Institute and Faculty of Actuaries

Whither Annuities – Again! A reprise looking at the market for annuities post 6 April 2015

(Session E6)

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Institute
and Faculty
of Actuaries

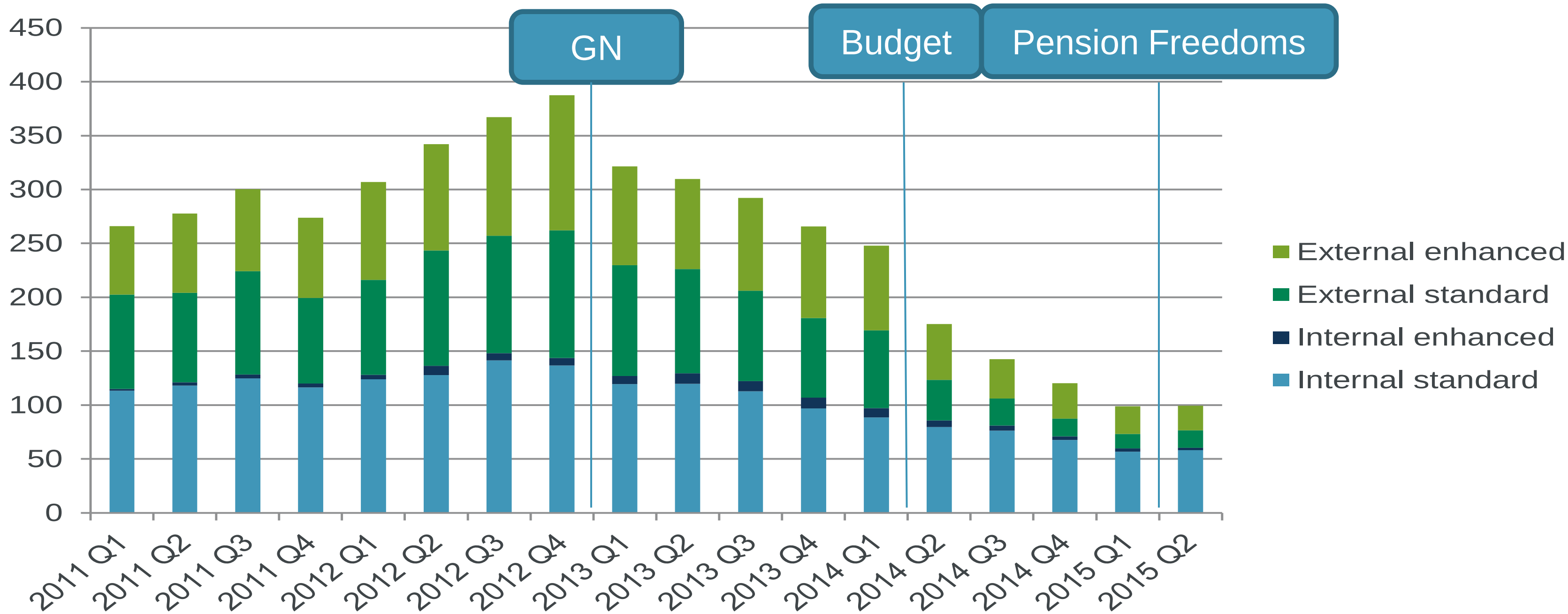
How have the insurance industry and its customers changed following the implementation of Pensions Freedoms?

13 November 2015

Outline of talk

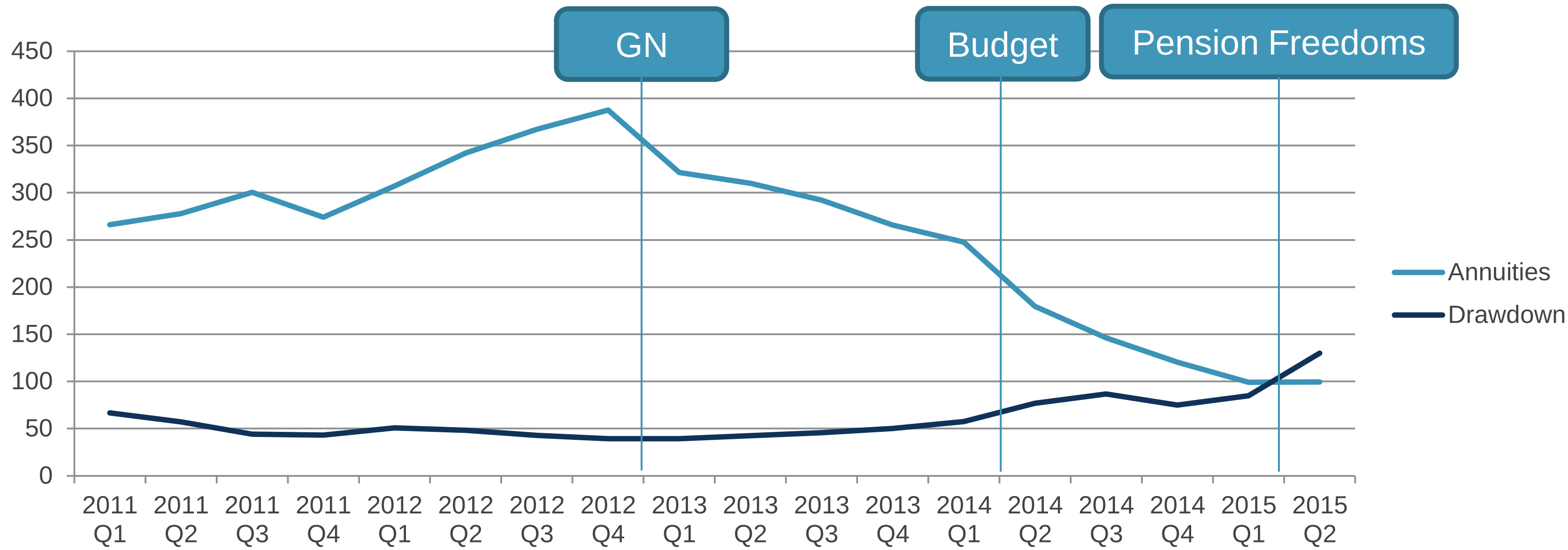
- Facts
- Inferences
- Predictions
- Influences on the ‘End State’
- Key Messages

UK Annuity market experience (ABI)



- Annuity sales were in decline before the 2013 budget but the data shows a marked decline following the announcement of pension freedoms with the impact falling most heavily on open market sales
- Sales stabilised in Q2 2015 following a long period of decline however this may have been influenced by customers deferring decisions leading up to the implementation of pension freedoms

UK Drawdown market experience (ABI)



- The significant decline is Annuity sales has been only very partially offset by the growth in Drawdown sales
- Drawdown sales exceeded Annuity sales for the first time in Q2 2015
- A significant proportion (45%) of drawdown policies are taken from the customer's existing pension provider

Other data sources

FCA (September 2015)

- 204,000 people accessed pension pots in the first 3 months since the reforms, double the number in the same period in 2013
- Over the same 3 month period there were 12,000 annuity sales in 2015 compared to 90,000 in 2013
- Of the remaining 192,000, 121,000 opted for cash withdrawal and 71,000 had accessed some form of income drawdown product. This compares to around 10,000 taking cash or drawdown in 2013.

TPR (September 2015)

- 93% of occupational pension savers had access to a decumulation option within their scheme
- But only 18% had access to drawdown

Other data sources

Pension Wise

- TPAS completed 6,850 telephone Pension Wise appointments between April and August
- Citizen's Advice completed 12,241 face-to-face appointments over the same period
- This suggests that fewer than one in ten people accessing their pots had a Pension Wise session
- The FCA told the Work and Pensions Committee in July that Citizen's Advice was running at 10-15% of its capacity to provide face-to-face appointments
- More than 90% of people who have used Pension Wise have been satisfied with the service

Other data sources

ABI (October 2015)

- In 95% of cases where savers accessed a cash lump sum, they withdrew the entire fund

Standard Life (October 2015)

- In Q3, c90% of customers with pots less than £30,000 have just taken cash

Inferences

The Obvious

- Demand for annuities at retirement has decreased significantly and will remain significantly below pre-Freedom levels
- This is particularly pronounced for low fund values due to the increase in triviality limits
- Pensioners are attracted by the greater freedom and control that they achieve through non-annuity solutions such as drawdown or taking cash

The Likely

- Many customers are making decisions without any advice
- More pensioners will experience periods of sub-optimal pension income during their retirement either as a consequence of drawing down too little income (for the risk averse) or too much too soon (for the risk takers)

Inferences

The Likely (cont'd)

- The value chain for at-retirement advice and solutions has shifted again as illustrated below:

	1990's	2000 - 2012	2013 – Q1 2015	Current
Market conditions	• Pre-RDR • Low take-up of OMO • Standard annuities dominate	• Pre-RDR • Increasing awareness of OMO • Advent of enhanced annuities • Just Retirement & Partnership market entry	• Post-RDR • OMO overtakes internal annuity sales • Enhanced annuities account for c1/3rd of sales	• Post-RDR • Post Pension Freedoms • SII looming
Annuity Providers	Good margins	Margins remain good although some erosion	Further erosion but still an attractive market	Very challenging market conditions
Financial advisers	Good margins where advice taken	Improved margins and growing demand for advice	Polarisation of advice market between fee based wealth managers catering for large funds and non-advised annuity specialists catering for small/medium funds	Good margins for advisers with Wealth Management, Platform and consolidation focus. Annuity specialists switching focus to Equity Release. Some momentum behind robo-advice to cater for the masses.

Predictions

- The current state is likely to be short-lived. Few market commentators believe that the market as it stands is effective and is adequately serving the best interests of customers.
- The Work and Pensions Committee undertook an inquiry to take an early look at the impact of pension freedoms. The report from that inquiry, issued in October, included the following conclusion:

> '**A watching brief** on pension freedom is imperative and we intend to return to this issue over the course of the Parliament. **Whether improvements in the quality and take-up of guidance and advice can be achieved will be central to the success of the policy**. It is right that people should be able to choose what to do with their retirement savings. However, **freedom to choose is not enough; people must have freedom to make informed choices.**'

Predictions

- There are a number of factors that are likely to evolve and the pace and extent of evolution of these factors will determine how the market develops. These factors include the following:
  - The media response
  - Default options
  - Stock market volatility/performance of target return type funds
  - **Provider innovation**
  - **Interaction of Government and Private pension provision**
  - **Customer engagement (including advice)**
  - **"Left field" – the unknowns**

Developments in the retirement market

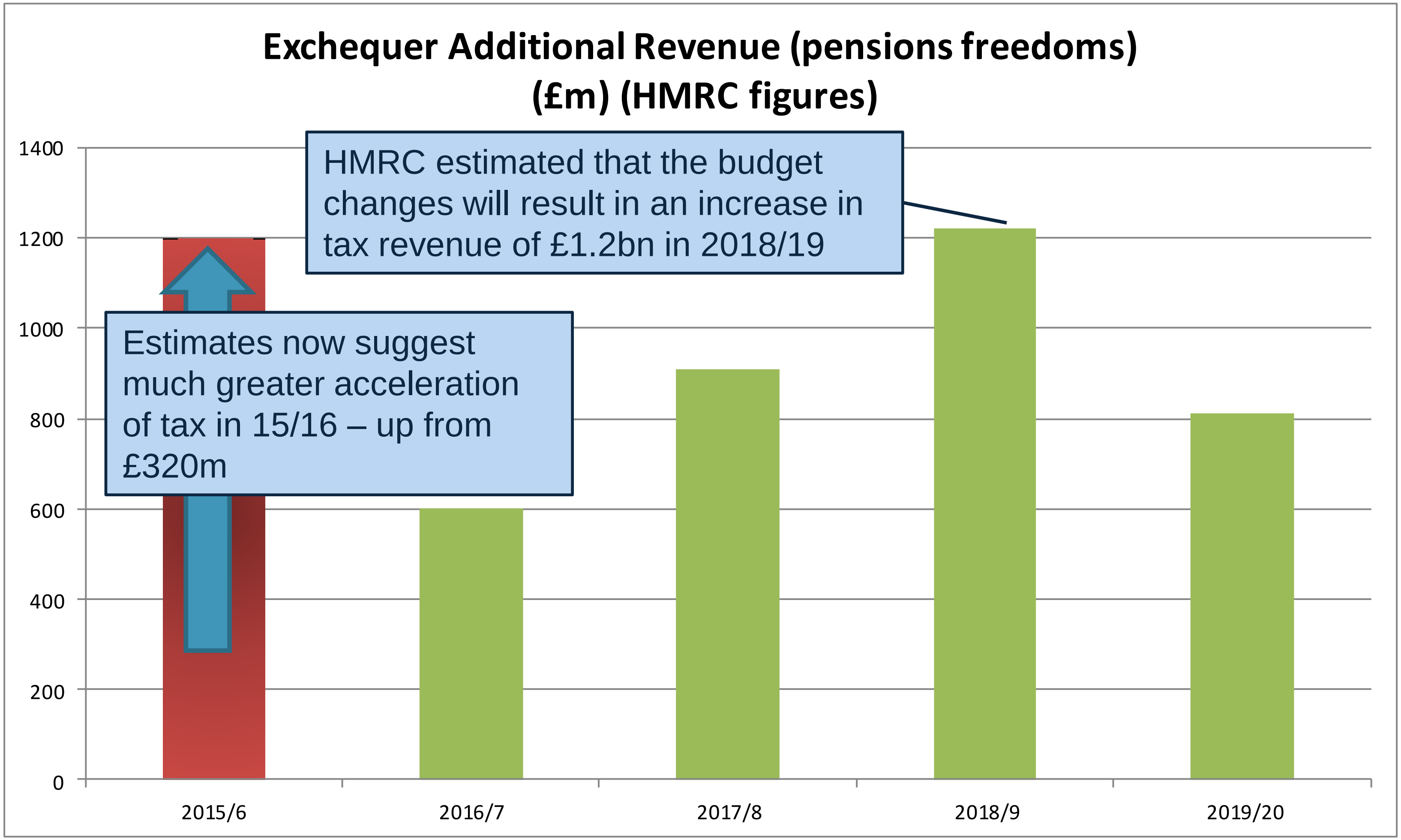
- Blended approach
  - mix of drawdown and annuity products
  - Or even wider mix of potential products healthcare/disability/spouse/..
- Multi-asset income funds – high income and capital preservation
- Phased funds – decumulation followed by annuity
- With-profits pensions revamp
- "Pension bank account"
- Pension ISA – more on this later

Provider innovation

Strengthening the incentive to save: a consultation on pension tax relief

- Currently incentivisation is in the form of tax relief of pension contributions at marginal rates
- In summary tax is levied during the lifetime of a pension plan as follows in simple terms:
  - Contributions attract tax relief (i.e. exempt from tax)
  - Interest and gains on the investments are exempt from tax during accumulation
  - Tax free lump sum is available; and
  - Pension income is taxed at marginal rates once fund is accessed
- Referred to as an "E-E-T" system

Tax and Pensions – the debate continues



Retirement freedom around the globe

	Australia	Chile	Ireland
Freedoms available	Drawdown Annuity Lump sums	Drawdown Annuity Deferred annuity Combinations	Drawdown Annuity
Tax treatment	T-T-E No tax on exits	Essentially E-E-T Voluntary contributions could be E-E-T or T-E-E	Tax free lump sums Tax on drawdown encourage 5%pa withdrawals
Comments	Very few annuities taken State pension means tested but property doesn't count	Annuities have 60% take up rate Quote system operated by regulator	Annuities have 30% take up rate Minimum income limits apply

Melbourne Mercer Global Pension Index

Sponsored by Victoria State Government, October 2015

Includes both government and private elements of each of 25 country's pension system.

For each country's pension system MMGP Index looks at 40 different indicators grouped into 3 areas:

- Adequacy (40%)
- Sustainability (35%); and
- Integrity (25%)

UK is in 9th position (score reduced from last year due to Pension Freedoms) behind Chile and Australia, but just ahead of Ireland (11th place)

Denmark in pole position.

Strengthening the incentive to save: a consultation on pension tax relief

- Radical proposals to change pension tax relief from E-E-T to T-E-E, or perhaps more accurately T-E-T, again in simple terms:
  - Contributions are made from after tax income with an incentive
  - Interest and gains on the investments are exempt from tax during accumulation
- Incentive is 50p for every £1 contributed
- Up to a maximum incentive of £4,000
- Contributions in excess of £8,000 will not receive incentive.

Strengthening the incentive to save: a consultation on pension tax relief

- Tax position on retirement is a bit more complex:
  - Return of non-incentivised contributions is tax free
  - Return of income and gains on non-incentivised contributions is taxed at marginal rate
  - Return of incentivised contributions and the earnings thereon is taxed at marginal rate
- Aimed at incentivising lower paid
- Dubbed – Pension ISA or Lifetime ISA (LISA)
- But has fewer tax breaks than the ISA
- And is more complex

Strengthening the incentive to save: a consultation on pension tax relief

- LISAs may have default funds and a charges cap
- Could be used as part of auto-enrolment
- Could convert existing pension schemes into LISAs
  - By one-off application of tax to be followed by adoption of new LISA rules
  - Morgan Stanley report (Sept 2015) suggests c£115bn reduction in UK debt!
- Concepts like Lifetime allowance could be eliminated
- But does it give enough of an incentive?

Strengthening the incentive to save: a consultation on pension tax relief

- Alternative ideas for reform of the current system include
  - Moving to a flat rate tax relief basis where all contributions attract the same level of tax relief (say 30%) independent of your own marginal tax rates
  - Further adjustments to the existing E-E-T system to reduce the amount of tax relief on contributions available

Customer engagement – challenges

- Advice and guidance
  - 18,000 guidance appointments (end-Aug)
  - 925,000 PAS website visits (some of them mine!)
- Policyholder communications (e.g. wake up letters)
  - Must not obscure Guidance
  - Providers may be too directive? FSCP comments
- "Pensions Passport"?
  - Simplify and standardise information from providers
  - Policyholders use the passport to obtain guidance/robo-advice/advice
- "Pensions Dashboard"?
  - To pull together all information from different providers

Customer behaviour – cash-hoarding?

- Savers have withdrawn £2.4bn from pension pots in the first three months of the new freedoms, according to the Association of British Insurers.
- Figures from the ABI show £1.3bn has been paid out in cash lump sums, with an average payment of around £15,000.
- Figures from FCA show 200,000 policyholders have accessed their pensions in period April- June (up from c 95,000 in same period in 2013)
  - Most taking cash – only 12,400 annuities purchased (down from 90,000 in same period in 2013)

Customer engagement – complaints

- The number of pension complaints has risen 20 per cent in the last six months, FCA data reveals.
- The latest complaints data from the regulator shows there was a total of 73,055 complaints about decumulation, life and pensions products between January and June.
- Complaints include
  - Need for advice before cash paid out (e.g. on GARs)
  - Inability to cash-in an annuity (see later!)

Customer engagement – complaints

Firm	Number of new complaints
Prudential Assurance	8,827
Friends Life	7,013
Royal London Mutual Insurance Society	5,688
Aviva Life Services UK	4,342
Scottish Widows	4,110
Zurich Assurance	4,004
Scottish Equitable	3,826
Phoenix Life	3,554
Legal & General Assurance Society	2,609
Abbey Life Assurance	2,543

Secondary Annuity Market

- Consultation launched in 2015 to consider the creation of a Secondary Annuity Market
- Another element of Pensions Freedoms - Potential for annuitants to sell their annuity
- May be a significant "backlog" of sellers initially
  - Purchased annuities in recent years with small pots
  - Don't need the income stream as enough from other sources
  - Want to gain access to the wider freedoms, to re-invest in drawdown etc
- But will this last for more than a few years?

"Left field" – the unknowns

Secondary Annuity Market

- Buyers are likely to include:
  - Main annuity players (several have expressed a keen interest)
  - A small number of larger pension schemes
  - Other players, new entrants?
- Infrastructure
  - Much debate has focused on how the buyers and sellers will come to market
  - Government portal; comparison website; independent benchmark; compulsory process
  - Blind or sealed bidding; e-bay style bidding; open market
  - Original provider veto?

"Left field" – the unknowns

Secondary Annuity Market

- Policyholder protection
  - Advice versus guidance (Pension wise, de minimis)
  - Transparency about charges and taxation matters
  - Spouses' benefits

- Other factors to be considered
  - Assignment and impact on original provider
  - Standardised underwriting questionnaire
  - National death register

"Left field" – the unknowns

Key Messages

Still more change to come

- Industry still catching up with changes and may be greater innovations to come
- Policyholders unsure where to go for advice and may not be getting optimal solutions
- Government and media concerns about current state of play – too much freedom?
- Secondary annuity market may add a further dimension
- Research shows interaction of Government and Private pension provision has a major influence on behaviour
- Pension tax relief is still a very hot topic

… despite all this there is still a place for the humble annuity and the insurance concept

Questions

Comments

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

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