



Institute
and Faculty
of Actuaries

A new retirement

ABI Call for evidence

13 January 2014

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.



Yvonne Braun
Retirement Review
Association of British Insurers
51 Gresham Street
London
EC2V 7HQ

13 January 2013

Dear Yvonne

Call for evidence – a new retirement

The IFoA welcomes the opportunity to respond to this call for evidence and provide the ABI with an insight into the work that actuaries have been doing in this area. The IFoA promotes independent thought leadership, working in the public interest, to provide analysis and insight in areas of uncertainty of future financial outcomes.

We have outlined below our suggested considerations and summarised the relevant research that actuaries and the IFoA have undertaken in relation to the three questions posed in this call for evidence.

What are people's financial needs in retirement?

It is a substantial public health achievement that in the UK over the last three decades life expectancy has improved by more than 6 years (with significant variations according to income and lifestyle). However, this improvement poses challenges to individuals, employers and governments because it has led to more people living longer in retirement, which needs to be financially supported. The Government estimates that 7 million people are currently not saving enough to give them retirement incomes they are likely to consider adequate.

Actuaries have the expertise and integrity to play a part in helping policymakers and the public understand financial needs in retirement. The Continuous Morality Investigation (CMI), supported by the IFoA, carries out research into the mortality and morbidity experience of various classes of insured lives, annuitants and pensioners and uses this information in preparing projections of possible future developments in mortality. These projections are widely used, including, in the conduct of long term assurance, annuity and pension business, and of sickness and related insurances¹. Another example is the IFoA Cause of Death Modelling Working Party which it is hoped will shed light on changing causes of death and implications for healthy vs unhealthy life expectancy.

In addition to research sponsored by the IFoA, an example of other work involving actuaries is the Extending Working Lifetimes Project, a collaboration between Club Vita and Glasgow University funded by the Medical Research Council (MRC). The research aims to provide authoritative evidence of the relationships between retirement decisions and subsequent health and longevity outcomes as we move into a world where the timing of retirement is the personal choice of the employee retirement. This research offers the fascinating opportunity to combine pension fund data with health records.

The IFoA's Sleepwalking into Retirement Working Party has started to explore how we could develop a communication for the public illustrating, in a simple format, an individual's estimated retirement age

based on their assumed current behaviours (i.e. level of savings) and their likely required income in retirement. This group has also illustrated what actions an individual would need to take, e.g. save more or accept a lower retirement income, should they wish to retire earlier; encouraging people to take a holistic view when planning their retirement incomeⁱⁱ.

How well does the current retirement income system cater for these needs?

The global financial crisis has impacted the retirement income system, and so it is important that we examine how products can address these vulnerabilities. Insurance companies and those that work in the pensions industry have a key role to play in designing and communicating such products.

In respect of product innovation the IFoA's Investment for Retirement Savings Working Party has produced a discussion paper 'Is there a place in the UK Defined Contribution pensions market for a guaranteed savings product'ⁱⁱⁱ. In this paper they look at the use of investment guarantees in pension systems from various countries. Identifying the typical wants and needs of the mass market in respect of pension provision and whether guarantees can help meet those needs and wants. They conclude that providers should be able to offer guarantees at a level of charge that still allows expected returns to be above risk-free returns and the biggest issue will be in connection with changes in provider and transferability of guarantees.

The IFoA's Consumer Information Working Party has published the discussion paper 'Transforming Consumer Information'^{iv}, exploring how product providers can better engage consumers regarding their long term savings products and investments. The working party considered the current state of consumer information, including; consumer insights, the current consumer information model, relevant considerations from behavioural economics, examples of information failures and some successes from other fields. The proposed outcomes to transform consumer information are for information providers to: communicate savings progress relative to the consumer's goal; communicate risk and reward by reference to the chances of achieving the consumer's goal; and ensure communications are engaging, easy to digest and free of bias.

As a next step the IFoA's Tomorrow's Consumer Needs Working Party is currently considering how customer needs are evolving. The group is researching potential impacts on the consumer environment such as technology, the economy, demographics, intermediation, political environment, the impact of consumer attitudes and behaviours (e.g. to debt, risk, value, risk sharing, confidence in current providers, use of social media) and regulation (capital regulation, sales regulation, pricing regulation). The next steps will be to develop thinking on how insurers could potentially react to meet these revised customer needs, looking at both how products could be designed if we were starting with a blank sheet of paper and what might be realistic potential alternatives (which could be provided by a range of organisations as well as current insurers).

The IFoA's Pensions and Long Term Care Products Research Group plan to publish a paper later this year, looking at a range of products (some of which are currently available and some new products) that could be used to help address people's financial needs in retirement.

- Life Insurance
- Income Drawdown
- Ring-fenced pension pot (Pension Care Fund)
- Immediate and deferred needs annuities
- Variable annuities
- Disability linked annuity
- Equity release
- Investment bonds and other savings vehicles

While the initial focus of this group has been the applicability to long term care needs, it is likely to be a catalyst for innovative thinking in the wider retirement market.

In addition to financial needs there is a requirement for access to information and advice to help people make good choices. The IFoA has considered how the Retail Distribution Review (RDR) has impacted on advice and developed thinking on strategic and operational issues for insurers. This work has begun to explore the questions that might be asked of product providers in light of developments involving the higher minimum adviser qualification, higher standards of disclosure, the higher threshold for independent advice and the banning of commission on advised sales. The presentation concludes that the issues arising for life insurers due to the implementation of RDR are; adviser charging design, facilitation of adviser charges, product management, disclosure and indirect benefits compliance^v. All of these will continue to be relevant in devising economically viable regimes for advice.

What changes do you think are needed?

Globally, governments are pursuing changes to their countries' retirement income systems. These changes include: increasing the state pension age (e.g. in Denmark state pension age will be linked to increases in life expectancy and is expected to increase to 72 by 2055); amending legislation to no longer make retirement a mandatory requirement (positive effects on employment rates for those aged 65 and over have been seen in the USA); increasing contributions and taxes or reducing benefits; and structural reform, with many countries moving from defined benefit to defined contribution schemes. As changes are happening globally, the UK has a real and valuable opportunity to learn from other countries.

Those working in the UK retirement income system can also learn from the work being done by actuaries in other countries. In the US, the Society of Actuaries has sponsored the initiative 'Retirement 20/20' which aims to bring together experts interested in and impacted by retirement issues, in order to design a new retirement system from the ground up^{vi}. The Australian Actuaries Institute is also researching post retirement funding. At their May 2013 Actuaries Summit^{vii} they discussed the specific role of annuities and concluded that annuitisation would benefit from: the framing of superannuation as an accumulation of wealth; encouragement that longevity risk can be managed by taking out income products that pay for five years more than expected lifetime; and paying sufficient attention to the risk of dementia and poor financial decision making. The insurance and pensions industries have a key role in meeting the changes needed to retirement income systems across the globe and actuaries have a valuable voice in these discussions.

The IFoA's Why retire? Alternative Models to Pensions Working Party is currently researching the concept of pensions as outmoded in light of increased longevity and decreased annuity rates. The scope for this group is to build on the existing notion of 'drawdown' pensions for those with large pension pots and to consider what alternatives could be built for other consumers. Initial ideas include moving away from the notion of an individual to that of family, or other groups, supporting each other inter-generationally and considering what sorts of investment ideas / vehicles might support such alternative models, including possibly resurrecting ideals like mutual associations.

The IFoA would welcome the opportunity to meet with you should you wish to discuss any of the points raised in further detail. Please contact Helena Dumycz, Policy Manager (helena.dumycz@actuaries.org.uk or 02076322118) in the first instance.

Yours sincerely,



David Hare
President, Institute and Faculty of Actuaries

ⁱ Link to the CMI's webpage - <http://www.actuaries.org.uk/research-and-resources/pages/continuous-mortality-investigation>

ⁱⁱ Link to presentation (May 2012) - <http://www.actuaries.org.uk/research-and-resources/documents/hot-topics-can-transforming-consumer-information-stop-generation-sl>

ⁱⁱⁱ Link to discussion paper (October 2012) - <http://www.actuaries.org.uk/research-and-resources/documents/there-place-uk-defined-contribution-pensions-market-guaranteed-sa-0>

^{iv} Link to discussion paper (April 2012) - <http://www.actuaries.org.uk/research-and-resources/documents/transforming-consumer-information-discussion-paper>

^v Link to presentation (May 2012) - <http://www.actuaries.org.uk/research-and-resources/documents/rdr-ready>

^{vi} Link to Society of Actuaries website - <http://retirement2020.soa.org/>

^{vii} Link to Summit Paper (May 2013) - <http://www.actuaries.asn.au/Library/Events/SUM/2013/Sum2013Retirement%20Incomes%20Working%20Group.pdf>