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Annuities in 2015: the role of 'longevity actuaries'

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30 January 2015



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Longevity education

Arguing the case for longevity insurance/annuitisation

Refining longevity models for annuity pricing/underwriting

Alternative product design

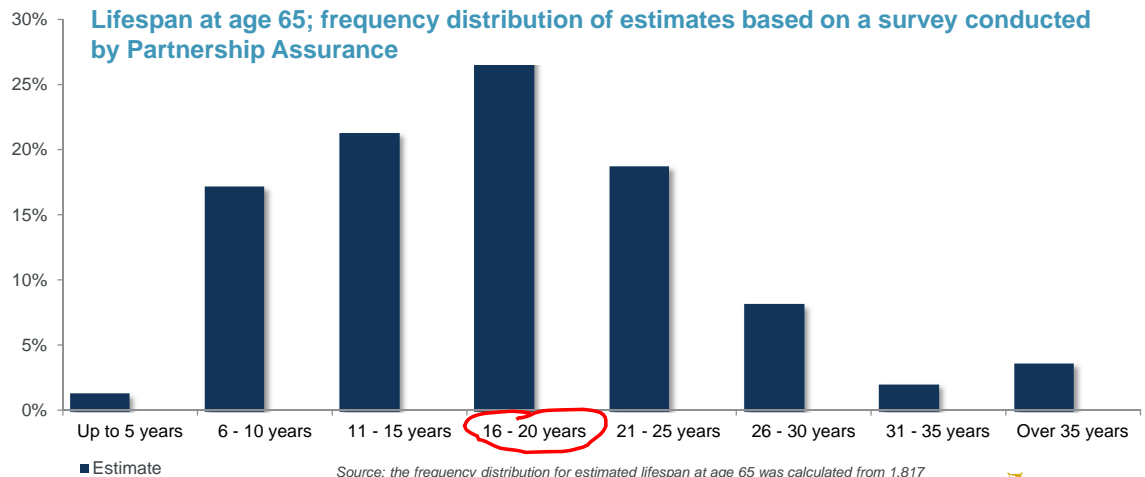


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Projected lifespans are significantly longer than people expect

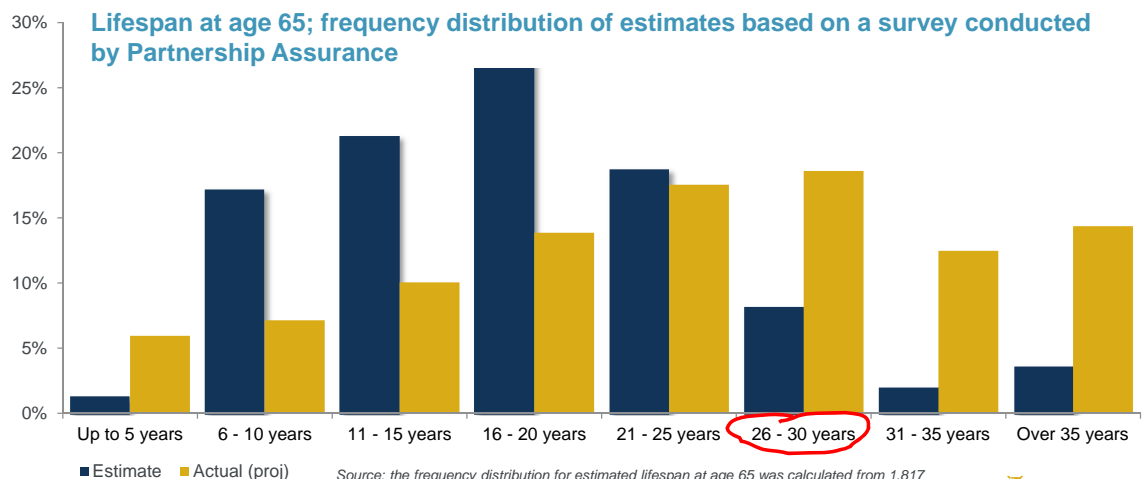


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Longevity guidance

People should be given estimates of how long they are likely to live in retirement...

Steve Webb, Pensions Minister (April 2014)

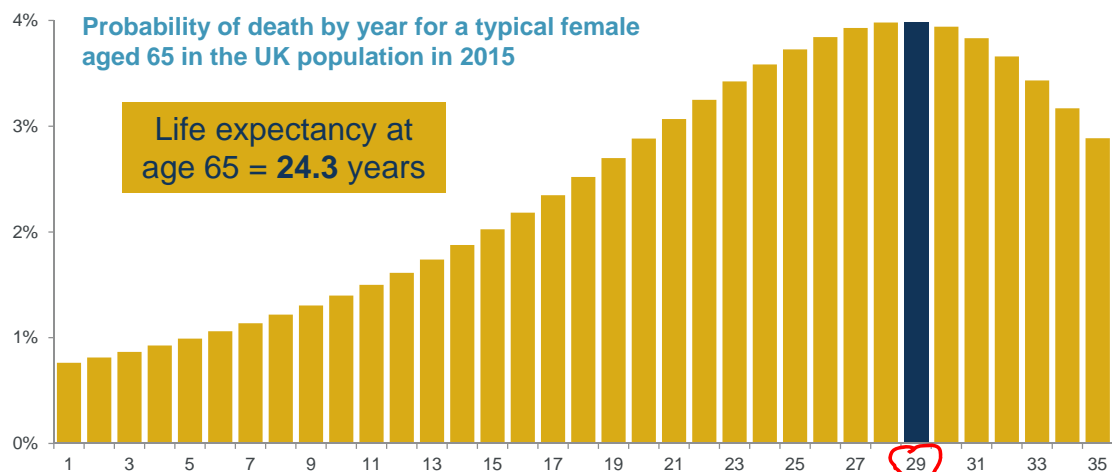


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Significant chance of living beyond life expectancy...



Source: figures derived from the ONS 2012-based projection for the UK population.

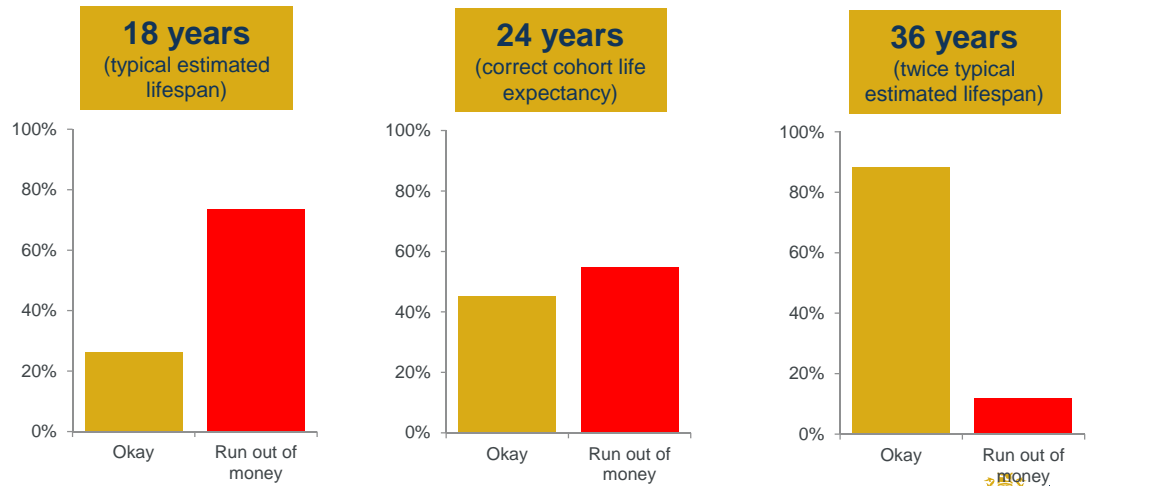


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How chance of depleting funds depends on 'withdrawal period'...



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For a low chance of running out of money...

... estimate how long you are likely to live ...

*... and **double it***



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Budget Day 2014

“most people still have little option but to take out an annuity, even though annuity rates have fallen by a half over the last 15 years...”

Pensioners will have complete freedom to draw down as much or as little of their pension pot as they want, anytime they want...

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

George Osborne, 19 March 2014



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Post Budget Day 2014

Results of survey of 2,000 people conducted by Partnership Assurance

Q: *“If you received your entire pension fund as cash when you retired, what would you do with it?”*

17% said “buy an annuity”



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ILC-UK report: Making the system fit for purpose

Results of survey of 5,000 people aged 55-70

- Nearly **70%** of all those with DC savings favoured using their pot to deliver a **“guaranteed income”**
- 75%** agreed with the statement “I would prefer a **secure guaranteed income** over an income that might rise and fall depending on financial markets.”
- Only **50%** of those with a DC pension said they understood what **an annuity** is (quite or very well).



Source: ILC-UK (Jan 2015)



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Advantages of annuities

- Provide insurance against living longer than expected...
- Protect against both under-consumption and over-consumption (with annuity purchase every penny is spent on providing retirement income)
- Have an implicit expected return (circa 3-4%)* which is high relative to alternative investments which provide a long-term guaranteed rate of return (e.g. long-dated gilts currently yield roughly 2%)
- Aid financial discipline by constraining flexibility!

* Source: own estimate

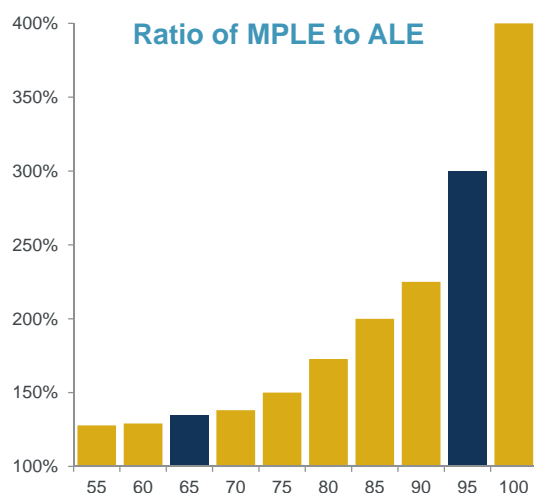


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The annuity proposition becomes increasingly compelling with age...



Source: figures are based on the PPMV00 standard mortality table with future improvements derived using CMI_2014_M [1.5%]

Age	ALE*	MPLE*	Ratio
65	26 years	35 years	135%
95	2 years	6 years	300%

* Note: the **ALE** (Average Life Expectancy) is the median lifespan, i.e. the duration to which **50%** of annuitants are expected to survive. The **MPLE** (Maximum Probable Life Expectancy) is the lifespan to which only **10%** of annuitants are expected to survive.



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... and even more so for people with medical impairments...

Partnership Assurance experience from annuity business written in the period 1995-98

- Some policies written for individuals with very low life expectancies (2-3 years)
- Annual annuity incomes up to 35% of the purchase price
- Small number still alive and receiving annuity income
- For some income received >500% of purchase price

Source: Figures from Partnership Assurance as described in the presentation 'Longevity Risks & Opportunities arising from the Growth of the Enhanced Market' – Westminster & City 17th Annual Conference on Annuities & Drawdown, 2013



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How will annuities be purchased post April 2015?

- (For some) as before... *“... purchasing an annuity will continue to be the best option for many individuals to provide an income in retirement.”* **HM Treasury, 2010**
- By DC pensioners with guaranteed annuity rates
- As part of a “retirement account” (e.g. a combination of an annuity and a SIPP/drawdown product)
- Trend towards phased annuity purchase and deferral of purchase (so increasing age)



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Purchase price

- Long-established relationship between mortality rate and purchase price or annuity amount
- Impact was modified by the introduction of postcode-pricing (but still remains an important rating factor)
- Likewise relevant for enhanced/impaired annuities
- In the ‘New World’ the ‘meaning’ of purchase price is likely to change with a shift in behaviour towards smaller purchases or phased purchases



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Retirement age

- Common observation that individuals purchasing their annuity at older ages (say 70 plus) have lighter mortality rates
- Deferral of annuity purchase may change annuity purchase ages and again change the 'meaning' of retirement age for mortality modelling



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Conscious selection

- Individuals who **expect** to live longer than average are more likely to purchase annuities
- To some extent this will be picked-up via medical underwriting, and use of lifestyle and financial factors
- However, some relevant factors may not be captured by the annuity underwriting process, e.g.
 - family history of exceptional longevity
 - genetic predisposition to longevity
 - diet, exercise and other lifestyle factors related to longevity



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Unconscious selection

- There may be a correlation between:
 - individuals who make risk-adverse, prudent decisions about financial planning in retirement [and purchase annuities]; and
 - individuals who make risk-adverse, prudent decisions about their lifestyle (e.g. diet and exercise) and hence live longer than average.



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General trend in annuity pricing/underwriting

Reinforced by Budget changes

Increasing use of underwriting to manage selection risk



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Alternative product design

- “Retirement accounts” (e.g. combination of an annuity and a SIPP/drawdown product)
- Annuities with flexible income/ deferred annuities
- Annuities with surrender options (or surrender options for existing annuities)

Tackling complex issues regarding the setting of longevity assumptions

Striking a balance between ‘actuarial perfection’ and simple products that are easy to understand



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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 presenter.



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