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Developing Better Retirement Products in the UK

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Modelling Innovative Pre and Post Retirement Products Working Party

21 November 2019

Agenda

01 Introduction to the Working Party

02 Background on the retirement market in the UK

03 Existing and potential products for servicing consumer needs

04 Our proposed framework for measuring success

05 Conclusion and next steps

06 Questions / comments

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Introduction to the working party

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Working Party Objectives

1) a selection of potential retirement products and/or investment techniques that could help improve the options available to consumers on retirement

2) a framework for assessing how successful the different approaches are when measured against consumer needs and wants

Paper 1 (Q1 2020)

3) modelling to analyse the success of each suggested approach against the outlined framework

Paper 2 (H2 2020)

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Background on the retirement market in the UK

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Background

LAMBORGHINI

NOT MORE THAN TWO PENSIONERS AT A TIME

Pension reforms: Two thirds of over-55s still confused, says Prudential

The most ground-breaking pension reforms in nearly a hundred years come into force

#NewTaxYear

Budget 2014: pensions shakeup could kill off annuity market, say analysts

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Background

Number of pension pots accessed by different methods 2015 to 2019

Full cash withdrawals
Partial UFPLS payment taken and not fully withdrawn
New income drawdown policies entered into and not full withdrawn
Annuities purchased
Pension Pots accessed

Source: Barnett Waddingham; compiled from data published by the Financial Conduct Authority (FCA)
* Figures for drawdown sales and UFPLS were not collected in the same format between July and September 2015 and were therefore omitted by the FCA.

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Background

Number and Value of DB Transfers
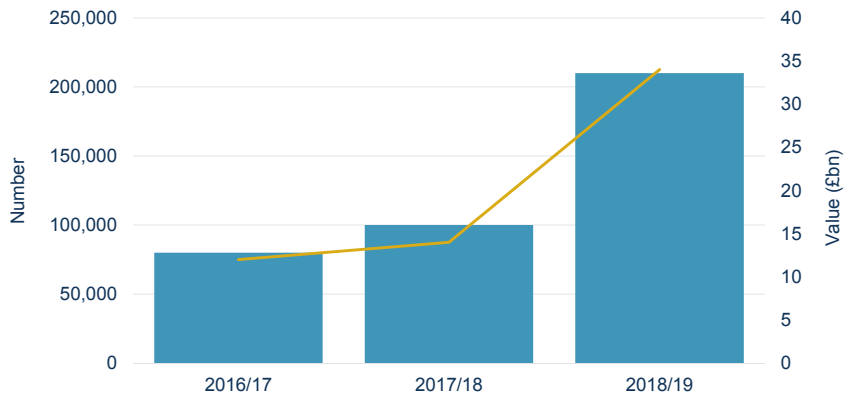
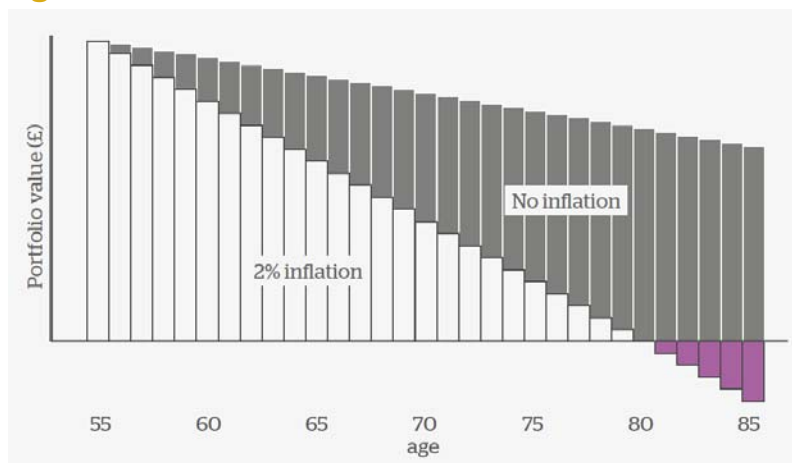*Source: The Pensions Regulator (via a Freedom of Information Request from Royal London)*

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Background

Risks to consider in retirement:

Longevity

Inflation

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Background

Source: Brooks Macdonald, March 2019

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Background

Risks to consider in retirement:

Longevity	Inflation	Market

Interest Rate	Investor Behaviour	Sequencing Risk

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Background

	1	2	3	4	5	6	7	8	9	10		Return
Client A	16%	12%	10%	8%	4%	2%	0%	-2%	-5%	-10%		+37%
Client B	-10%	-5%	-2%	0%	2%	4%	8%	10%	12%	16%		+37%

Whilst **Saving** for Retirement

End at the **same** value

Client A   Client B
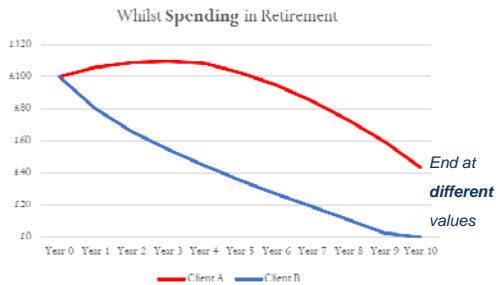
Outcome depends on return

Whilst **Spending** in Retirement

End at **different** values

Client A   Client B

Outcome depends on sequence of return

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Existing and potential products for servicing consumer needs

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Example of products considered

Annuities

| Immediate annuity | Deferred annuity | Variable annuity |

Other products

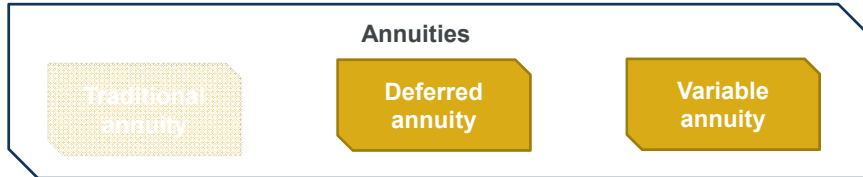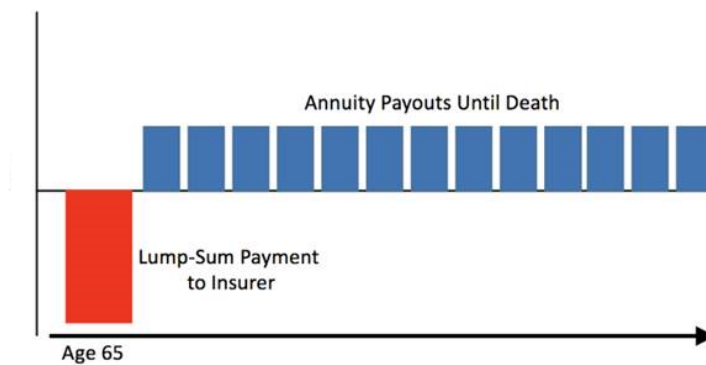| Drawdown | Equity release mortgages | Tontines | With-profits |

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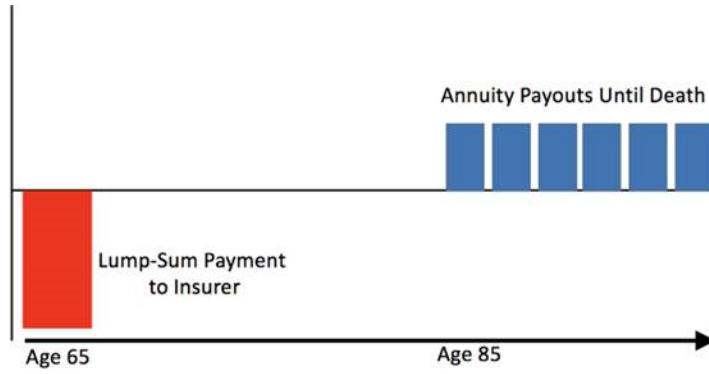## Products which merit further exploration

Annuities

Traditional annuity | **Deferred annuity** | **Variable annuity**

Other products

Drawdown | **Equity release mortgages** | **Tontines** | With-profits

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Deferred annuity

Traditional Immediate Annuity

Annuity Payouts Until Death

Lump-Sum Payment to Insurer

Age 65

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Deferred annuity

Deferred Annuity

Annuity Payouts Until Death

Lump-Sum Payment
to Insurer

Age 65   Age 85

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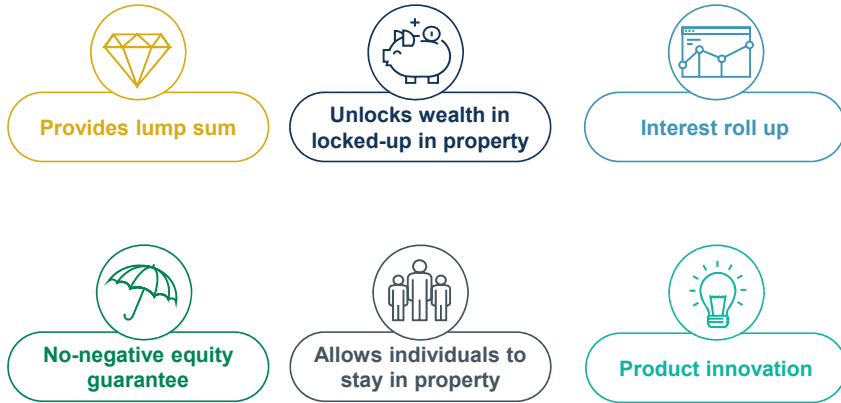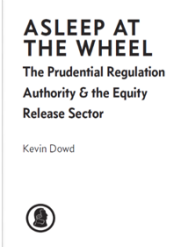

Variable annuity

Seen as a crossover between annuities and drawdown

Variable income

Guaranteed
minimum income

Lump-sum
payment to insurer

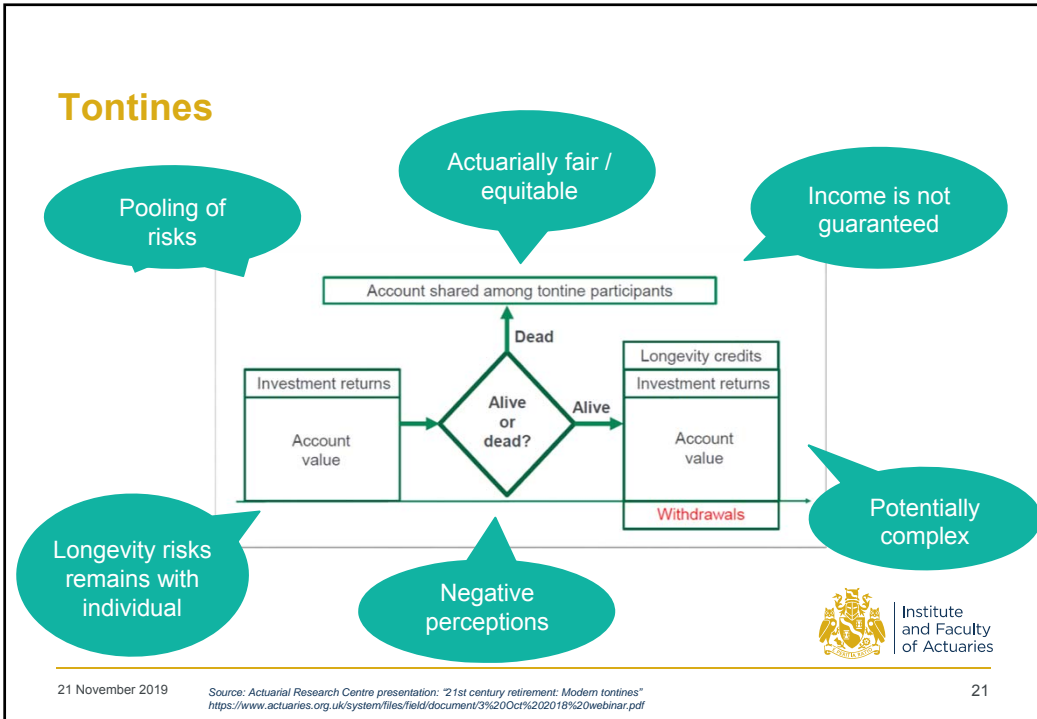**Age 65**

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Equity release mortgages

Provides lump sum

Unlocks wealth in locked-up in property

Interest roll up

No-negative equity guarantee

Allows individuals to stay in property

Product innovation

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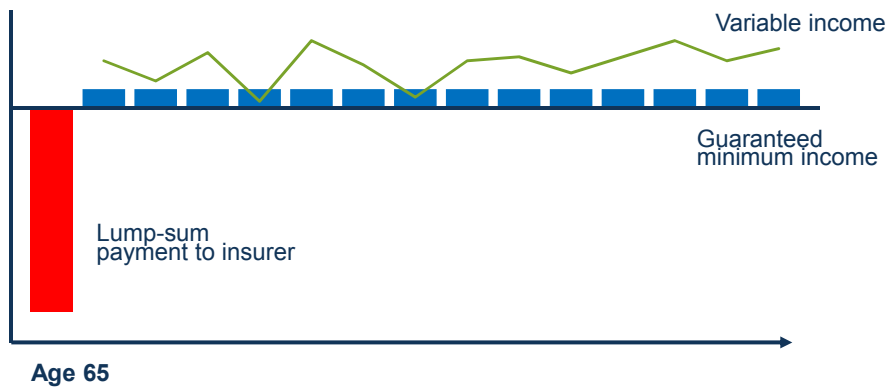
Equity release mortgages (continued)

Market opportunities	Product risk
• *Rising demand for old age care*	• *Borrower has no incentive to maintain the property*
• *Lack of pension savings*	
• *Rapidly growing market (£3.94bn lending in 2018[1])*	• *Behavioural/perception aspects (e.g. viewed as failure to save for retirement, reduced inheritance)*

Regulatory/Public scrutiny

ASLEEP AT THE WHEEL

The Prudential Regulation Authority & the Equity Release Sector

Kevin Dowd

Policy Statement | PS31/18
Solvency II: Equity release mortgages
December 2018

Policy Statement | PS19/19
Solvency II: Equity release mortgages –
Part 2
September 2019

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21 November 2019   Source: (1) Equity Release Council Spring 2019 Market Report.

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Some consumer needs

- **Management of longevity risk**
    - Low probability of running out of funds

- **Reliability of income**
    - Sufficient income to live on from year to year
    - e.g. inflation protection, not too volatile

- **Flexibility**
    - Ability to change solution over time

- **Possibility of leaving a bequest**

- **Perception of good value for money**

- **Simplicity**
    - Simple for consumers to understand

- **Low maintenance for the consumer**
    - Requires minimal input from consumer on ongoing basis

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Metrics for measuring success

Quantitative measures

Stochastic simulations for each combination of products and assess:

- Probability of nominal income >x% of initial income

- Probability of real income >y% of initial income

- Probability of total value >z% of starting fund value

Qualitative measures

- Level of simplicity / ease of understanding

- Any ongoing requirements

- Level of flexibility in early years

- Longevity protection after age 95

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Conclusions and next steps

Conclusions

1 There are opportunities in the current retirement market

2 A combination of products could offer attractive solutions for consumers

3 Getting this right will be of great benefit to both consumers and providers

Next steps

- Publish first paper in Q1 2020 setting out
    - More detailed framework for measuring success
    - The combination of products to perform modelling

- Perform modelling on the selected combinations and share results of analysis in second paper

Feedback welcomed!

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Questions

Comments

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