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The future of the individual annuity market

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Hymans Robertson

21 November 2019

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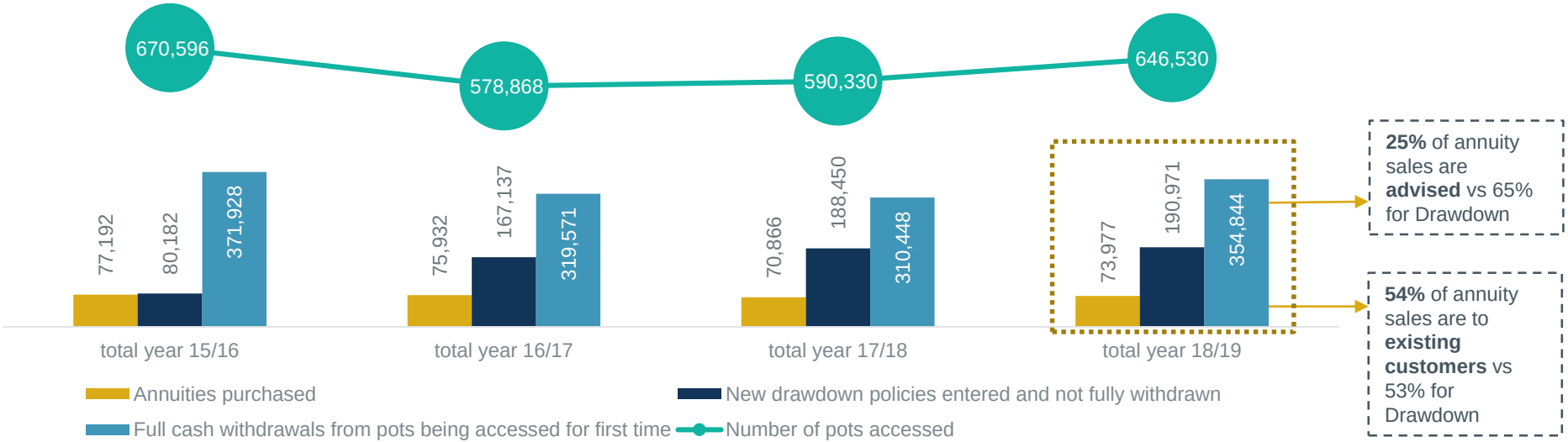
Retirement market since pension freedoms

Annuity sales since 2015



25% of annuity sales are **advised** vs 65% for Drawdown

54% of annuity sales are to **existing customers** vs 53% for Drawdown

Annuities continue to be bought by customers

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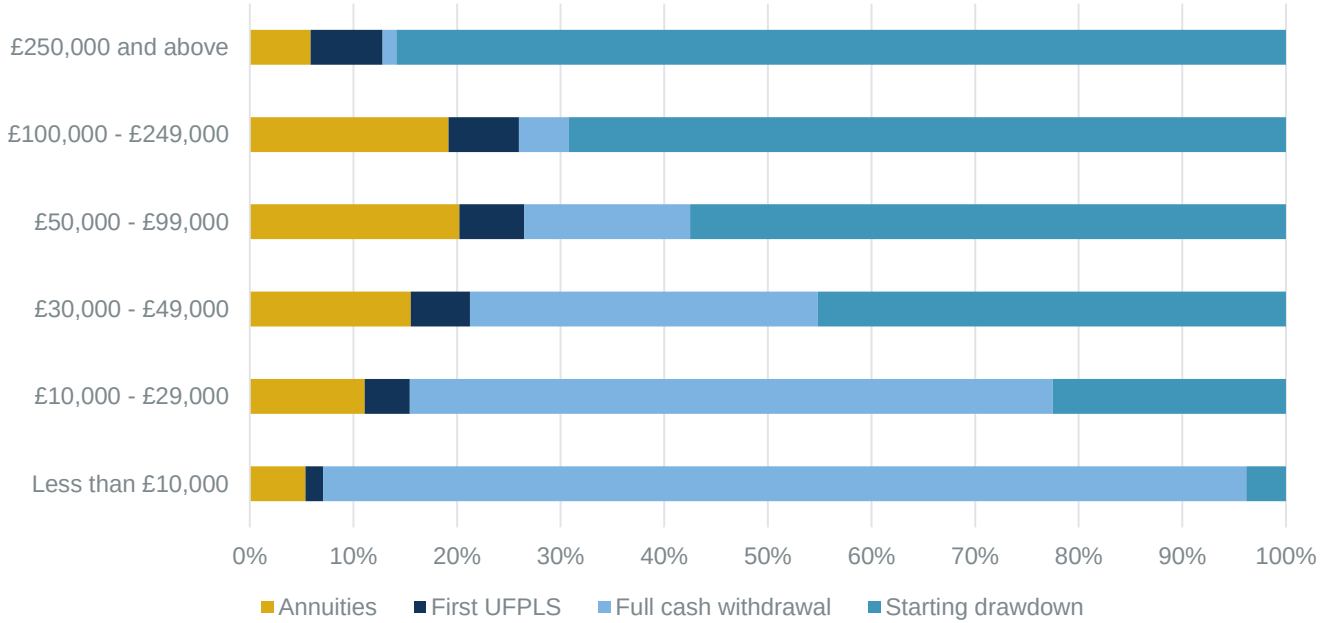
Source: FCA Retirement Income Market Data (September 2019)

How pots have been accessed



Composition of product purchases made between October 2018 and March 2019

Annuities play an important part for medium sized pots

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Source: FCA Retirement Income Market Data (September 2019)

Current trends – what do retirees want?

Avoiding the risk of running out of fund

What to invest in

How long to plan for

Flexibility

Generating the right level of income

Inheritance

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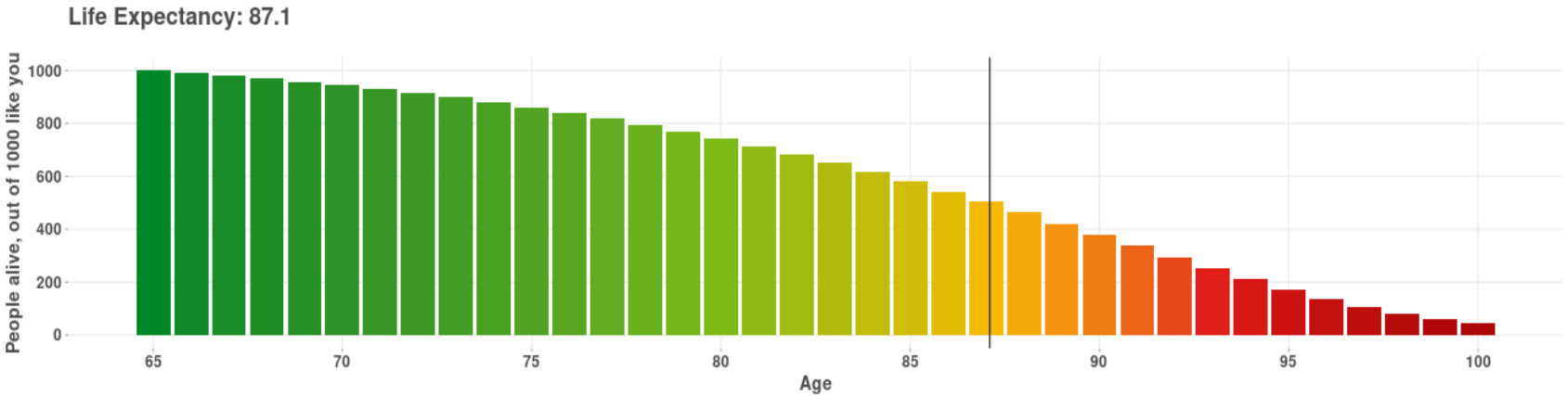
Variability of life expectancy

Life Expectancy | Pot Projection | Objective Likelihood | Suggested Income | Assumptions



This chart illustrates the uncertainty surrounding the client's age at their time of death. If we were to start with a group of 1000 people (all with the same age, gender, postcode and health status as the client) the vertical bars represent the number of people in that group that are expected to still be alive at each age.

Longevity risk sits with individuals – not easy to manage

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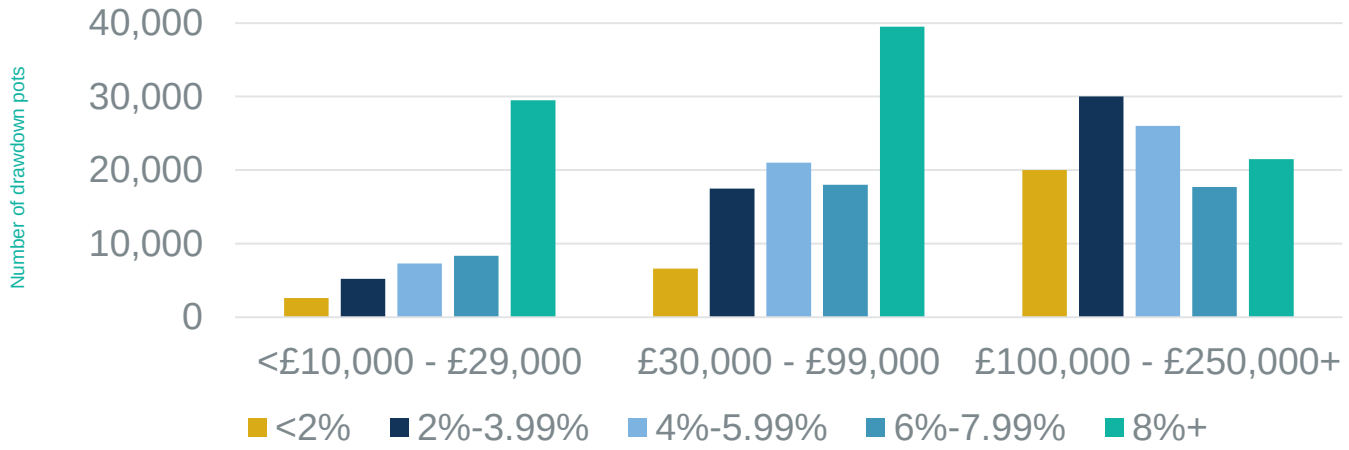
Source: Club Vita life expectancy API

Regular withdrawal rates by pots size



Withdrawal rate since Pension Freedoms has averaged c. 6%

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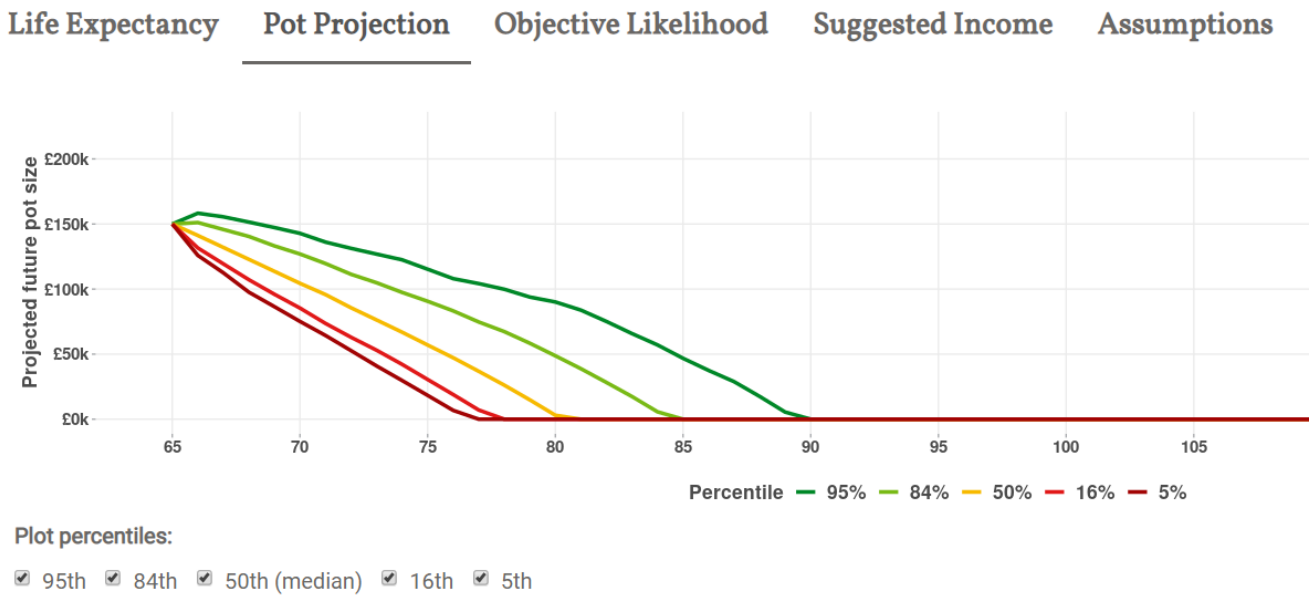
Source: FCA Retirement Income Market Data (September 2019)

Drawdown with 8% withdrawals



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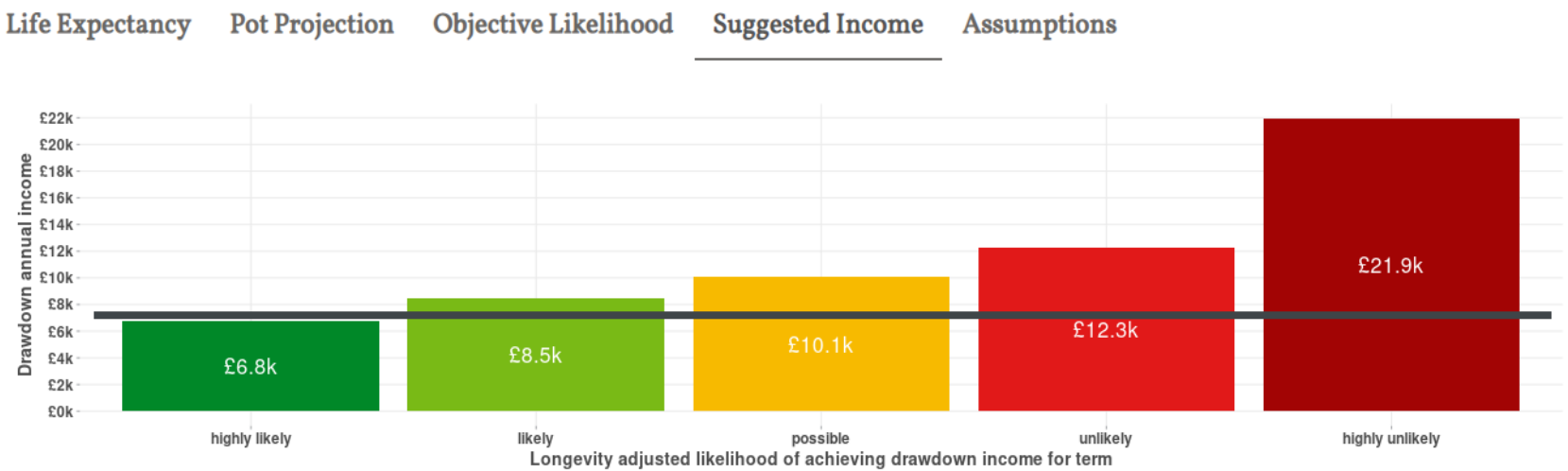
Source: Hymans Robertson Track and Go tool

Drawdown with cautious investment vs annuity



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Source: Hymans Robertson Track and Go tool

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A role for deferred annuities?

Deferred annuities – definitions

- The deferred annuity is a contract that is purchased by an individual, at retirement, but does not pay until the annuitant survives to a pre-specified age.
- Regarded as insurance against living longer or into the tails of the life expectancy, so using the term ‘tail annuity’.

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CASS research

DOCTORAL THESIS

The impact of behavioral factors on annuitisation decisions and decumulation strategies

Author:
Anran CHEN

Supervisors:
Prof. Steven HABERMAN
Prof. Stephen THOMAS

September 2017

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Deferred annuity – product idea

- Long term deferred annuity which is more like an insurance for long living.
- Relatively small part of pot at retirement is used to pay for the income stream which won't kick in until age 90 (say).
- If the individual doesn't survive until this age, then doesn't receive anything.

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Potential costs

	Deferral Age			
Age	65	80	85	90
65	£150,000	£54,500	£33,000	£17,000

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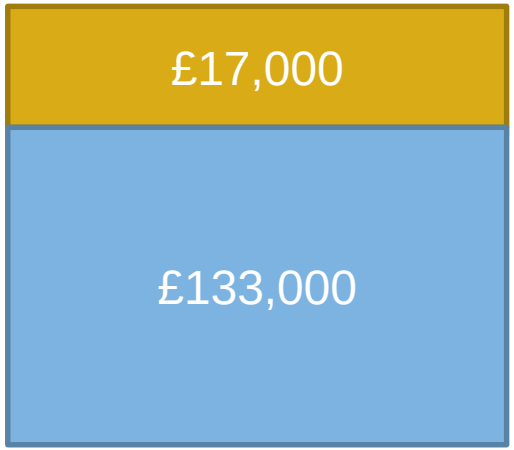
Source: Hymans Robertson calculations.

Revised retirement plan

- Retirement pot of £150,000 – now split between drawdown and tail annuity



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Source: Hymans Robertson calculations.

Impact on overall retirement plan

Life Expectancy | Pot Projection | Objective Likelihood | Suggested Income | Assumptions

Plus a guaranteed £7.5k from age 90

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Source: Hymans Robertson Track and Go tool

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Challenges for deferred annuities

Acknowledging the difficulties

Sourcing assets

Capital intensive

Sourcing of reinsurance

Matching Adjustment

Member optionality

Consumer understanding

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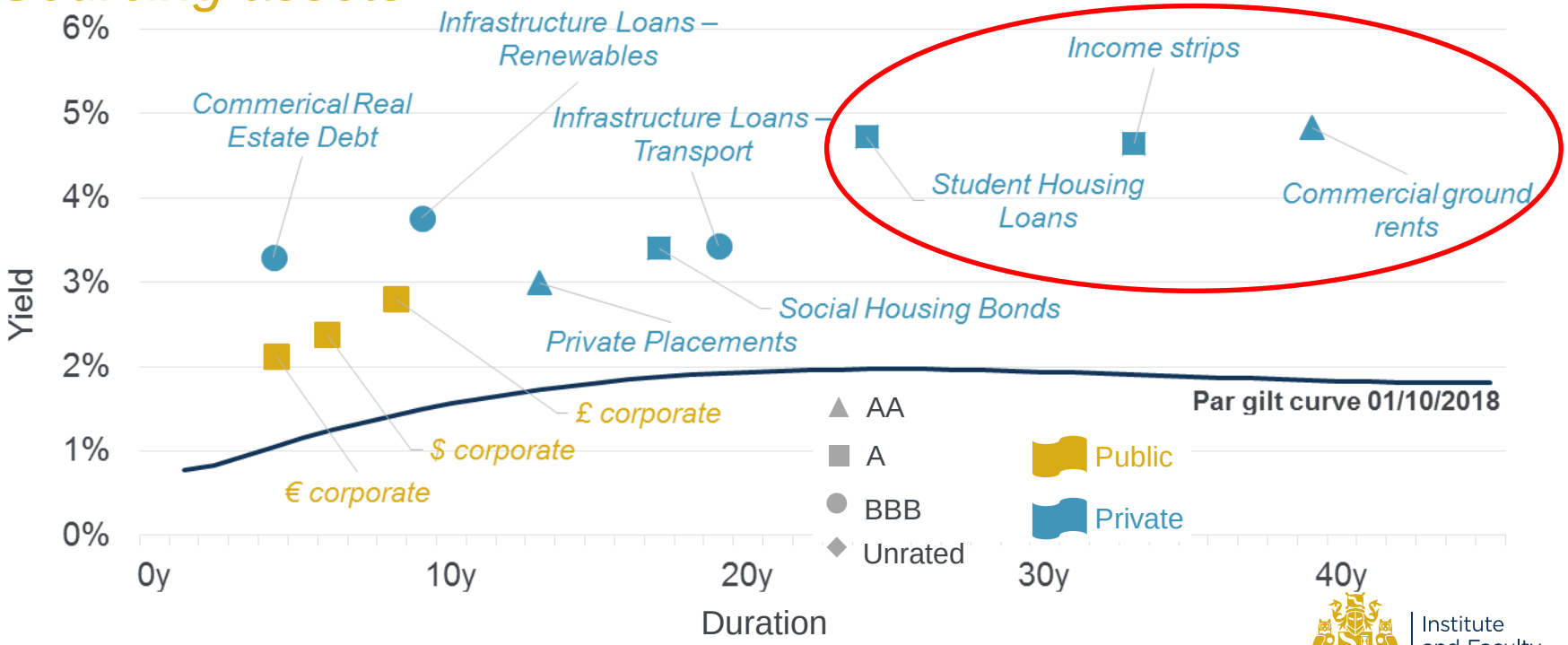
Challenge #1

Sourcing assets

Chart is for illustrative purposes only



Source: Hymans Robertson research, October 2018.

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Challenge #1

Sourcing assets

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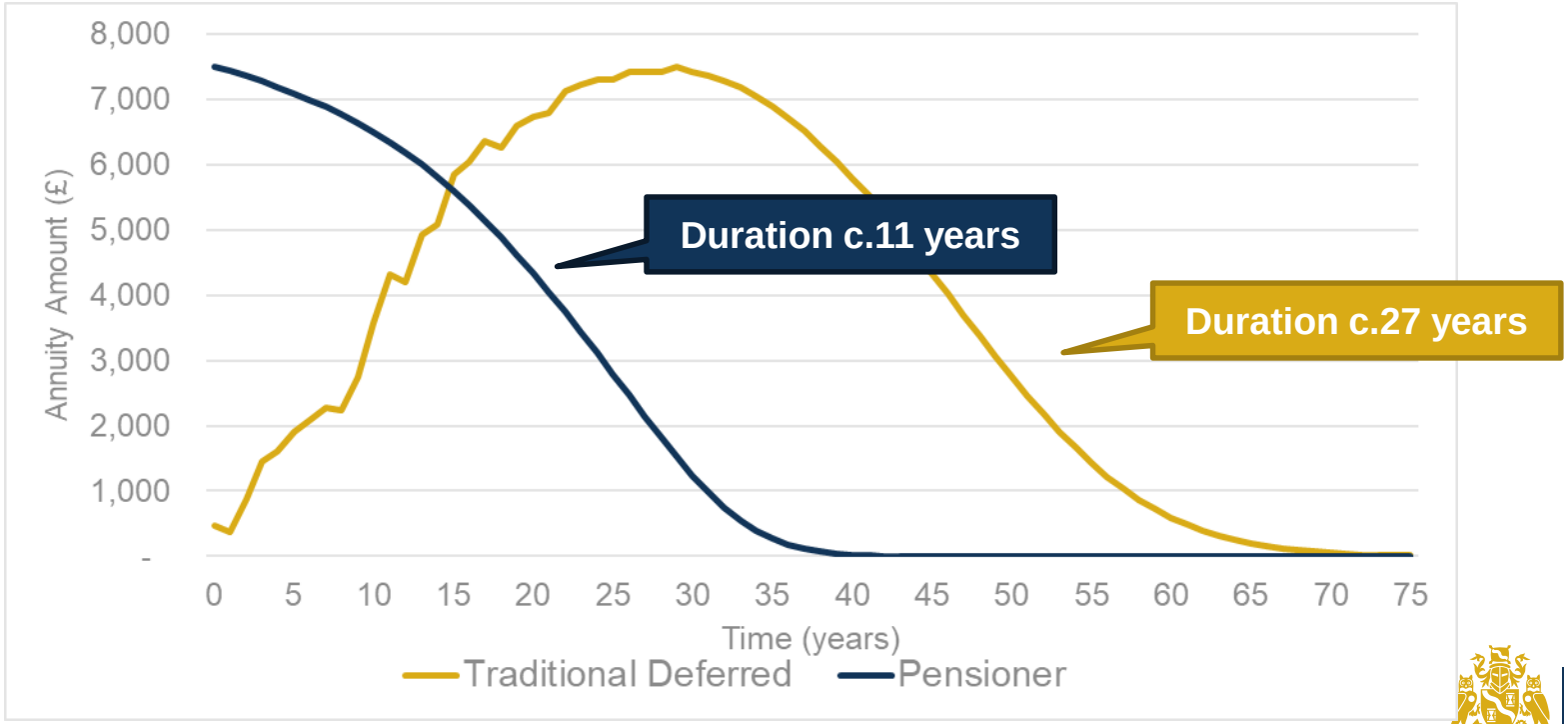

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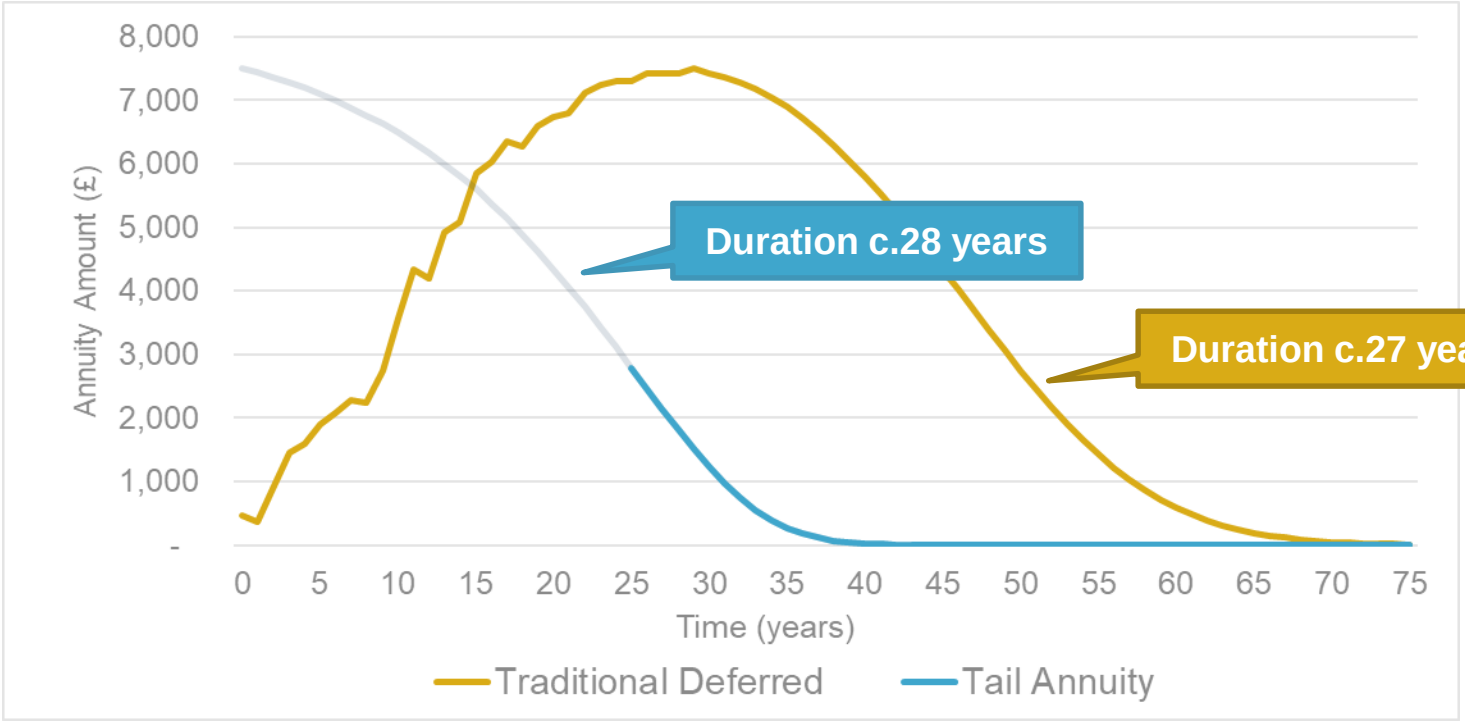
Source: Hymans Robertson calculations.
Pensioner life based on life aged 65 with starting annuity of £7,500 per annum
Deferred life based on life aged 52 with starting annuity of £7,500 per annum

Challenge #1

Sourcing assets

Chart is for illustrative purposes only



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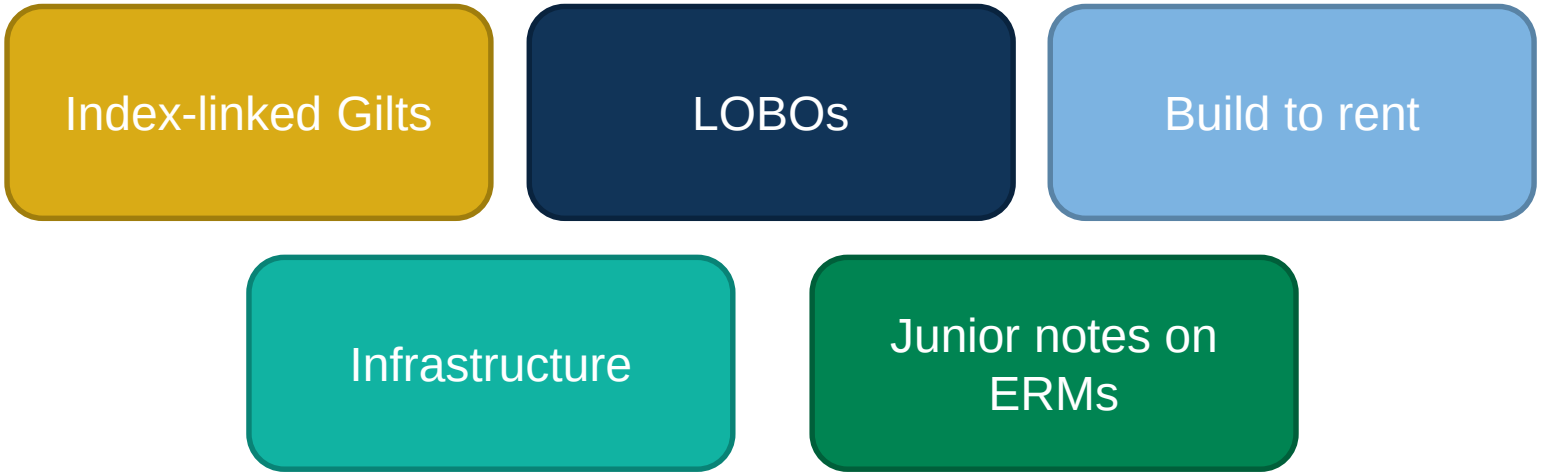
Source: Hymans Robertson calculations.
Tail annuity life based on life aged 65, deferred for 25 years, with starting annuity of £7,500 per annum
Deferred life based on life aged 52 with starting annuity of £7,500 per annum

Challenge #1
Sourcing assets



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Challenge #1
Sourcing assets

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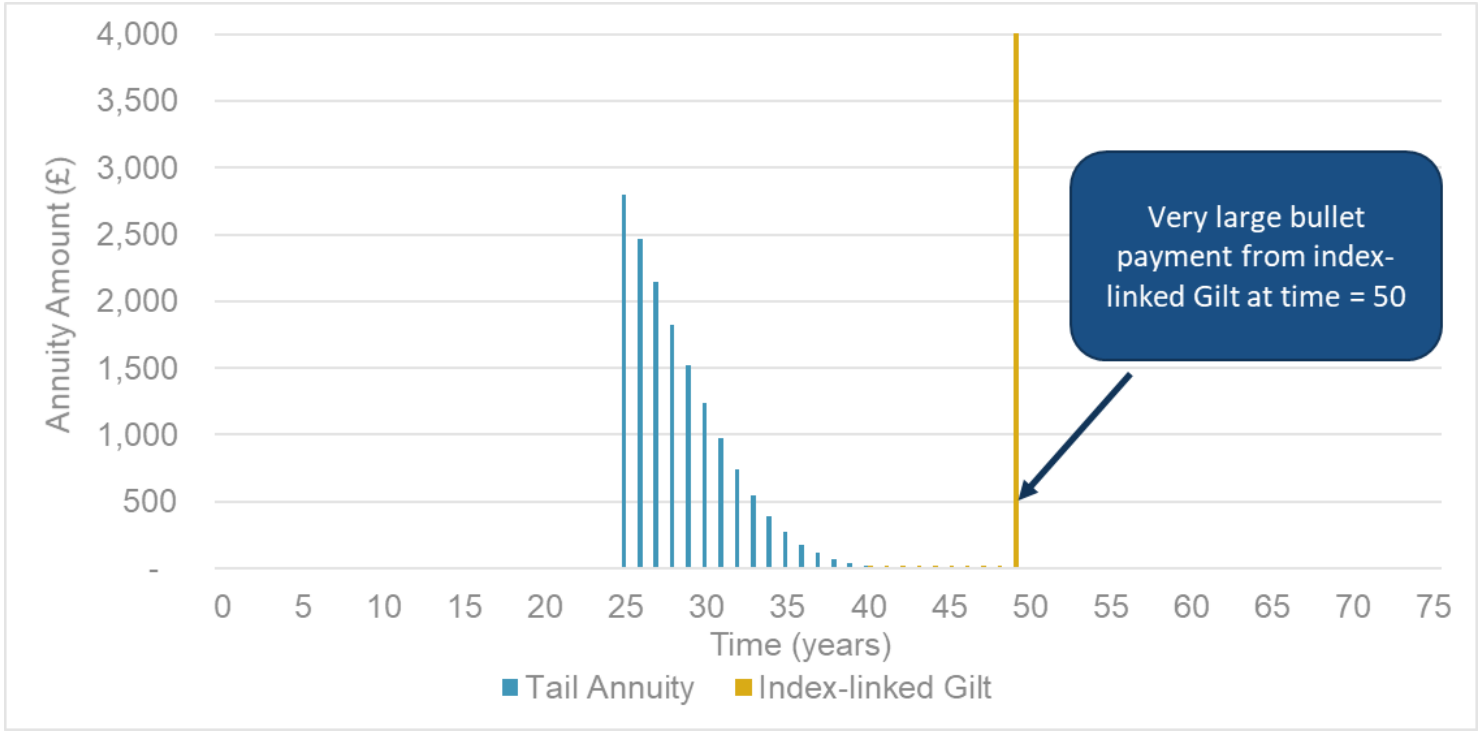

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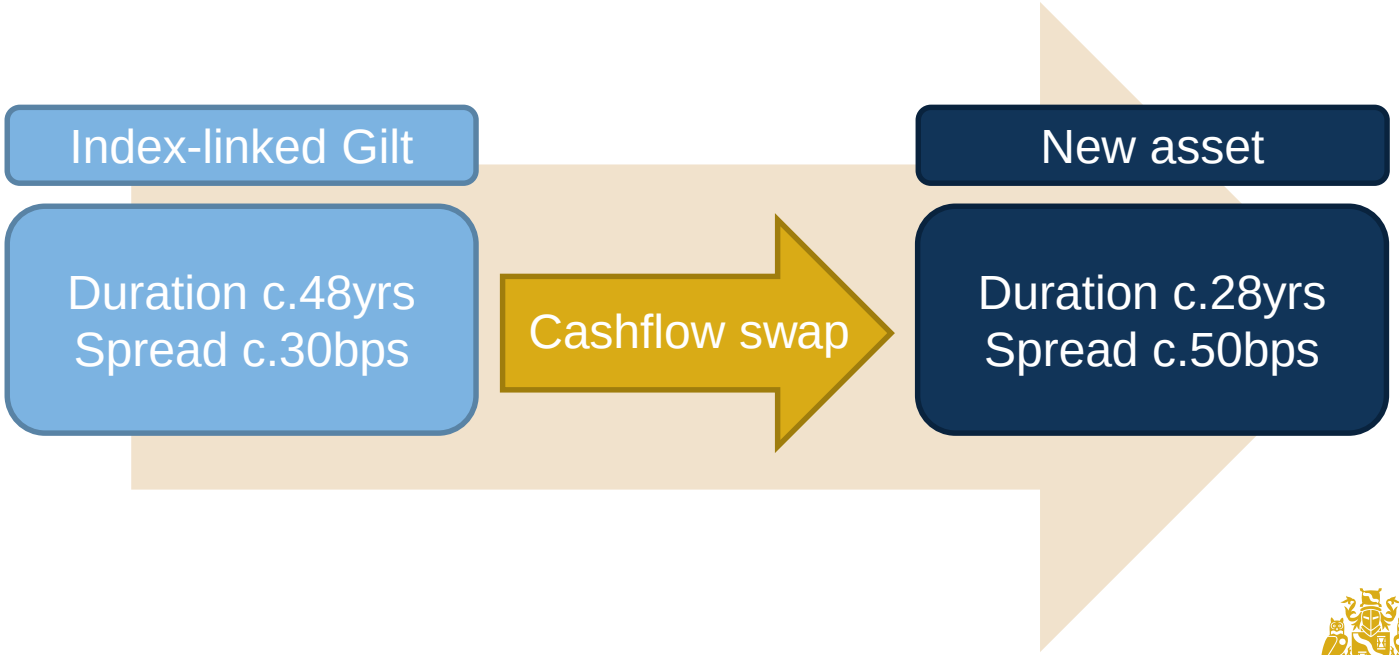
Source: Hymans Robertson calculations based on life based on life aged 65, deferred for 25 years, with starting annuity of £7,500 per annum and an index-linked gilt with the same PV (discounted with the RFR)

Challenge #1

Sourcing assets



For illustrative purposes only.

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Source: Hymans Robertson calculations based on life based on life aged 65, deferred for 25 years, with starting annuity of £7,500 per annum and an index-linked gilt with the same PV (discounted with the RFR)

Challenge #2
Capital intensive

Premium = c.150%*BEL to achieve 10% RoC vs. c.112% for immediate annuity

Risk Margin PV01 = c.0.30% vs. c.0.15% for immediate annuity

Risk Margin = c.40% vs. c.5% for immediate annuity

SCR = c.40% vs. c.11% for immediate annuity

For illustrative purposes only. Source: Hymans Robertson calculations.
Tail annuity life based on life aged 65, deferred for 25 years, with starting annuity of £7,500
Immediate annuity life based on life aged 65 with starting annuity of £7,500
Only Longevity and Credit risk assumed, calculated using standard formula stresses

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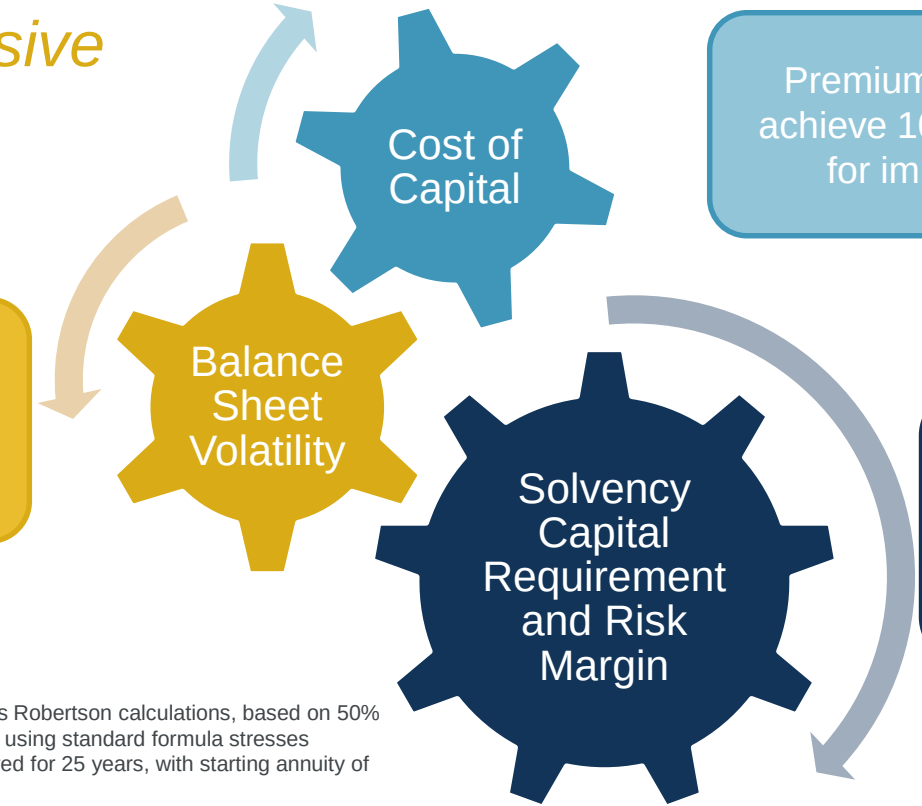
Challenge #2
Capital intensive



Premium = c.130%*BEL to achieve 10% RoC vs. c.109% for immediate annuity

Risk Margin PV01 = c.0.30% vs. c.0.15% for immediate annuity

Risk Margin = c.20% vs. c.2% for immediate annuity

SCR = c.20% vs. c.7% for immediate annuity

For illustrative purposes only. Source: Hymans Robertson calculations, based on 50% longevity reinsurance, with 5% fee, calculated using standard formula stresses
- Tail annuity life based on life aged 65, deferred for 25 years, with starting annuity of £7,500
- Immediate annuity life based on life aged 65 with starting annuity of £7,500

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Challenge #3

Sourcing of reinsurance

Number of participating reinsurers

Low initial volumes of business

Size of reinsurance fee

Lack of experience data

Structure of reinsurance fee

Selection risk

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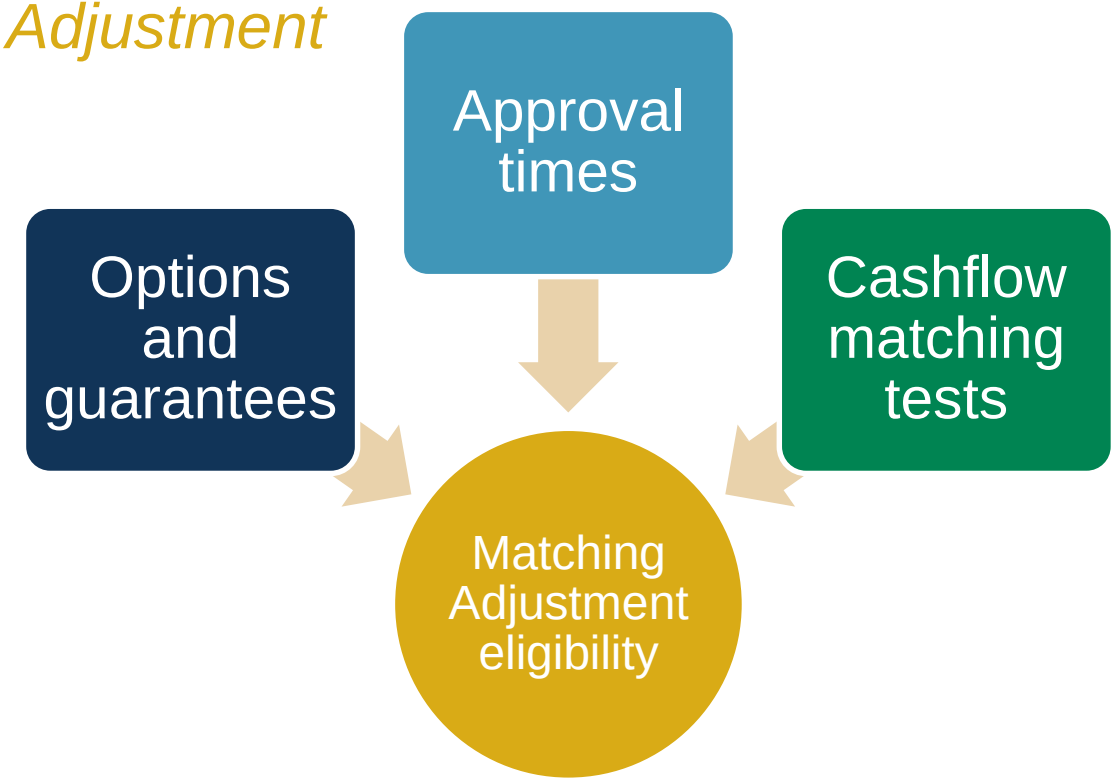
Challenge #4

Matching Adjustment



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Challenge #5

Member optionality

- Lump-sum on death
- Guaranteed payment period
- Transfer to a spouse
- Commutation

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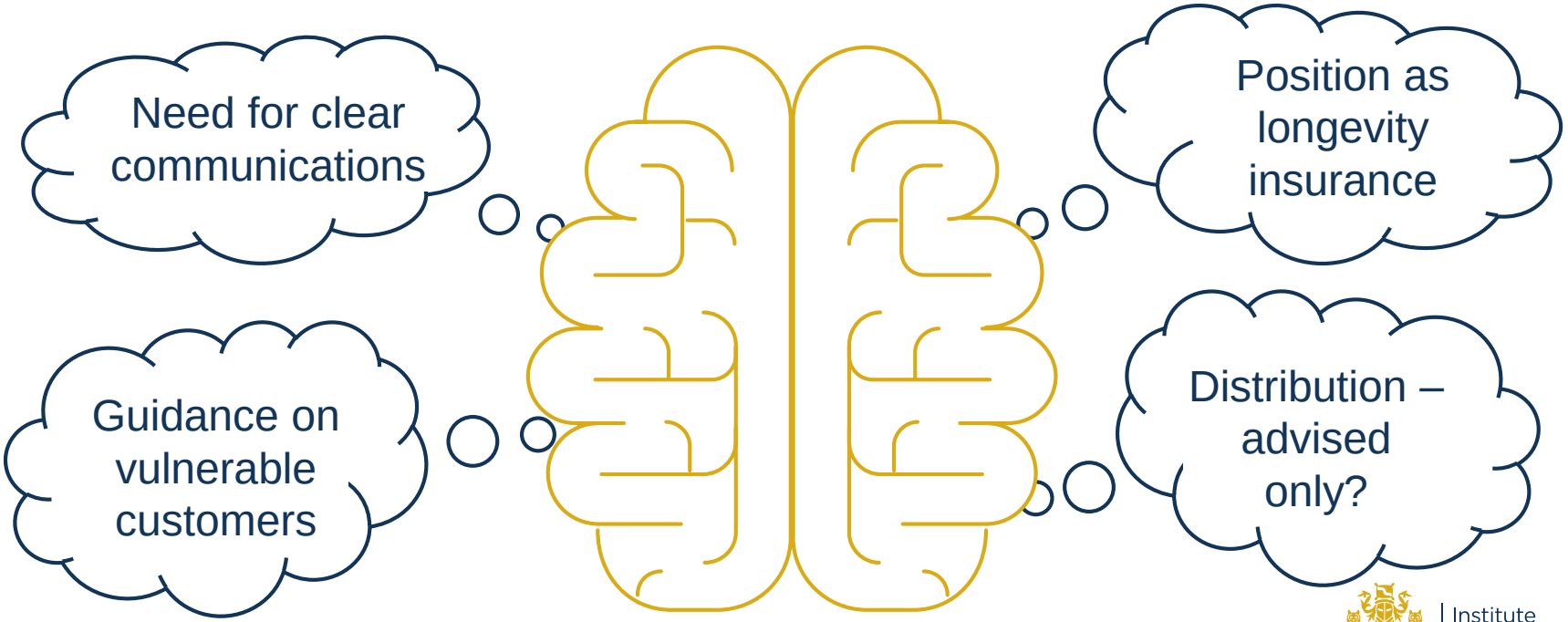
Challenge #6

Consumer understanding



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Questions

Comments

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