

## The Longevity Income Plan - By Life Trust

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The subject of this month's product article is another new product – the Longevity Income Plan, from newly launched insurer Life Trust. This article, part of a series of monthly analyses using **LifeBase** (no relation!) product analytical tools, takes a first look at the Longevity Income Plan, and its highly innovative concept.

### Company

Few readers – particularly so outside of the UK - may have heard of Life Trust, so let me start by introducing the company. Life Trust Insurance plc is a new Dublin-based offshore insurance company and the Longevity Income Plan, launched in 2008, is its first product.

Life Trust is a subsidiary of Life Trust Holdings plc, which is owned by a mix of institutional investors and management. Three institutional private equity investors own 50.1% of the company, namely JP Morgan, Royal Bank of Scotland and D.E. Shaw (a US investment and technology firm). Life Trust raised initial equity capital of £25m from its investors, and so is well-financed by the standards of other start-ups.

### Concept

The concept behind the Longevity Income Plan is quite unique. Life Trust argue that, unlike the 19<sup>th</sup> and 20<sup>th</sup> centuries when the biggest financial risk was dying young, in the 21<sup>st</sup> century this has radically changed. Instead, increased longevity and an older population means that there is now a major risk of running out of money in old age.

Statistics and headlines in relation to longevity are compelling, and familiar to anyone who works within the pensions world. For example:

“Life expectancy is increasing by 5 hours every day”

“A 55 year-old person today has a 1 in 4 chance of living to age 95”

“There are currently over 9,000 centenarians in Britain today. This figure is expected to reach 40,000 by 2031.”

Acknowledging these issues, Life Trust aims to provide modern investment products which will address the “problem” of longevity, helping individuals to meet the financial needs associated with living longer. Future products are expected to extend the offering into other areas, including pooling arrangements, where longevity risk is otherwise a concern.

In the case of the Longevity Income Plan, the unique feature is that **surviving policyholders benefit from the deaths of other policyholders**. An individual who does survive to age 95 can achieve an extra return equivalent to +5% pa, according to Life Trust, which should certainly help to pay for a glass of port or two in extended old age.

### **The Product**

In technical terms, the Plan is a unit-linked deferred temporary purchased life annuity. Put more simply, the Plan has two phases – an accumulation phase and a decumulation phase.

### **Accumulation Phase**

In the accumulation phase, the Plan works just like an investment bond, except it has no surrender value (for reasons which will become clear). Life Trust’s experience so far is that a typical new policyholder is aged 60, i.e. contemplating retirement and (for those not lucky enough to have a final salary pension) beginning to recognise the financial challenges associated with retirement.

The Plan links to a choice of 10 unit-linked funds, chosen with advice from Old Broad Street Research. The funds are:

<b>Cash</b>	Henderson	Liquid Assets Fund
<b>Cautious</b>	Henderson	Strategic Bond Fund
	Invesco Perpetual	Monthly Income Plus Fund
	JP Morgan	Cautious Total Return Fund

<b>Balanced</b>	Gartmore	Cautious Managed Fund
	Jupiter	Merlin Balanced Portfolio
	New Star	Managed Distribution Fund

<b>Growth</b>	HSBC	FTSE 250 Index
	M&G	Global Leaders Fund
	Newton	Managed Fund

Fund switches are restricted to a maximum of 3 per year, both pre and post-vesting. Switches are subject to a charge of £25 (with the first switch in any year free).

During the accumulation phase, and indeed after it, the investor continues to benefit in full from the normal investment growth associated with these funds. Being an offshore bond, the returns roll up free of UK (unlike the case with a UK life policy), and inheritance tax planning is possible in the usual way, via trusts.

### Decumulation Phase

The decumulation phase commences at the pre-selected vesting age, either age 75 or age 80. The Plan pays out annually to the policyholder, by encashment of units, commencing on the 75<sup>th</sup> or 80<sup>th</sup> birthday. The Plan pays up to 21 annual payments, over 20 years, provided the policyholder is still alive. The age 75-95 plan comes to an end at age 95 (plus a day), and the 80-100 plan at age 100 (plus a day).

The amount of each annual payment is defined as a set percentage of the total units held by the Plan, at each year. For example, in the 1<sup>st</sup> year of vesting, the annual payment will be equal to the amount achieved by encashing 8.0% of units; in the 10<sup>th</sup> year, 11.3% of units. The full redemption schedule each year is shown in the table below.

Year	% of units redeemed
1	8.0
2	8.2
3	8.5
4	8.7
5	9.0

6	9.3
7	9.7
8	10.1
9	10.7
10	11.3
11	12.0
12	12.8
13	13.9
14	15.2
15	16.9
16	19.2
17	22.4
18	27.2
19	35.3
20	51.5
21	100.0

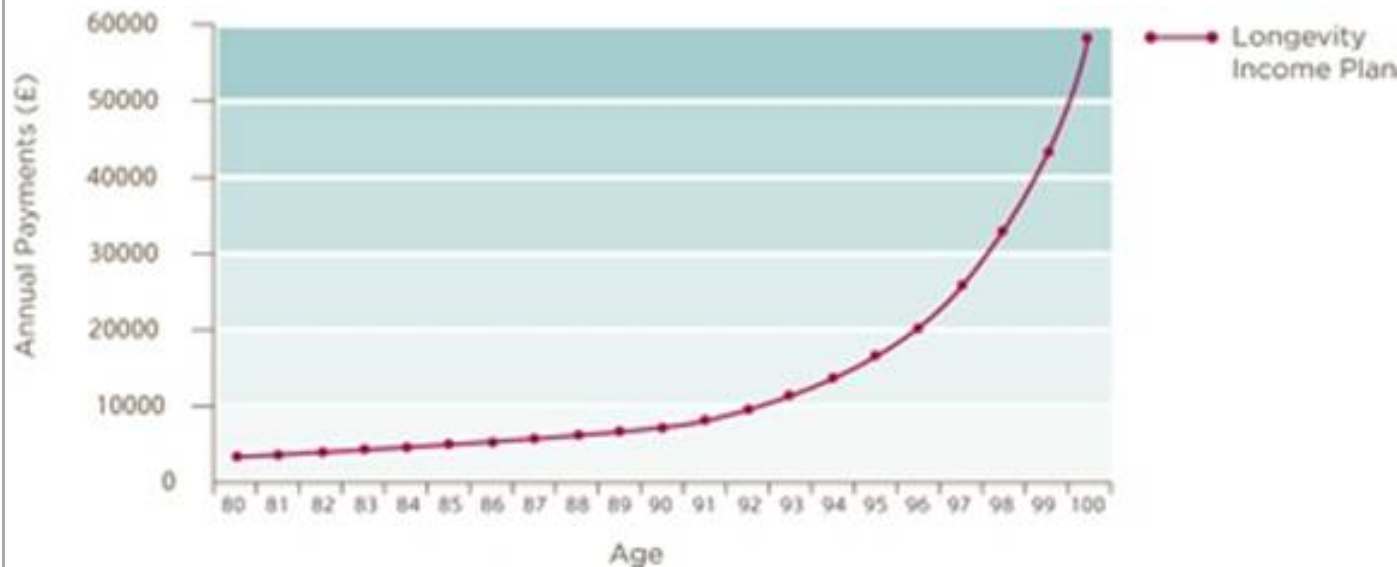
These payments are treated for UK tax purposes as a purchased life annuity, i.e. part capital and part income. The capital content is tax-free.

### **Birthday Units – Live and Let Die**

The concept of birthday units is where the Longevity Income Plan is quite unique. What happens is that throughout the plan, i.e. even in the accumulation phase, surviving policyholders benefit from the mortality profits released from policyholders who die. This is achieved by the addition of birthday units, the amount of such units being linked to the mortality experience of the policyholder pool. The more deaths, the more birthday units. The concept is akin in some ways to a tontine, where the policyholders who survive get the spoils. Once allocated, birthday units are added to the normal unit account, i.e. are treated no differently, and their vesting is permanent.

The birthday unit addition is achieved because of the nature of the death benefit, which is only equal to the initial premium (reduced by the amount of any payments received post vesting). In effect the "bounty" unit value for dead policyholders gets allocated to a pool to be shared out amongst surviving policyholders. The way in which it is shared is based on actuarial principles, rather than equal shares for all.

What this means in practice is that surviving policyholders can expect to receive a rising income post vesting. Annual income will rise both from (hopefully) increasing unit values *and* (even more hopefully!) from the mortality uplift associated with surviving to earn Birthday Units. The chart below (source: Life Trust) shows this pictorially, being an FSA-style projection for a male aged 55 at outset, investing £15,000.



By way of a further example, what this means in terms of possible pay-outs, both from normal unit redemption and the addition of birthday units, can be seen from the table below, which shows the possible income post-vesting for a 50 year-old male investing £25,000 in the 75-95 Plan. For the lucky survivor, an investment of £25,000 could result in total payments of £231,000 over 20 years. (For the 80-100 Plan, the possible return is even greater, at over £637,000.)

Age	Annual Payments (£)	Cumulative Payments (£)
75	6,830	6,830
76	6,850	13,600
77	6,950	20,600
78	6,970	27,600

78	6,970	27,600
79	7,080	34,700
80	7,190	41,900
81	7,370	49,200
82	7,540	56,800
83	7,860	64,600
84	8,160	72,800
85	8,530	81,300
86	8,950	90,300
87	9,570	99,900
88	10,200	110,000
89	11,200	121,000
90	12,400	133,000
91	13,900	147,000
92	15,900	163,000
93	18,500	182,000
94	22,000	204,000
95	26,600	231,000

Because of the unusual nature of the investment, and the fact that survival is a key part of the investment proposition, the Longevity Income Plan is clearly only suitable for individuals in good health. It is to be expected that there will be considerable self-selection, and it is to be expected that the mortality experience of the pool will be quite different, i.e. much lighter, to that of any other product, even annuities. Only the healthy need apply. However, if you're 65 and your granny is

still alive, then it may well be that this is just the product for you!

## Design

The Plan is available to anyone aged 18+, though clearly the target market is the 55-70 age group. The maximum age at entry is determined by which option is selected, as there has to be at least 10 years between commencement and vesting. Thus, the maximum age is 65 for the 75-95 version, and 70 for the 80-100 version.

The minimum premium is £5,000, the maximum £1,000,000. The Plan is available in £-only.

The charges in the Plan are simple, with one exception:

- Initial charge = 5% of premium
- Annual management charge = 1.35% to 1.95% pa, depending on fund. Average 1.73% pa.

The annual management charge includes trail commission of 0.5% pa of premium for the first 10 years, reducing to 0.25% pa until vesting. The initial charge of 5% covers initial commission of 3%. At present, an introductory offer of 5% commission applies, until 30<sup>th</sup> June 2008.

The one extra charge which is not so simple is an age-related death benefit charge. The death benefit, you will recall, is simply a return of premium. The reason why there is a charge for this is that the *whole* of the value on death is credited to the birthday unit pool, not just the excess over the premium. In effect, a group insurance is effected across all the lives, and an annual mortality charge is applied to cover this cost. For a £10,000 premium/sum assured, the mortality charge is quoted as £21 pa for a 50 year-old male, rising to £516 pa at age 80. The mortality charge is variable, being linked to the mortality experience of the group. Although the charge seems cumbersome, Life Trust point out that it is more than offset by the addition of Birthday Units.

## Price

The Longevity Income Plan is in a category all of its own, so the normal detailed projection comparisons are of limited value. On standard terms, and for a typical fund, the annual reduction in yield (RIY) over 10 years is around 2.2% pa. This cost is therefore greater than that of "normal" offshore investment bonds, which on a like-for-like basis can have an RIY of 1.8% - 1.9%.

On the other hand, looking through actuarial eyes, the persistency of the Longevity Plan business should be quite exceptionally high, given that it has no surrender value and will be taken out by a very healthy long-living group of lives! Given all of these things, a good margin of profitability for Life Trust seems assured.

## Summary

The Longevity Income Plan is a most welcome new addition to the offshore bond world, and there is no doubt that the demographics position it at the right end of the customer market. The concept potentially opens up a new seam of business for offshore insurers.

As with any innovative concept, it may well be that the first on the block merely warms the market for those that follow and reap the spoils. There is no doubt that Life Trust have created an interesting product. But is it perfect? I'm not sure. Can other insurers improve on it? Quite possibly....