



Institute
and Faculty
of Actuaries

Whither Annuities – or should that be “Wither Annuities”? (Session C7)

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05 November 2014



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How will the insurance industry and its
customers be affected following the
Chancellor's Budget announcement?

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Expertise
Sponsorship
Thought leadership
Progress
Community
Sessional Meetings
Education
Working parties
Volunteering
Research
Shaping the future
Networking
Professional support
Enterprise and risk
Learned society
Opportunity
International profile
Journals
Support

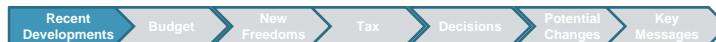


Developments in the retirement market

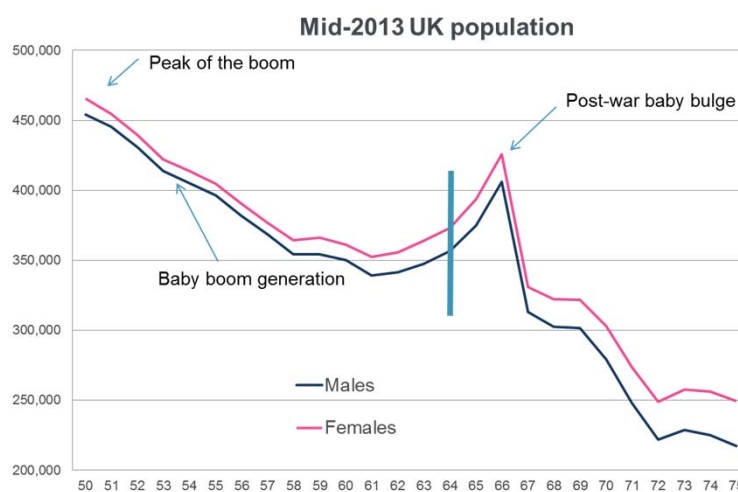
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 - Change in the demand for annuities
 - Some consequences and unintentional consequences
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 - Effect of Budget developments on flexibility;
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 - Potential changes
 - Product development etc

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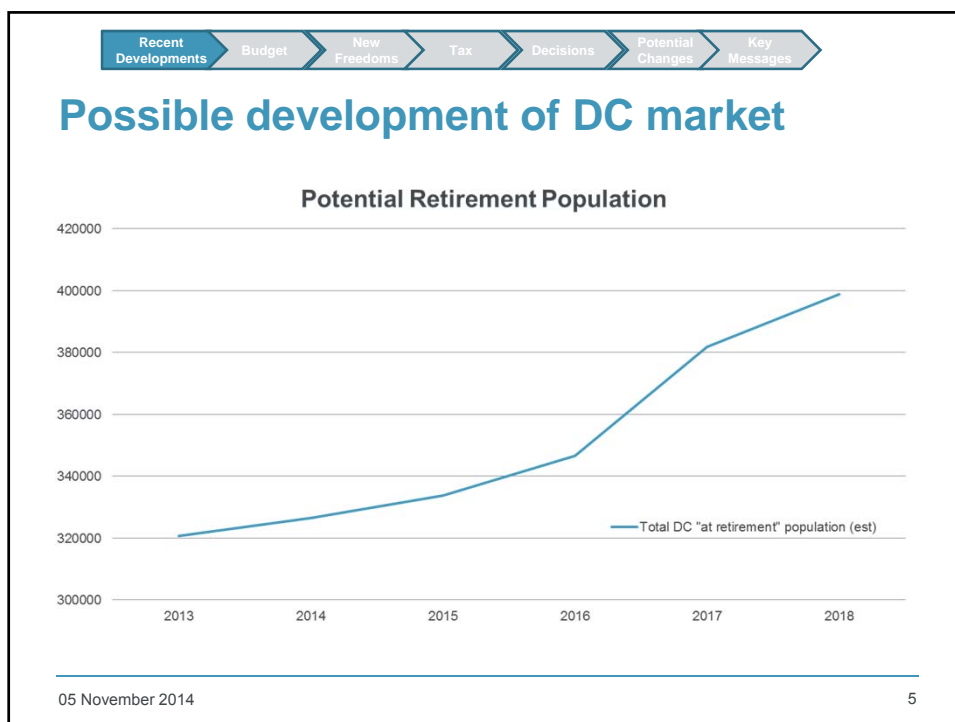


UK Demographics



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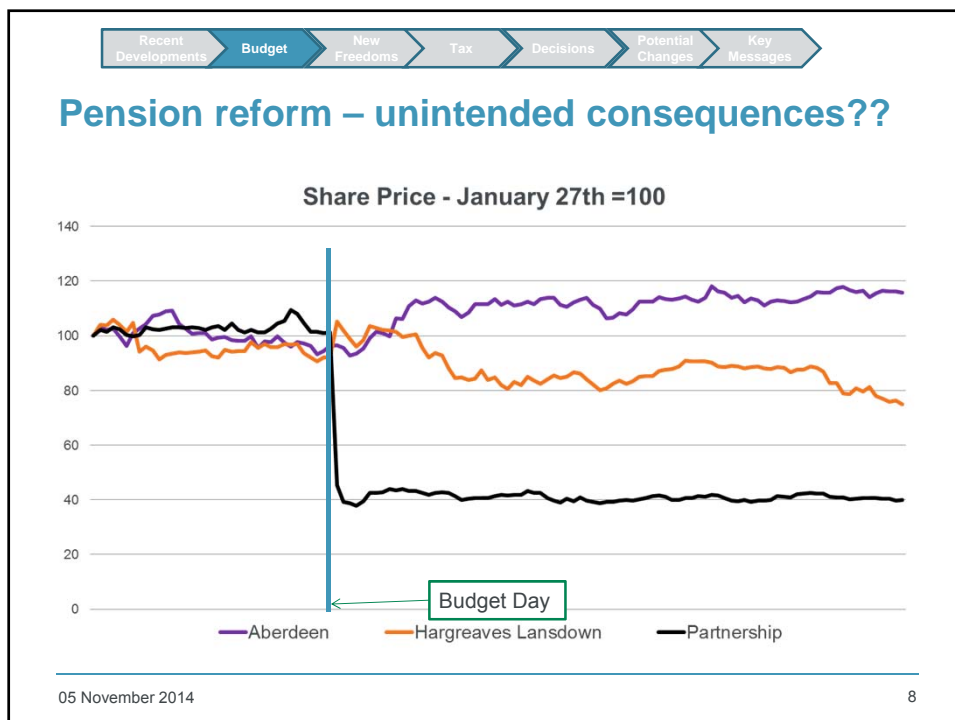
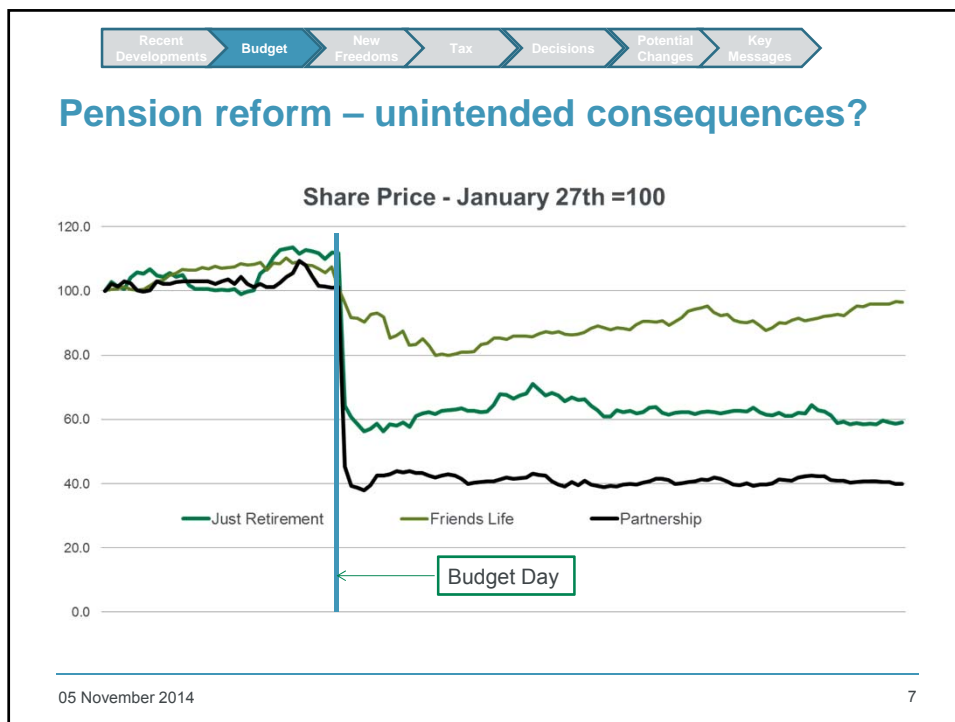


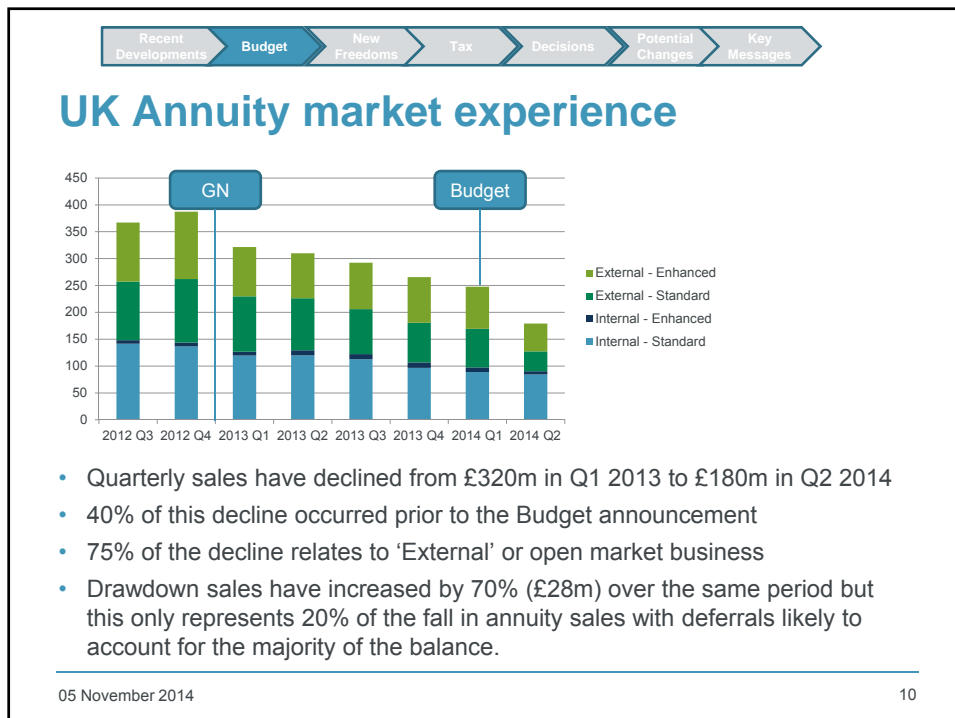
George Osborne 19 March 2014

"Let me be clear. No one will have to buy an annuity."

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Some more obvious consequences

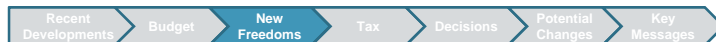
- Year on year annuity sales down 34% in Q2
- Partnership annuity sales fall over 70% (Q3 year on year)
- Prudential annuity sales down over 40% (H1)
- Standard Life 59% drop in profits from annuities (H1)
- [Govt to create new pension withdrawal option](#)
- [Revealed: The new Budget pensions recycling loophole](#)
- Free guidance for all retirees
- Citizens Advice Bureau and The Pensions Advisory Service to lead (Money Advice Service supporting)

Some exceptions

- LV= annuity sales up 30% (profit margin down) (H1)

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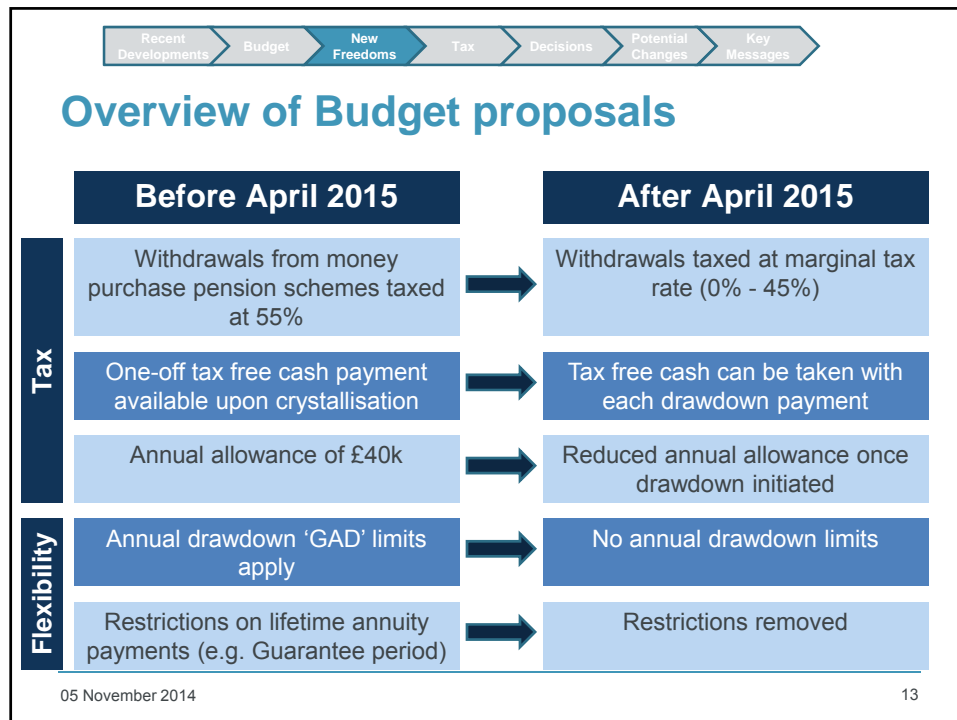


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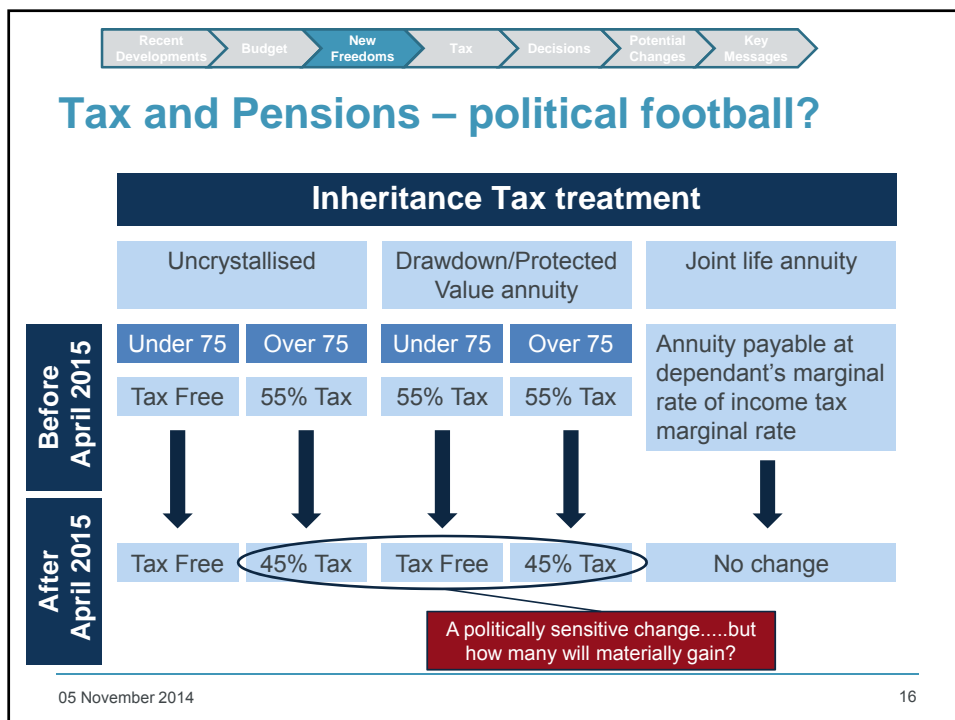
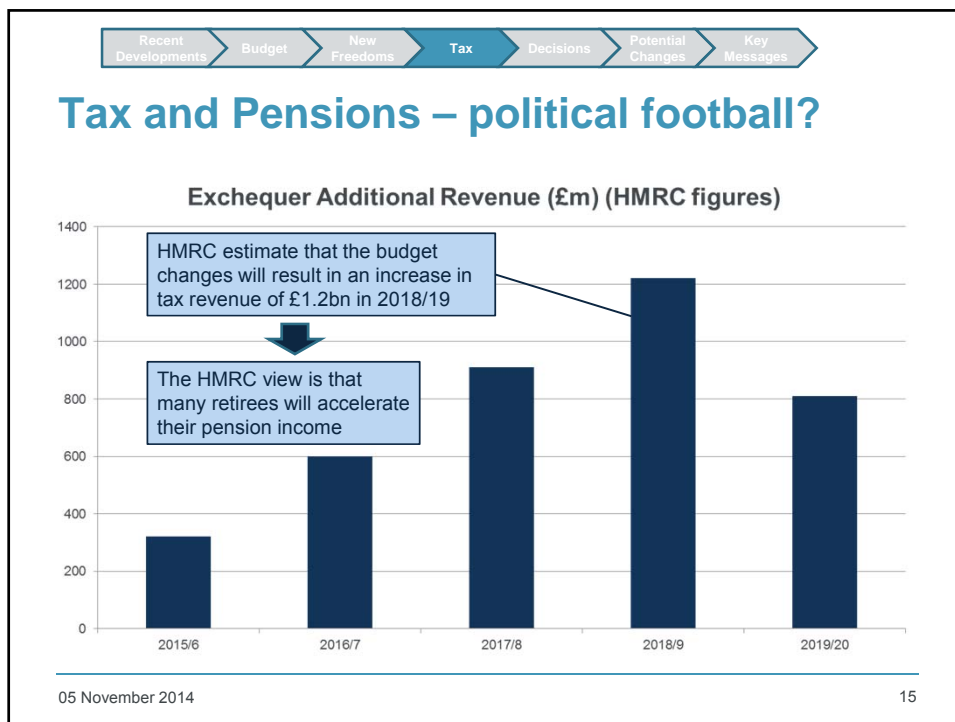


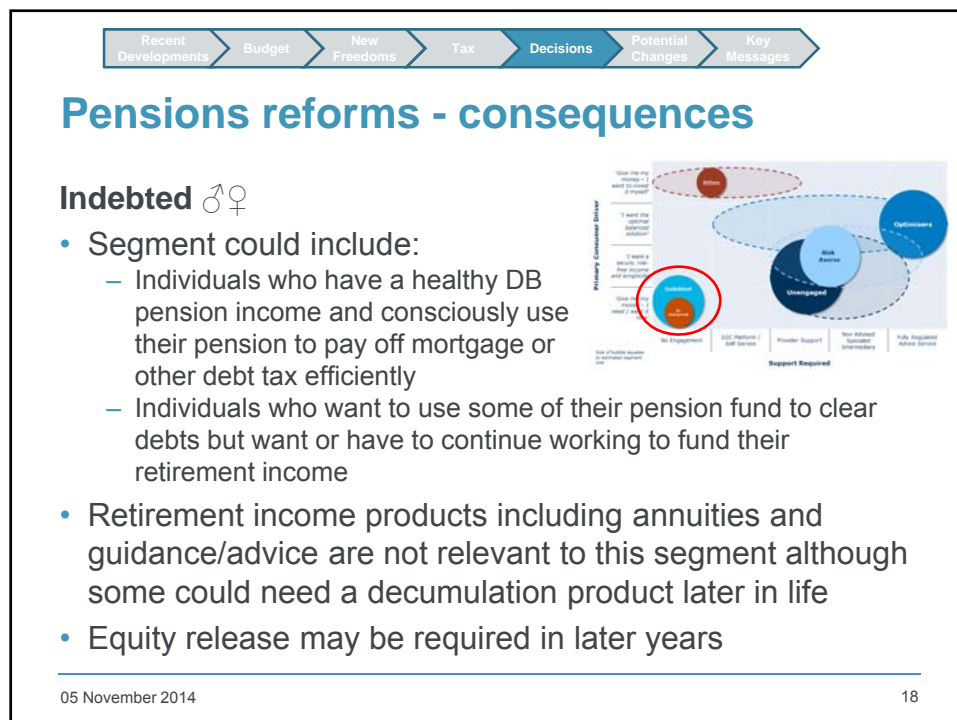
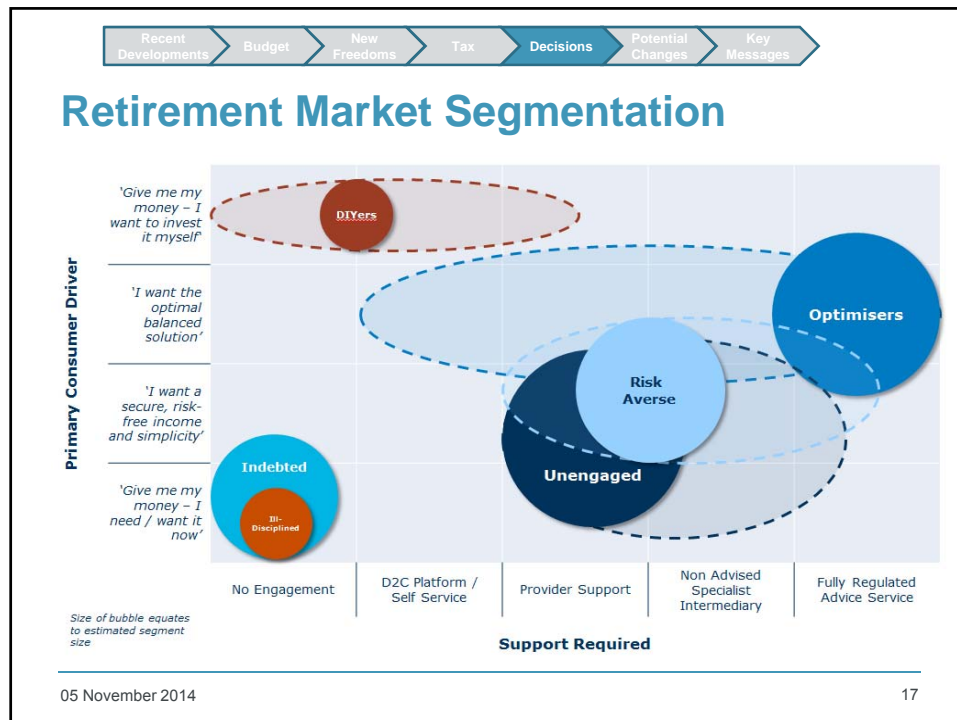
Recent Developments → Budget → **New Freedoms** → Tax → Decisions → Potential Changes → Key Messages

Budget proposals – a little more detail

- Flexible access DC pot (aka “bank account”) – for each payment out 75% taxed at marginal rate and 25% tax free
- Annuities may decrease, may have guarantee >10 years
- Override for schemes to make payments under new flexibility rules
- Policyholders must make all their providers aware of using the flexibilities ...
 - ... Or face **fines** if they do not ...
 - Based on information about withdrawals from providers

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Pensions reforms - consequences

Risk Averse ♀

- This segment will be risk averse both in the decision making process, hence guidance/advice will be sought, and the solution selection process, hence annuities are likely to provide at least some of their retirement income
- Where a DB income is also available there may be an appetite to leave some of the DC fund in a more flexible product
- Some of this segment may choose to drawdown but are likely to take a relatively low income potentially leaving a partially unutilised fund at death



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Pensions reforms - consequences

Unengaged ♀

- This segment has little or no appetite to research options, manage investments or monitor projected income levels.
- They will seek guidance or advice because they simply want someone to tell them what they should do
- The 'hassle-free' nature of an annuity product is likely to be appealing
- Some of this segment may choose drawdown but fail to monitor the funding and projected income levels, may switch to an annuity at a later age



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Pensions reforms - consequences

Optimisers ♂

- This segment are likely to have large pot sizes and therefore see the value from taking advice
- Tax considerations may be more complex, for example assets may exceed the inheritance tax threshold. Consequently holistic financial planning is required.
- This group may be willing to take on more risk than other market segments or at least adopt a blended approach whereby an annuity provides a safety net and drawdown offers flexibility and potential outperformance



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Pensions reforms - consequences

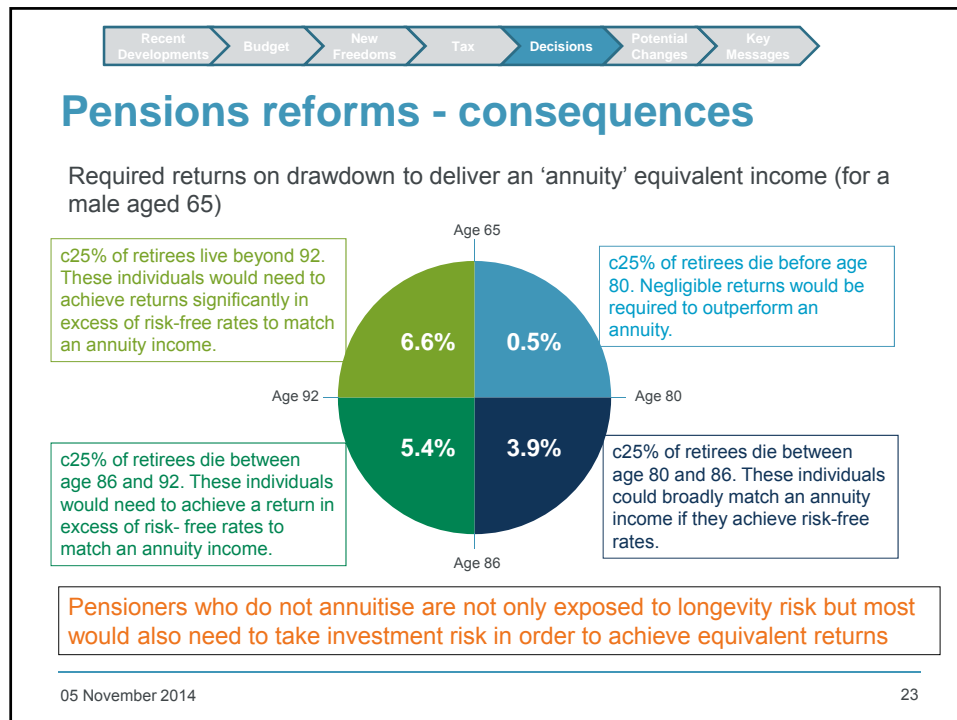
DIYers ♂

- This segment of the market should be financially literate, have an appetite for risk and are likely to have larger funds (or/and a DB income) relative to other market segments
- Their level of confidence is such that advice is unlikely to be sought
- A platform is likely to be used to manage their assets



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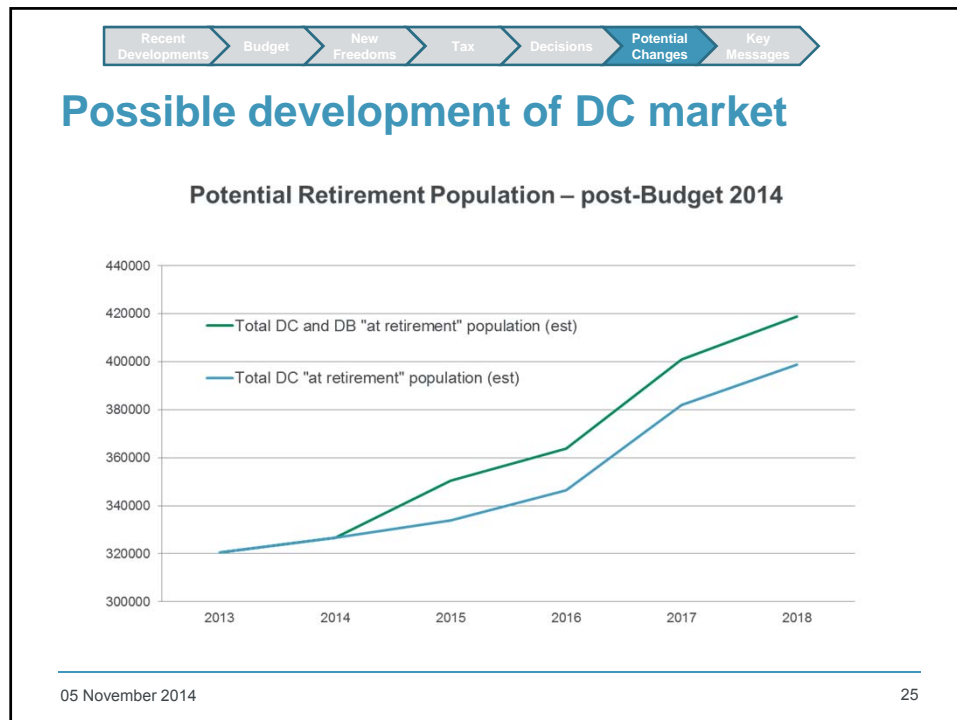


Recent Developments → Budget → New Freedoms → Tax → **Decisions** → Potential Changes → Key Messages

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Recent Developments > Budget > New Freedoms > Tax > Decisions > **Potential Changes** > Key Messages

The Australian Experience

- Pensions assets can be used to fund pre-retirement lifestyle.....
 - Housing debt among people aged 50 to 64 jumped by 120% between 2002 and 2010 with other debts rising by 43%
 - After two decades of saving, Australians now have \$1.5trn in superannuation savings. However, the growth in superannuation has been matched by households taking on an equivalent amount of personal debt
- Significant exposure to longevity, inflation and investment risks.....
 - Half of those who accessed their superannuation fund in 2012 received a lump sum distribution. Of the remaining half, almost all chose a phased withdrawal product over an annuity

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Retirement freedom around the globe

The Good

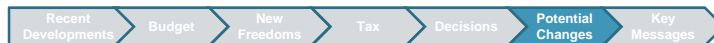
- Nature of interaction with State benefits is key
- Tax incentives or penalties act to defer withdrawals
- A guaranteed annuity rate at retirement increases use of annuities (shock!)

The Not-So-Good

- People tend to underestimate longevity
- People may over-estimate investment returns
- Therefore many will run out of money in retirement
- If there is a State back stop people will use it!

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Retirement Planning and Behavioural Economics

- An FSA paper identified a number of cognitive biases which may give us clues as to how people will respond to the budget
- Procrastination and hyperbolic discounting
 - People tend to apply higher discount rates at shorter terms and consequently advancing a benefit to the present, even if this implies high future costs, is considered attractive
- Loss aversion and regret aversion
 - People are concerned not only with what they have now but what they used to have and with what they might have had
- Curse of knowledge
 - People draw incorrect inferences, focus on inappropriate or unimportant data, are distracted by too much information and may over-deliberate. Unjustified optimism is rife.

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Customer engagement – challenges

- Guidance (not advice)
 - Signposted by providers
 - Delivered by independent bodies (CAB, TPAS, ..)
 - Funded by levies
- Policyholder communications (e.g. wake up letters)
 - Must not obscure Guidance
- “Pensions Passport”?
 - Simplify and standardise information from providers
 - Policyholders use the passport to obtain guidance (or advice)

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Tax and Pensions – more political football?

- Devolution
 - Differing tax rates by region?
- Lifetime allowance (was £1.8m)
 - May be further reduced to perhaps £1m from £1.25m?
- Tax Free Lump Sum
 - Could be reduced from 25% or removed?
- Tax relief on contributions
 - Amount to be reduced from £40k?
 - Flat rate of tax at 30%?
- Surrender annuity policies???

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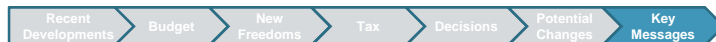


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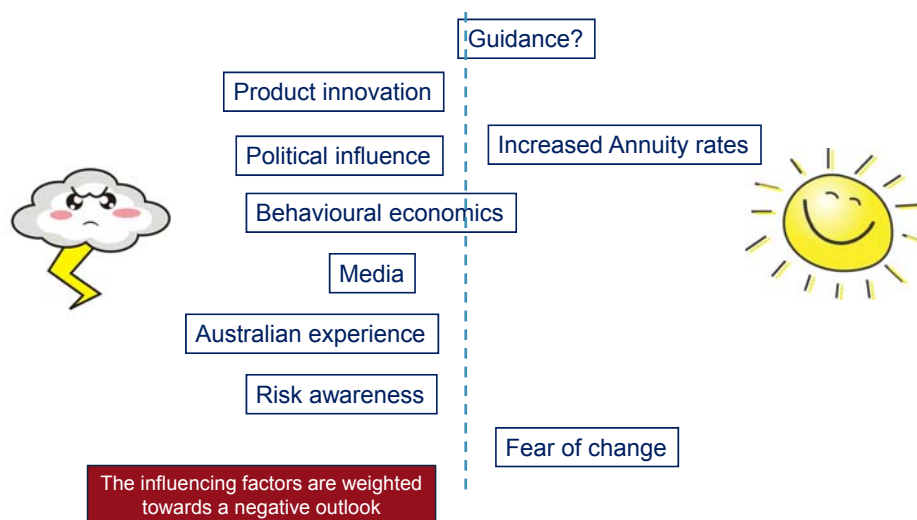
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Key Messages: The Outlook for Annuities



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Recent Developments → Budget → New Freedoms → Tax → Decisions → Potential Changes → Key Messages

Product development

Customer needs	Potential Product Solutions	
Risk Management	Drawdown + guarantee	Variable Annuities
Flexibility	Fixed term annuities	Retirement 'Bank Account'
Safety net	Equity Release	Annuities?

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Filling the Annuity “Void”

- More assets retained in linked or with-profits form?
- More broadly invested for longer?
- Ease of access to funds essential
- Life-styling options to be reviewed and revised
- Guarantee underpin on income levels?
 - New era for with-profits annuities?
- Competition on asset management fees?
- New challenges regarding HMRC information requirements and personal tax calculations?

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Key Messages

- Annuity Volumes likely to fall further
 - Impacts on mortality, expenses, pricing and profitability....
- Customer inertia likely to be a huge factor
 - More choices, changing tax rules, lack of a default option
- Longevity and investment risks
 - Hard to get across to policyholders?
- The effectiveness and take-up of 'Guidance' will have a significant impact on the decumulation landscape
- Technology requirements high
 - To provide sufficient flexibility and deal with admin challenges....

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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenters and not those of our employers.

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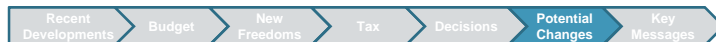
FCA consultation on Pension Reforms (1)

Guidance:

- Funded by a levy on Life Insurers, Asset managers, Deposit takers, Advisers (and mortgage lenders?)
- Signposted by providers and trustees
- Delivered by independent organisations (TPAS, CAB?,...)
- Will inform, educate and help empower pension savers
- Will be subject to standards to be set and monitored by FCA

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FCA consultation on Pension Reforms (2)

Conduct requirements:

- Signposting of guidance in Wake-up letters
- Guidance not to be obscured by other information
- Continue to provide information about open market option
- Consumers to be able to access a range of cost-effective advice?
- Sustainability of income levels to be presented
- Query anomalous policyholder behaviour?

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Thoughts on advice and “guidance” (1)

Personal recommendations or “advice”:

- FCA rules on what constitutes advice are complex
- There are also ordinary laws which apply here
- Each policyholder will be different with different requirements, knowledge and expertise
- The starting point is to ascertain what the client wants: if it is advice, then it is almost inevitable that is what he will get
- Can advice be automated? The FCA says it can and case law agrees: see “1998 Re Market Wizards Systems”

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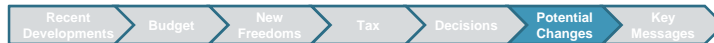
Thoughts on advice and “guidance” (2)

What constitutes advice? (regulatory definition)

- Regulated advice (simplified!) :
 - Relates to a specific investment;
 - Given to an investor or potential investor; and
 - Relates to the merits of buying/selling/etc the investment
 - Is defined more widely than a “personal recommendation”
- Generic advice:
 - Is anything not meeting above criteria
 - Is not regulated
 - This is where “Guidance” must land (subject to FCA standards)

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Thoughts on advice and “guidance” (3)

Simplified advice?

- Simplified advice is a form of “restricted advice”
- Typically using automated, process driven services
- Cheaper to deliver than full advice
- But likely to be subject to the full regulatory arsenal
- So many firms concerned about
 - Unsuitable recommendations
 - Misselling
 - FOS:

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Evolving consequences - devolution

- Since the Scottish “No” vote for Independence all parties are laying out ideas for further devolution
- Scotland Bill 2012 already contains powers for Scottish government to set taxes in Scotland from 2016
- Tax rates could be different in Scotland from rest of UK
 - Within certain constraints
- Labour party proposes greater freedom
- Conservative and Liberal Democrat parties propose complete freedom
- Providers will need to track where policyholders pay tax...

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Possible effects on Life Insurers

More regulatory hurdles to trip over

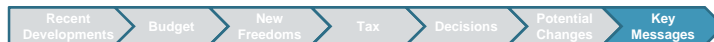
- Signposting of guidance – not to be obscured
- Open market option – still to be mentioned
- Sustainability of income - to be presented
- Anomalous policyholder behaviour – to be challenged

Plus

- Attractive new propositions – to be designed?
- Existing annuity products – price for selection effects?

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Other possible effects on Life Insurers

A new era for misselling and unclear advice?

- Advice vs guidance –where is the dividing line?
- Regulatory intervention – to be expected
- PI cover – higher risks of litigation against advisers
- D&O cover – higher risks of regulatory action or “class action”

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