Institute
and Faculty
of Actuaries

Combining traditional and novel retirement solutions

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Agenda

- Background
- Consumer needs
- Combining existing products
- Potential new solutions

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Working party objectives

- A selection of potential retirement products and/or investment techniques that could help improve the options available to consumers on retirement
- A framework for assessing how successful the different approaches are when measured against consumer needs and wants

Paper 1 (March 2022)
Link

- Modelling to analyse the success of each suggested approach against the outlined framework

Paper 2 (H2 2023)

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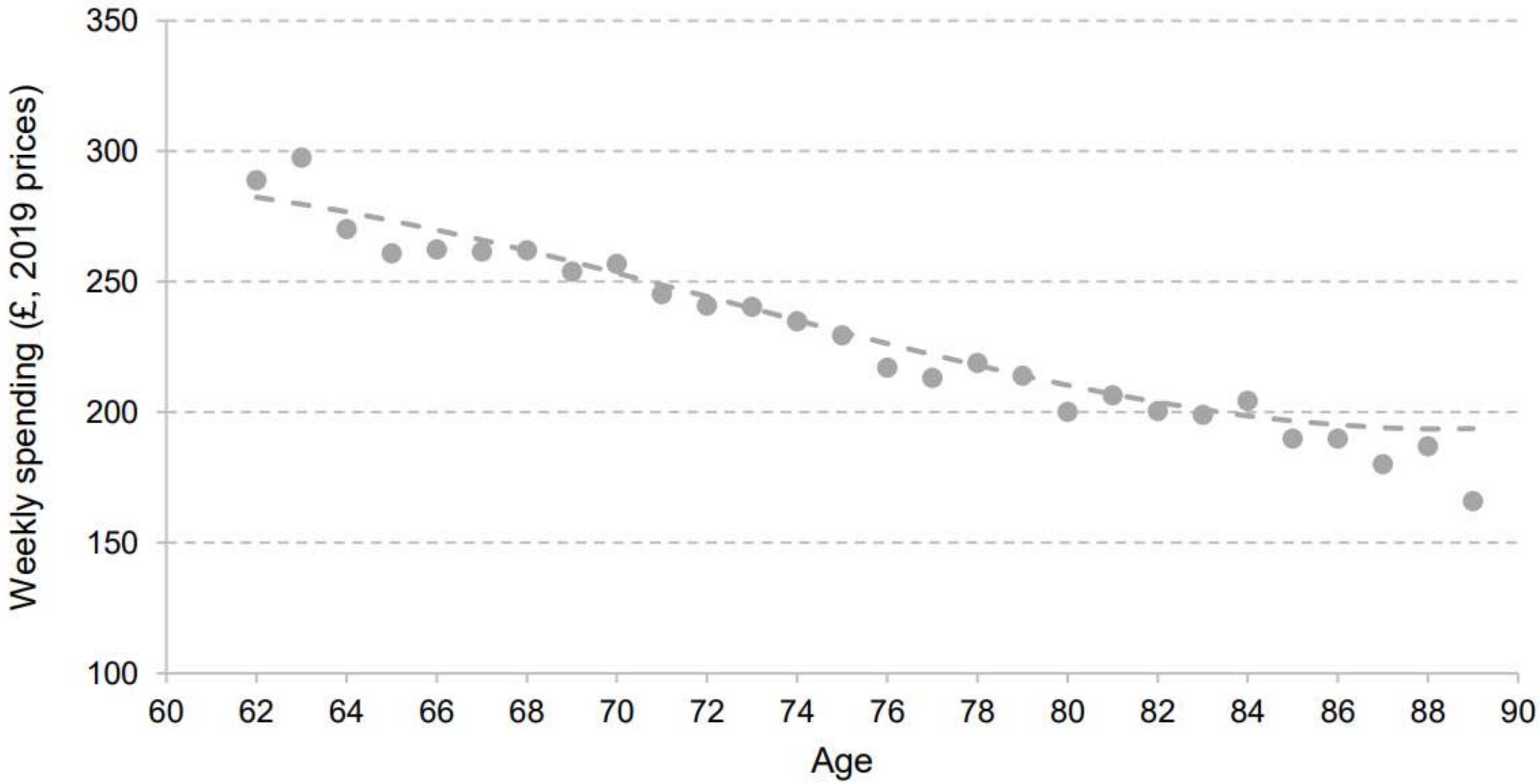
Putting a number on retirement

RETIREMENT LIVING STANDARDS
PENSIONS AND LIFETIME SAVINGS ASSOCIATION

Source: The PLSA/Loughborough University Retirement Living Standards
https://www.retirementlivingstandards.org.uk/

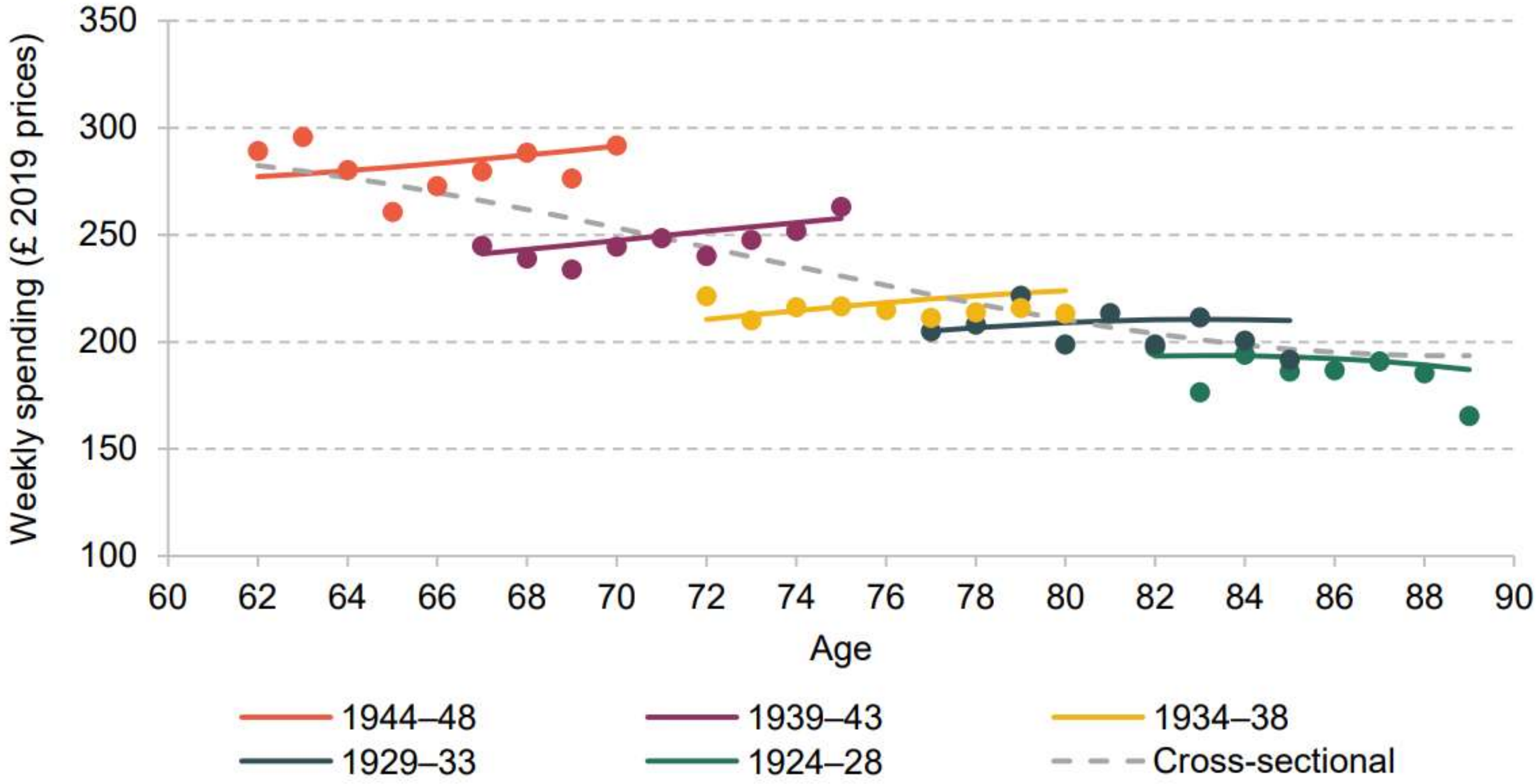
IFS research – spending in retirement



Mean and fitted cross-sectional age profile of total household expenditure

Source: IFS research “How does spending change through retirement”

IFS research – spending in retirement



Mean and fitted age profiles of total household expenditure, by birth cohort

Source: IFS research "How does spending change through retirement"

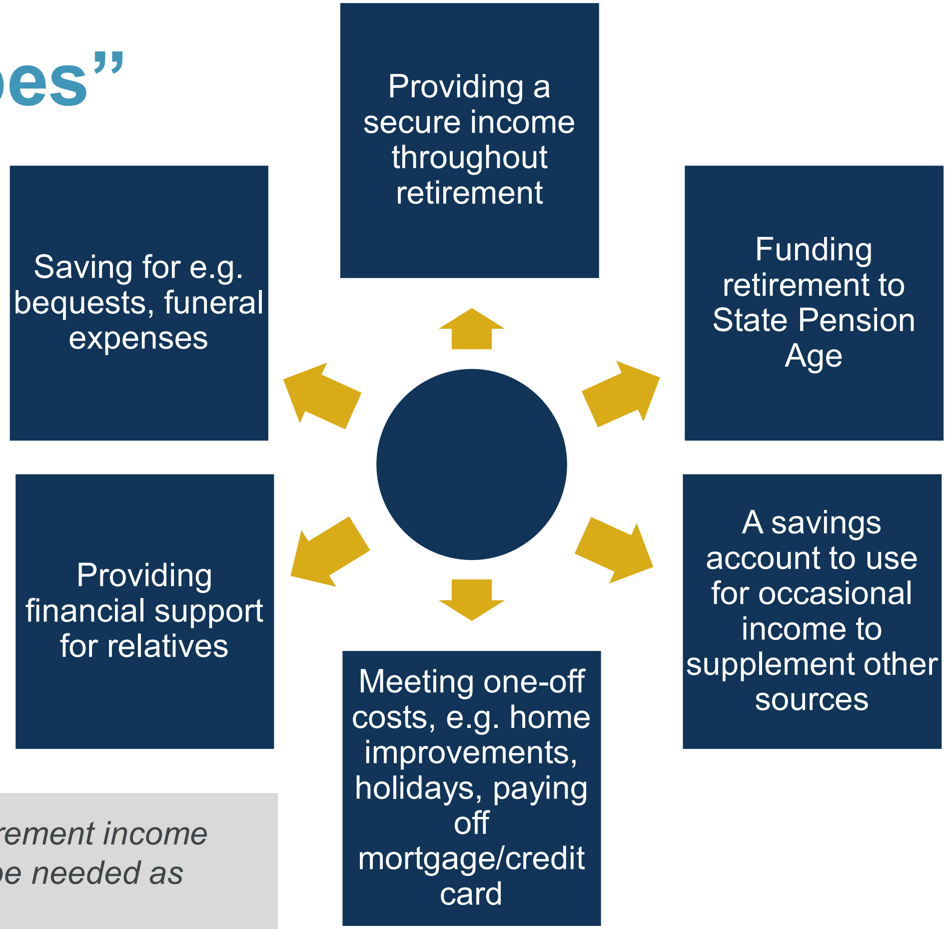
PPI research – "Need archetypes"

"Future pensioners will have different savings portfolios, needs and characteristics than current pensioners"

"A lack of appetite for annuities means that hybrid products which offer both flexible withdrawals and guaranteed income may appeal more to consumers in future"

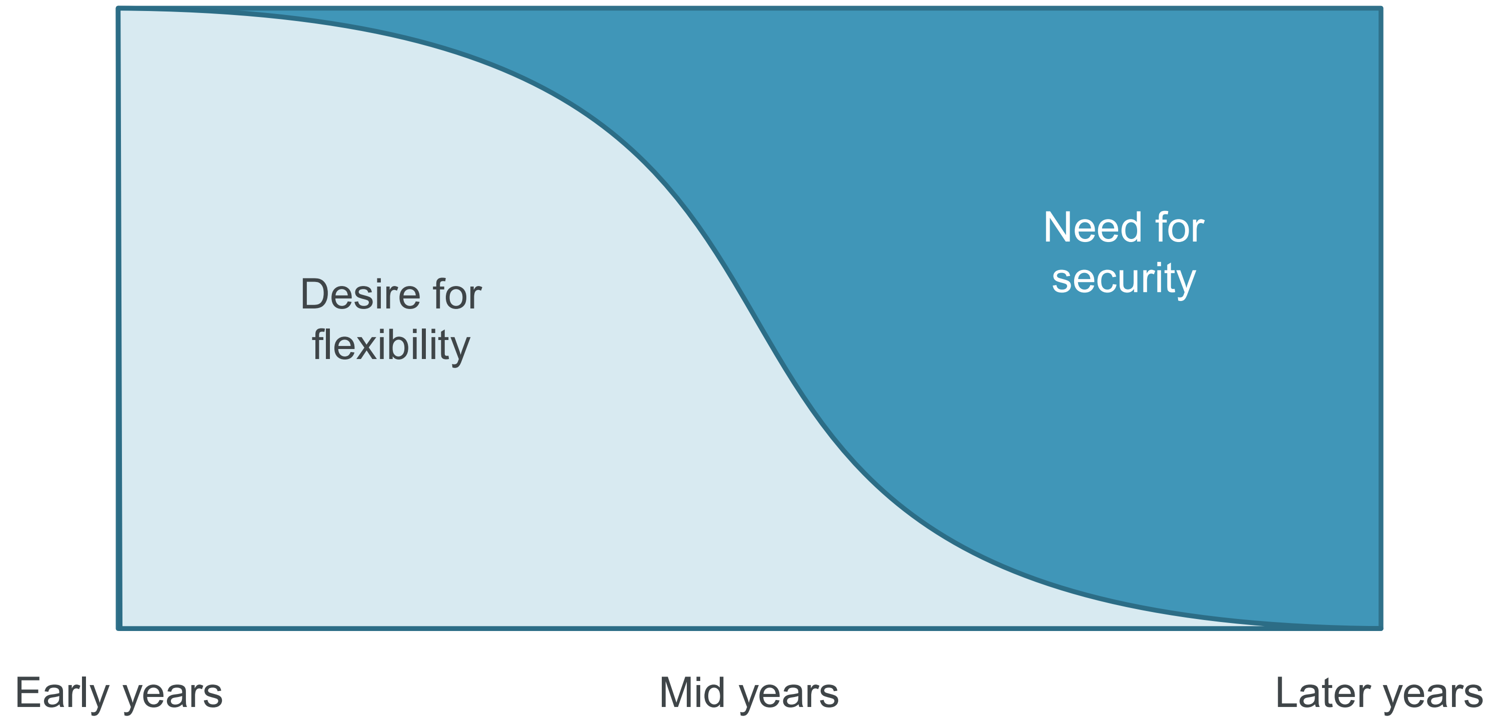
"Soft defaults which are tailored for different retirement need/desire archetypes could help people to better manage their retirement income"

"Current retirement choices are geared toward people committing to a retirement income strategy at the beginning of retirement; going forward, more flexibility will be needed as circumstances may change as people age"



Source: Pensions Policy Institute research "[How will future pensioners use guaranteed income products]"

Changing balance of needs



Potential products to consider further

Annuities

- Immediate annuity
- Deferred annuity
- Variable annuity

Other products

- Drawdown
- Equity release mortgages
- Tontines

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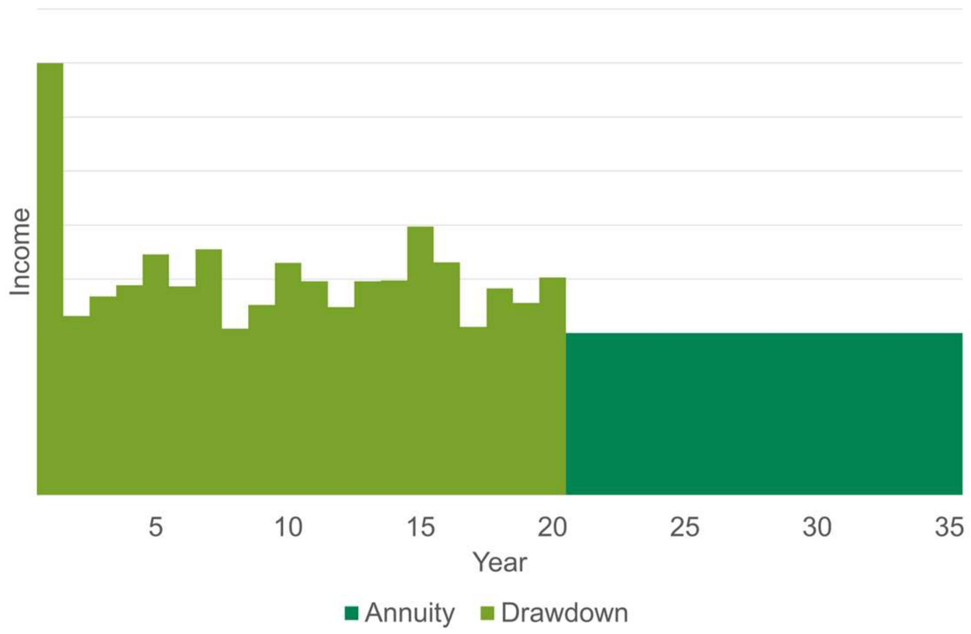
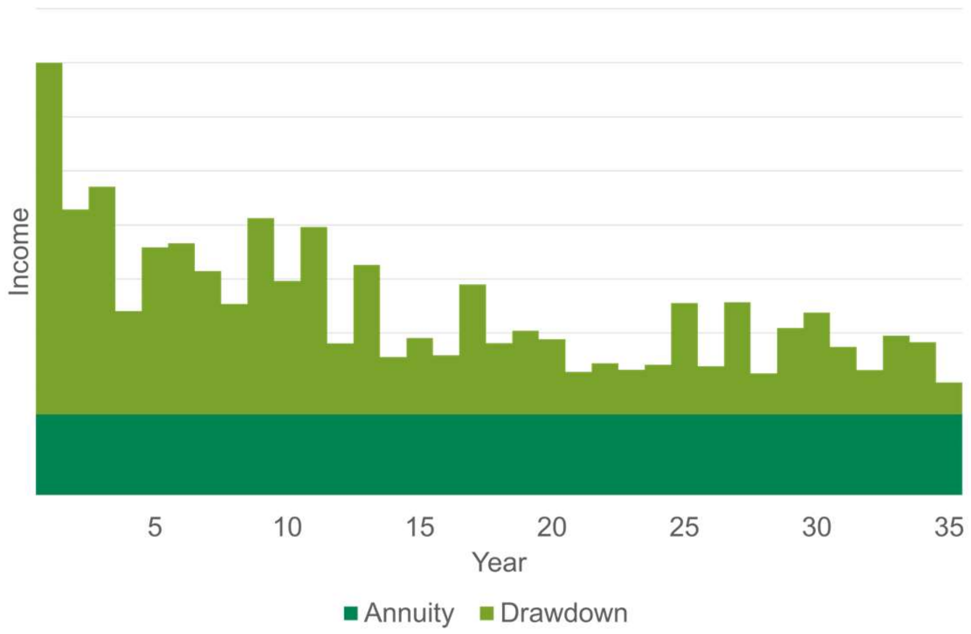
Greater than the sum of the parts

Drawdown then annuity



Annuity with drawdown top up



Products available today

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The Retirement Account

A flexible pension for your changing needs

A flexible personal pension plan that can be adapted to suit your changing needs. Whether you're working, close to retirement or already retired. The Retirement Account is simple, low-cost and lets you bring all your pension pots together under one simple plan. As you enter retirement, you can choose to take a guaranteed income, pension drawdown or a combination of both.

+ Also many solutions offered by IFAs

JUST.

SECURE LIFETIME INCOME

Secure Lifetime Income is a new option for enhancing drawdown portfolios. Sitting innovatively within a client's chosen drawdown arrangement, Secure Lifetime Income provides an element of guaranteed income alongside their retirement income portfolio.

As part of a retirement income plan Secure Lifetime Income can improve client outcomes in a wide variety of circumstances.

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- Annuity in a drawdown wrapper – taxed when income drawn down
- Value protection style death benefit – starts at 75% of the fund and reduces at 2 times the income
- Customers can "cash-in" – capped by the death benefit, reduces if interest rates increase
- Income guaranteed until death, unwinds in the drawdown wrapper
- Rates comparable to a 5 year guarantee annuity
- Simple benefit structure: no escalation, single life.

Case study – Drawdown vs Drawdown + Annuity

70 year old, average health, with £300k fund, state pension £9.1k,

Wants a moderate income £23.3k inflation adjusted

50% Equities/50% bonds vs Replace bonds with SLI

ASSET CLASS	WEIGHT
Equities	
Global Equities	50%
Bonds	
UK Aggregate Bonds	50%

ASSET CLASS	WEIGHT
Equities	
Global Equities	50%
Secure Lifetime Income	
Secure Lifetime Income	50%

Case study – Drawdown vs Drawdown + Annuity

900 economic scenarios projected to age 97

50% Equities/50% bonds vs Replace bonds with SLI

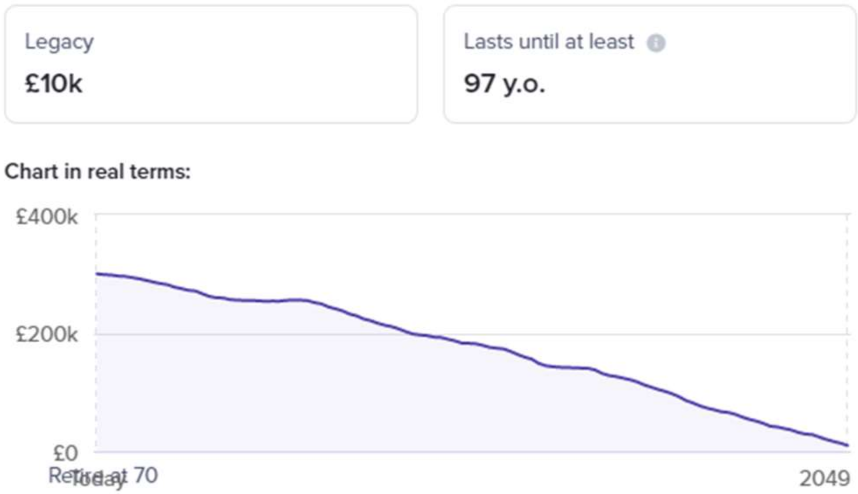
50% scenarios sustain income vs 72% scenarios sustain income

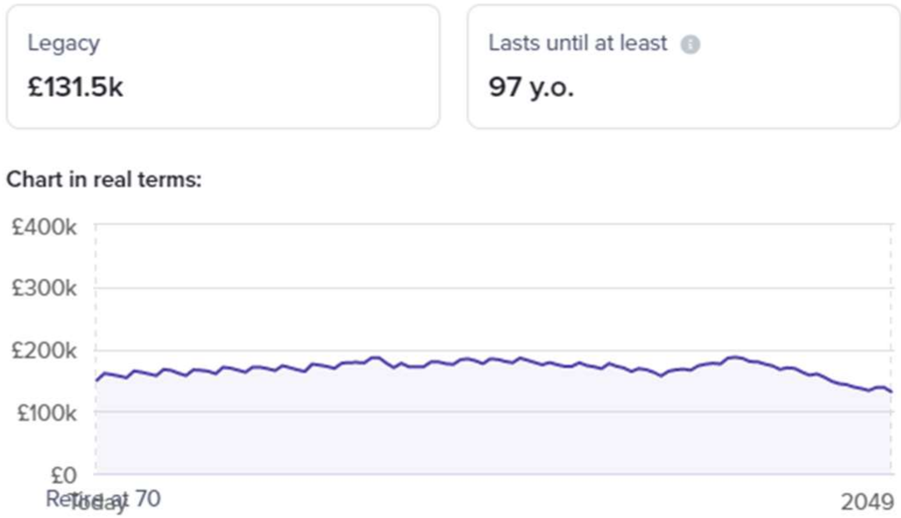
Source: Timeline Planning (900 scenarios across 108 years economic history, projection to age 97)

Case study – Drawdown vs Drawdown + Annuity

Median outcome – 50th percentile

50% Equities/50% bonds vs Replace bonds with SLI





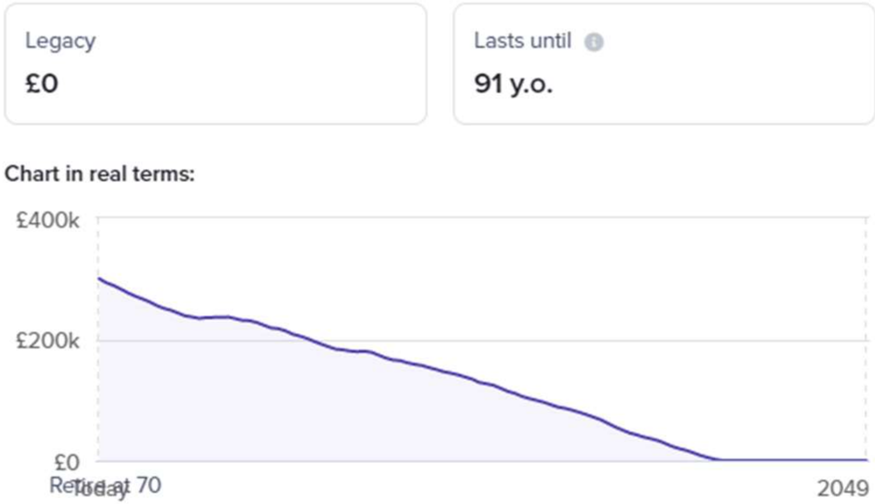
£10k legacy vs £131.5k legacy

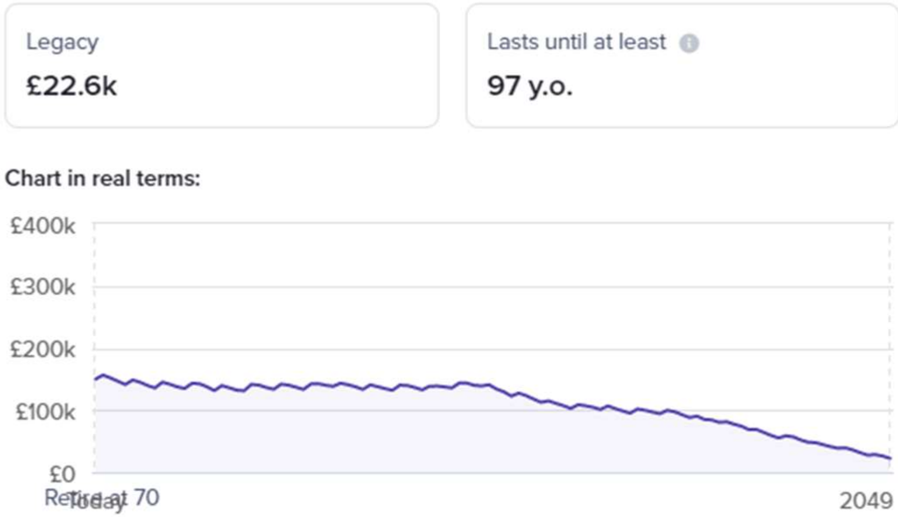
Source: Timeline Planning (900 scenarios across 108 years economic history, projection to age 97)

Case study – Drawdown vs Drawdown + Annuity

Pessimistic scenario – 30th percentile

50% Equities/50% bonds vs Replace bonds with SLI





Runs out at 91, no income

lasts until the end of the projection
£22.6k fund at age 97 + £21.3k income

Source: Timeline Planning (900 scenarios across 108 years economic history, projection to age 97)

Case study – Drawdown vs Drawdown + Annuity

Summary of case study:

- **Replacing bonds with a Secure Lifetime Income (or annuity) provides more optimal outcomes**
- **The combined fund is likely to sustain income in more scenarios**
- **The legacy fund is higher**
- **If funds run out the Secure Lifetime Income continues**
- **Security allows for more aggressive investment of the remaining fund**
- **Flexibility is retained by not annuitizing the whole fund**

Equity release mortgages – extra asset, different needs

- 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

ERMs remains a popular product with £4.8bn lending made in 2021[1] – increasing from £3.9bn in 2020[2]

Source: (1) Equity Release Council Q4 and FY 2021 market statistics.
(2) Equity Release Council Q2 and FY 2020 market statistics

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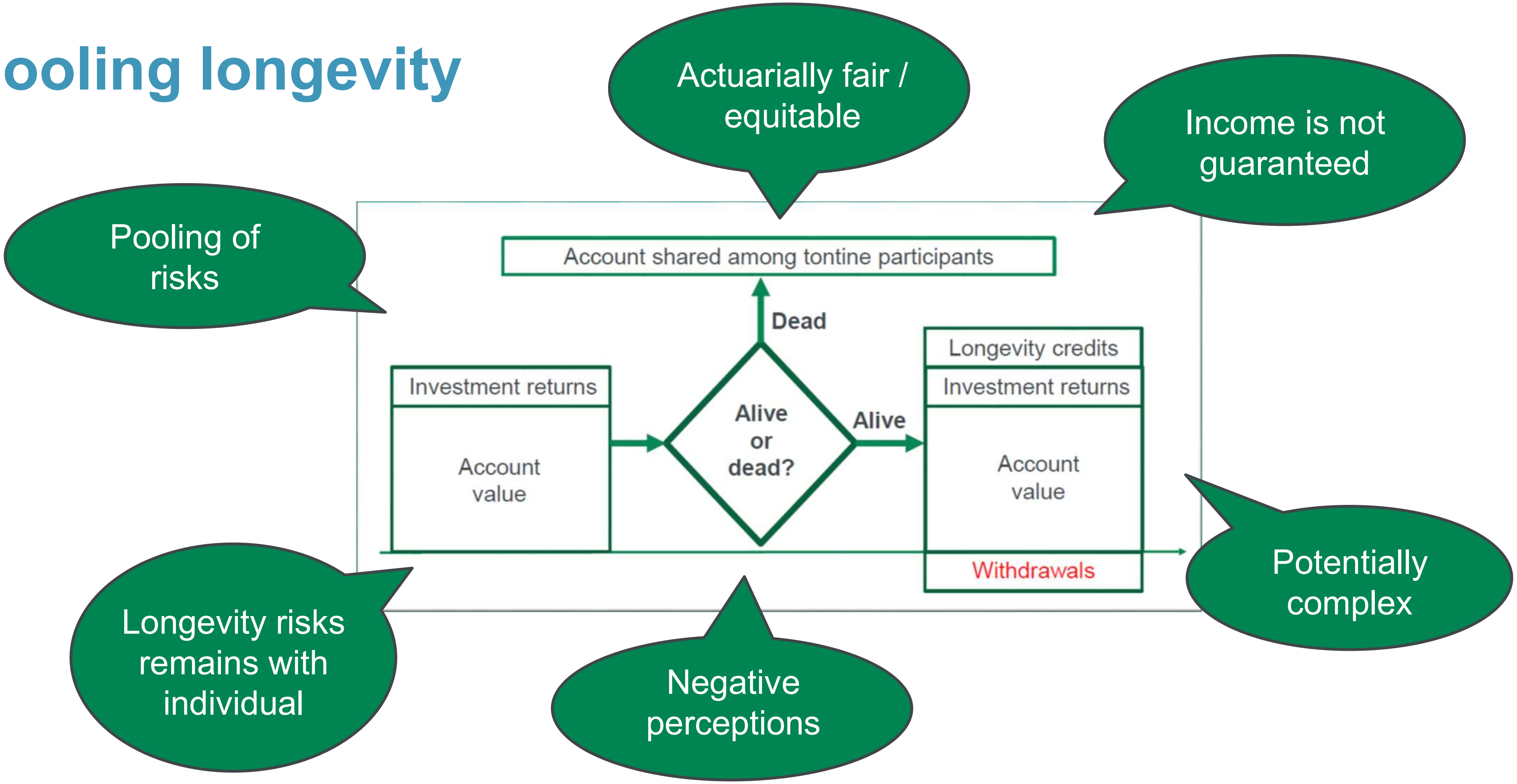
Pooling longevity



Source: Actuarial Research Centre presentation: "21st century retirement: Modern tontines"
https://www.actuaries.org.uk/system/files/field/document/3%20Oct%202018%20webinar.pdf

Collective Defined Contribution (CDC)

- Royal Mail: new UK-specific form of CDC
- It is a form of DC – no promises
- Collective investment and longevity risk pooling

- Potential for "decumulation only" CDC?
- DWP launched consultation – closes 27 March
- Detail is critical – eg options for surrender

Deferred annuities

Customer's view:

- Provide an income at a later defined date (on survival)
- Protects the customer's individual tail longevity risk
- Plan spending in the deferred period
- Allows customer's to stay invested & provides flexibility on remaining fund

Provider's view (cf immediate annuity):

- Lower single premium allows for lower £profit
- Protecting tail risk still requires majority of capital
- Therefore return on capital is lower
- Overall less attractive to sell

Making a market:

- Mortality cross subsidies make deferred annuities appear cheap
- Can deferred annuities work at a higher price?

Deferred annuities – smoker aged 70, £300k fund

Customer's view:

- Could use £150k to buy an immediate annuity of £12.4k p.a.
- A 15 year deferred annuity for the same income costs £26.0k*
- £274k left in the pot to flexibly manage income & remain invested

*targeting same expected customer return

Provider's view:

- Premium/reserves c17% of the immediate annuity premium/reserves
- But capital required is only c36% of the original amount
- Thus strain as a % doubles
- Reduces Return on Capital

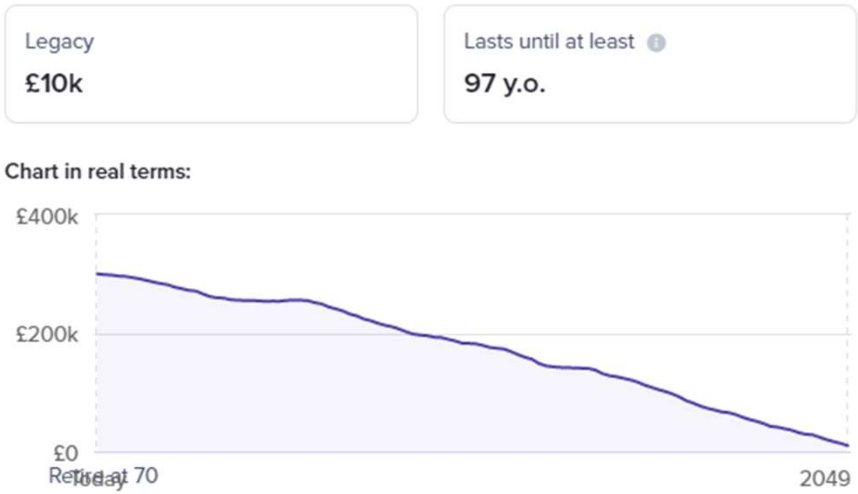
Making a market:

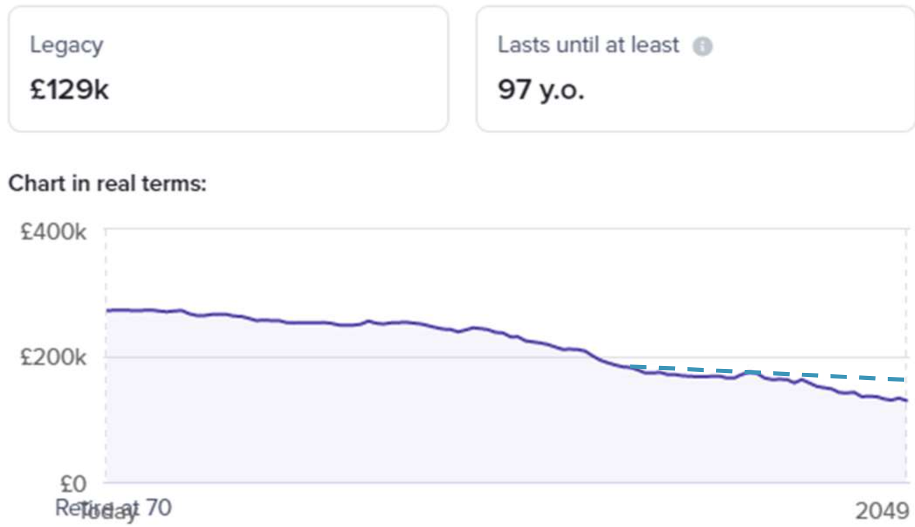
- Increasing the premium c£2.5k resolves this
- Would the customer be willing to pay £28.5k? (and keep the other £271.5k invested)

Case study – Drawdown vs Deferred Annuity

Median outcome – 50th percentile

50% Equities/50% bonds vs £271.5k (100% equities) + def annuity





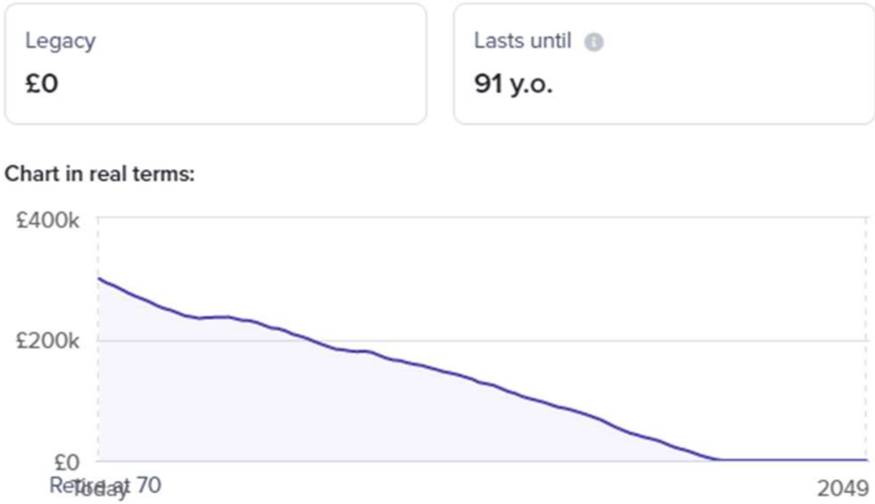
£10k legacy vs £129k legacy, flexibility, £21.5k guaranteed from 85

Source: Timeline Planning (900 scenarios across 108 years economic history, projection to age 97)

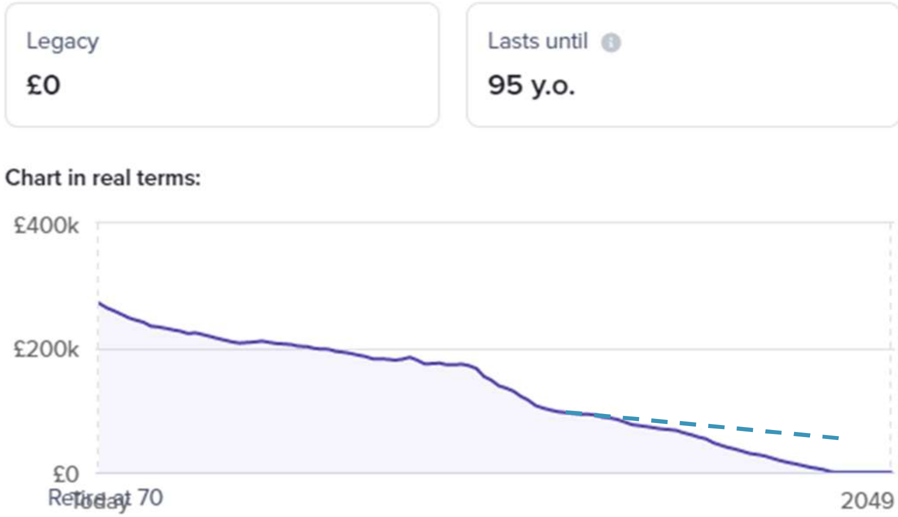
Case study – Drawdown vs Deferred Annuity

Pessimistic scenario – 30th percentile

50% Equities/50% bonds vs £271.5k (100% equities) + def annuity



Runs out at 91, no income



Manage funds flexibly + £21.5k income guaranteed from 85

Source: Timeline Planning (900 scenarios across 108 years economic history, projection to age 97)

Conclusions

1. Incorporating equity release and/or different forms of longevity pooling could be of interest
2. Combining drawdown and annuity provides a more optimal strategy than either alone
3. Remaining questions on how much and when to annuitise

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.