

The Actuarial Profession
making financial sense of the future

Pensions, benefits and social security colloquium 2011
Fiona Stewart, OECD



Managing the Decumulation Phase

25-27 September 2011

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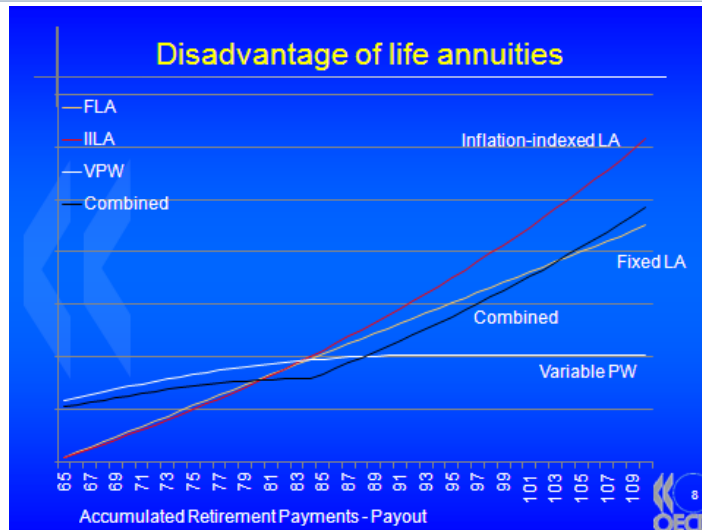
Decumulation Choices

Pay-out Options	Country
Lump sum only	Hong Kong, India and Philippines (Mandatory Provident Funds)
Lump sum or Programmed Withdrawal (PW)	China, Indonesia, Malaysia
Lump sum or Life Annuity	Greece, Spain, Belgium, Czech Republic, USA
Partial Lump sum + Life Annuity	Germany (Riester), Ireland, Italy, Portugal, UK
Life Annuity or PW	Chile, Costa Rica, Mexico, Peru, Kazakhstan, Macedonia, Slovak Republic, Canada, Norway
Life Annuity only	Bulgaria, Hungary, Poland, Austria, Netherlands, Sweden
Full range of options	Australia, Brazil, Denmark, Japan, Singapore

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Is there a 'best' option?



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Main recommendations

- Policy on the decumulation phase should be consistent with overall goals of the pension system – more reliance on DC pensions more security required in decumulation phase
- There should also be consistency between accumulation and decumulation phases – if choices in the former may need to allow choices in the latter
- Combining deferred LA bought at the time of retirement that starts paying at later ages (e.g. at age 85) with PW provide flexibility, liquidity and bequests during the first years in retirement and protection from longevity risk thereafter

Challenges in Selecting Products for the Pay-out Phase

1. Choice Between Products

- Rise DC pensions makes transition to decumulation phase important
- Individuals risk making choices which could lock in suboptimal pension payouts for the rest of their retirement
- Complicated nature of pension and annuity products makes individuals dependent on advice received— often from sellers of the products
- Making choices between products time consuming and difficult
- Demand for voluntary annuities is often lower than expected.
 - *Seen as inflexible and illiquid products, can't access funds, can't leave money as bequests, may be locked in at poor rate*
 - *Seen as bad value, think money goes to insurance company if die early, don't understand risk pooling*

What should policy makers do?

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Financial Education and Payout Phase

Individuals may be right:

- Maybe high levels of annuitization from PAYG and DB pension plans
- Logical preferences related to liquidity or bequest motives
- Maybe inefficient mispriced markets (lack of supply/ adverse selection)

Then no policy response or improve annuity supply

Individuals may not know that flexible products exist:

- Real annuities protect against inflation
- Impaired life and enhanced annuities address adverse selection
- Deferred annuities allow for flexibility over timing
- 'Flexible annuities' control payouts /investments
- Some products may allow for the inheritance of capital
- Some allow payment of long-term care or healthcare costs

Policy makers need to ensure that suitable products are available and that consumers understand them properly

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Financial Education and Pay-out Phase

Individuals may be wrong

- Research shows perception of annuities can be changed by how they are 'framed' or presented in comparison with alternative investments - **an investment frame vs. consumption frame**
- Implies knowledge and understanding of products poor

Financial Education and Awareness can help

- Governments could take a lead in improving knowledge of annuities
- Education may be provided by employers at the point of retirement
- Information and advice on annuities may be incorporate into financial education relating to pensions and savings as a whole
- Need to ensure that financial intermediaries provide appropriate advice / check that clients understand the products they are purchasing
- Regulators could provide easily understood and comparable information on annuities products

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Challenges in Selecting Products for the Pay-out Phase

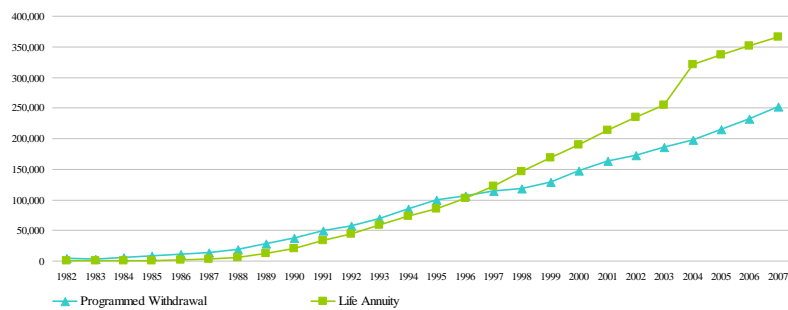
2. **Ensuring Best Annuity price**

- Where annuitization compulsory, ensuring the best price is the challenge (may be 'locked in' to provider from accumulation phase can't shop around)
- Several countries provide centralized system for comparing annuity prices
- Such systems can help to increase knowledge and understanding - particularly when coupled with some product explanation or advice
- They may also deliver cost savings and efficiencies (via potentially lower marketing and distribution costs for providers) and also assist with the timing of an annuity purchases
- In most countries, comparative annuity quotations can be obtained via third-party advisor or brokers
- But they may be paid by commissions, be tied to one provider, may not be able to provide advice, or be unwilling to take on clients with small balances
- Impartial advice provided by public sources is preferred

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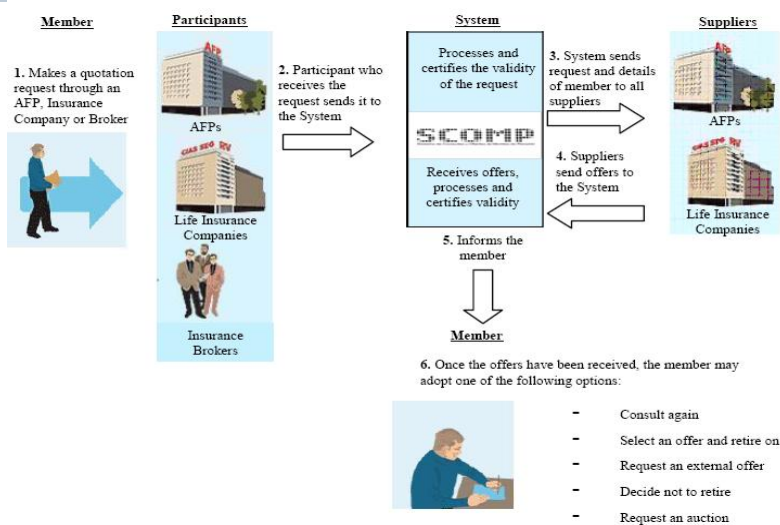
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Number of Pension by Mode Source SAFF



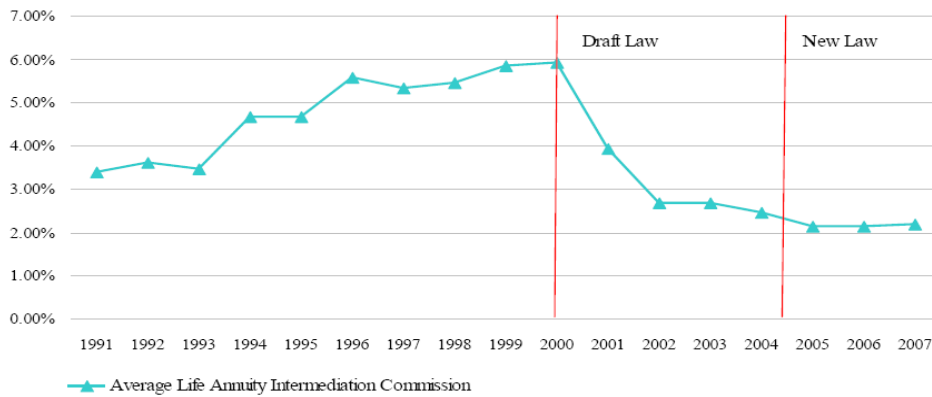
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How SCOMP Operates



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Results



Source: SVS

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The screenshot shows the FSA's Financial Watchdog website. The top section is titled 'Annuities choices' and contains a questionnaire with the following questions:

- Are you: ☐ Male ☐ Female
- At what age do you intend to buy a lifetime annuity?
- Are you a smoker? ☐ Yes ☐ No
- How much of your pension fund will you want to buy a lifetime annuity? Please enter the amount after taking off any tax-free lump sum you will take.
- Do you want to see the rates for a lifetime annuity that is: ☐ Single life? ☐ Joint life?

The bottom section is titled 'Annuities results' and displays a table of recommended annuity products. The table has the following columns: Short list, Provider, Smoker, Age, Level, Monthly income (Increasing by 2%), Monthly income (Increasing by RPI), Better Rates Available (Enhanced/Unimpaired), and Restricted availability.

Short list	Provider	Smoker	Age	Level	Monthly income (Increasing by 2%)	Monthly income (Increasing by RPI)	Better Rates Available (Enhanced/Unimpaired)	Restricted availability
<input type="checkbox"/>	ABN AMRO	Yes	60	£200	£200	n/a	No	No
<input type="checkbox"/>	ABN AMRO	Yes	60	£200	£200	£174	No	No
<input type="checkbox"/>	ABN AMRO	Yes	60	£200	£200	n/a	No	No
<input type="checkbox"/>	ABN AMRO	Yes	60	£200	£200	£170	Yes	No
<input type="checkbox"/>	ABN AMRO	Yes	60	£200	£200	£164	Yes	Yes
<input type="checkbox"/>	ABN AMRO	Yes	60	£200	£200	£170	Yes	No
<input type="checkbox"/>	ABN AMRO	Yes	60	£200	£200	n/a	No	Yes
<input type="checkbox"/>	ABN AMRO	Yes	60	£200	£200	£164	Yes	No
<input type="checkbox"/>	ABN AMRO	Yes	60	£200	£200	£164	Yes	Yes

The 'Annuities results' page also includes a 'Useful info' section and a 'Your choices' section. The 'Your choices' section lists the user's selections: Male, Age 60, Single life, £2000, and Level of interest for annuity 10%.

UK – OMO



Need help? ☎ Call us on
0845 601 2923
Open 9am to 5pm, Monday to Friday

TPAS Online Annuity Planner

You are in Part 1 of 4

Tax Free Lump Sum

It is likely you will be able to take part of your fund as a tax-free lump sum. The value of the lump sum could be as much as 25% of the value of your fund. The remaining fund must be used to provide a [lifetime annuity](#) or transferred to an alternative arrangement (further information about these appear later).

[What are the advantages and disadvantages of taking a tax free lump sum?](#)



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Lessons for other countries

- Informing individuals of their right to get a quote from an alternative annuity supplier to their pension provider may not have sufficient impact
- Comparative quotation systems add value and improve annuity choices + can reduce costs and commissions
- Compulsory participation by providers may be necessary to ensure full industry involvement and overcome resistance
- 2-tier systems providing information as well as quotes are preferable
- Government organized or supervised systems can ensure broad coverage and provide credibility
- Involving a wide range of players in system development is helpful - if challenging
- Standardized system are relatively economic and not too technically challenging - though need to make sure sufficiently flexible software used
- Information and data need to be understandable to a broad audience
- Given low levels of financial literacy and confidence with these products, building a role for intermediaries to provide advice and assistance may still be recommended - but free, objective provision of such information from government sources may be desirable (particularly for those with low balances who may not be able to access or afford such advice)

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Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

