or the use of a certain benefit provision. Importantly, it can provide sufficient information to meet the insurers' strict risk management standards. The usage data of a special benefit provision for example can do wonders in convincing an insurer that few members are taking advantage of a provision that would typically be expensive to price. Incomplete and inconsistent data are red flags for insurers, and force insurers to use conservative assumptions, which are rarely in the plan's favor.
2. **Investment strategy:** Insurers determine the investment strategy backing the pension obligations they are taking on by seeking a balance of public and private market placements. A significant proportion of their portfolio is illiquid and unanticipated changes to their illiquid investments caused by anticipated data changes or premium adjustments lead to additional costs; this is reflected in the pricing of group annuity premiums.
3. **Capital level:** Capital requirements exist to ensure that benefits can be paid under almost all circumstances. As those benefits are paid out, capital reserves are released and become available for other transactions and projects. The long-term planning and viability of the insurer can be affected by mispriced risks that may be attributable to poor data.
4. **Profitability:** In addition to the above items, profitability can also be impacted by unexpected administrative costs attributable to poor data or poor data governance. Such costs can quickly add up (e.g. locating unlocated members, collecting proofs of age, verifying member information). Insurers price-in anticipated costs to protect the book of business' profitability, increasing their pricing for pension plans with poor data.

Making your pension plan marketable to insurers often starts with the quality of the data that is being collected and communicated. More consistent quality data is definitely an important driver of an insurer's willingness to undertake your obligations and their pricing.

Ok I get that annuity purchase data is critical, **so what can I do in practical terms?**

Data archiving and storing are a major challenge for plan administrators. By now, you're probably thinking that your data may benefit from a good spring cleaning! Unfortunately, there is no magic eraser to eliminate all data errors. A rigorous record-keeping process, combined with regular survival audits and occasional reach outs to deferred vested members will do wonders for the basic data. Should a risk transfer strategy be contemplated, consultants can guide you in collecting your plan specific information that could have the greatest impact.

- The dangers of poor record keeping go far beyond poor annuity pricing and can ripple out into much larger issues including legal, governance and cyber-security. It is important to establish a governance process that covers data-related issues by adopting some best practices.
- A regular survival audit, in which one verifies that all members and spouses entitled to benefits are still alive, is a good tool to implement in your governance process. It is imperative before an annuity purchase and may be required by insurers under certain contracts. The difference in insurer pricing between a life only and a joint survivor pension can represent a saving of 15-25%. Even if risk transfer isn't on the table, the reduction in liabilities for identifying deceased individuals typically far outweighs the cost of the audit. It is no secret that recuperating overpayments can prove to be difficult and sometimes impossible. Survival audits can often be combined with the annual statement process and be used to confirm the data on file: two birds one stone.
- When members terminate their employment, they do not stop being members in the plan. They leave a lingering liability on the plan's balance sheet, but sometimes disappear into the mist. Keeping in touch with deferred vested members is always important, and even more so in the context of an annuity purchase. Deferred vested members rarely notify their past employer of changes in addresses or life events and in some cases may even forget they have entitlements in the plan

and lose their former employer's contact information. As such, sending deferred vested annual statements is a good step in maintaining the link, even though it might not be required by all jurisdictions. Locating deferred vested members and collecting their emails upon termination are steps in the right direction and in the case of a plan wind-up, publishing a notification in the local newspaper often helps.

- Depending on the plan characteristics, deferred vested members can be significantly more expensive than retirees mainly due to the uncertainty in the amount and timing of their entitlements. Minimizing the number of deferred vested members in a transaction can be helpful to improve its marketability. Many plan sponsors tackle this issue by creating windows of lump-sum offerings. Annual or biennial statements can also serve as a reminder to deferred vested members to cash out their entitlements, confirm their data and locate them.

In this age of big data, the importance of data governance has grown tenfold, and this is especially true for insurers, since their pricing is established at the time they take on the obligations. Information is power that enables insurers to release margins and improve pricing; margins that can easily be reduced by providing quality annuity purchase data. There is merit to establishing a governance process even before a transaction is contemplated. Data validation is an important step in the preparation process to purchase group annuity contracts and being transaction-ready enables sponsors to capture short-lived opportunities when they arise.

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