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E2: What happens when the money runs out?

Ian Collins Pacific Life Re

26 June 11:40-12:40

Hilton, Glasgow



What happens when the money runs out?

- UK “at retirement” market & drivers of change
- US & other overseas markets
- The case for UK Deferred Payment Annuities
 - Consumer & advisor perspectives
- Technical considerations
- Conclusions





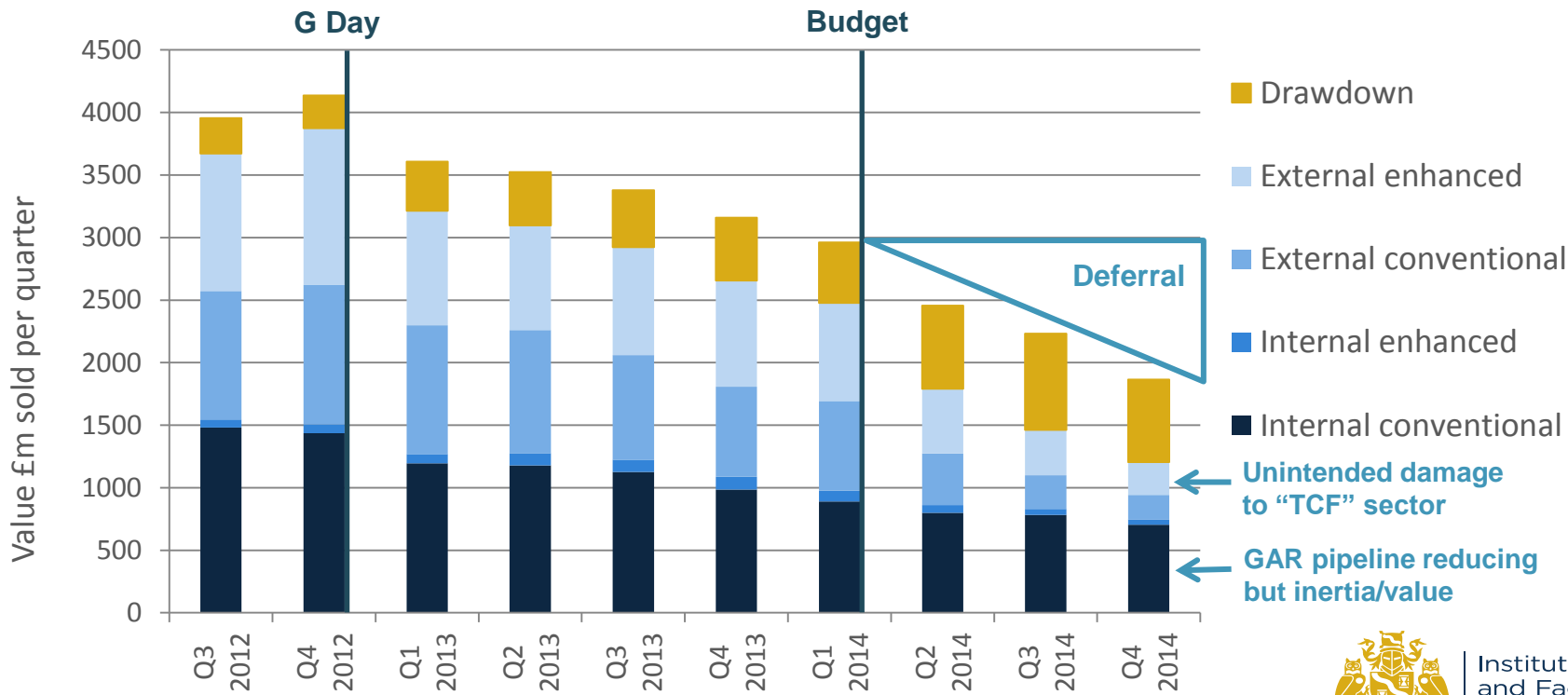
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UK “at retirement” market

Drivers of change

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Annuities & Drawdown



Projected “At Retirement” Market

Reduced but material demand for annuities?

2023 “at retirement” market:

~£50bn* pa (£16bn* 2013)

2023 annuity market:

~£11bn* pa (£12bn 2013)

Main source – occupational DC schemes



Projected at retirement cohort
+ future contributions & auto enrolment
+ investment income

Current at retirement cohort

Fund £k	2013 £bn	Fund growth	Relative annuity propn.	2023 £bn
<10	0.6	313%	16%	0.3
10-30	2.4	313%	16%	1.1
30-100	5.7	313%	33%	5.8
100-250	2.4	313%	33%	2.4
250-500	0.7	313%	50%	1.0
500+	0.2	313%	50%	0.4
Total	12.0	313%	30%	11.0

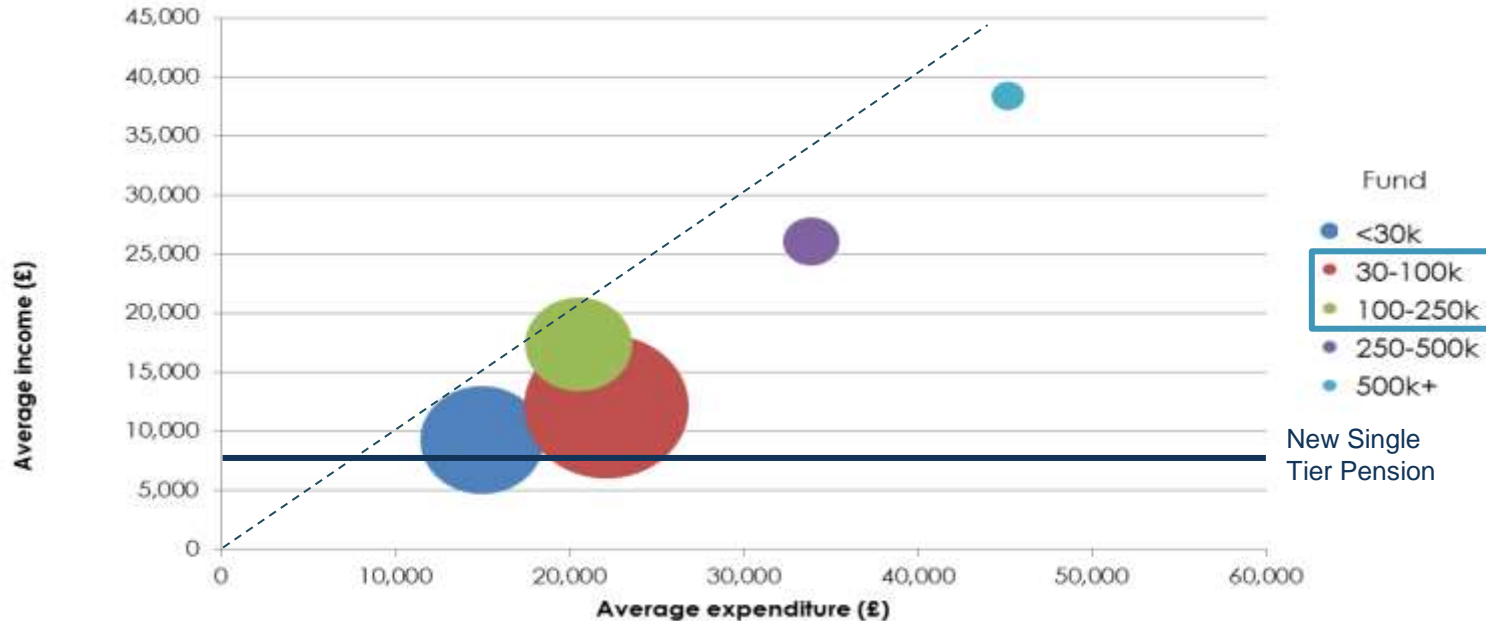
Predicted behavioural change



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* Source ABI/Towers Watson estimates (Chris Fordham)

Annuity market segmentation



- The size of each bubble reflects the aggregate size of each market annuity segment (ABI 2013 data)
- The income amounts include state pension and estimated DC fund annuity income assuming 35% enhanced annuities



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Towards an open market

Financial Conduct Authority



Thematic Review

TR14/20

Annuities sales practices

December 2014



Financial Conduct Authority



Thematic Review

TR14/2

Thematic Review of Annuities

February 2014



- Stronger signposting to an underwritten OMO



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Other Drivers?

- Guidance & wider “advice” interactions
 - Further fiscal changes?
 - Tax free lump sum
 - Single vs. marginal rate tax relief
 - Auto-enrolment creates a new customer segment?
 - Secondary market for annuities
-
- Defined Ambition/Collective DC
 - Sponsor appetite?
 - Eventually...what happens when the money runs out?



Solutions – key elements

- **Pure investment** solutions - maximise decumulation as a longevity hedge e.g. protected funds
- **RISA's** – simple & popular accumulation vehicle rolling on
- “Vanilla” **drawdown account** – simple default option for small pots then fall back on State
- **Equity release** – last resort asset & shifting attitudes towards inheritance
- **Temporary Annuities** – certain payments “match” high outgo phase
- **Variable annuities** – existing UK provider base (Axa, Met Life & Aegon UK)
- **Immediate Annuities** – buy later potential enhancement due to health, clearer outgoings
- **Care needs** annuities – worry about LTC when it happens
- **Deferred Payment Annuity** – simple & efficient longevity insurance





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Overseas markets

Retail longevity protection

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Annuities vs. other choices

Country	Lifetime Annuities	Income Drawdown	Lump Sums	MWR estimate	Annuity Take up	Comments
Netherlands	Mandatory	x	[x]	90-99	[100%]	Small pots <€12k can be taken as LS
Singapore	Mandatory	x	x	99.7	100%	
Switzerland	✓ default	x	✓	108.2	80%	Cross-subsidies with accumulation
Chile	✓ default	✓ restricted	x	96.7	60%	Includes ~30% deferred (short periods)
Ireland	✓ low income	✓ high income	✓ 25% TF	87.4	30%	
UK	✓	✓	✓ 25% TF	?!	[30%]	Estimated excl. TF LS for pots >£30k
Canada	✓	✓	✓ restricted	98.1	[30%]	DC pots still minority funding source
USA	✓	✓	✓	92.7-97.4	9%	Includes deferred payment annuities
Australia	✓	✓	✓	98.6-101	1%	





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US market



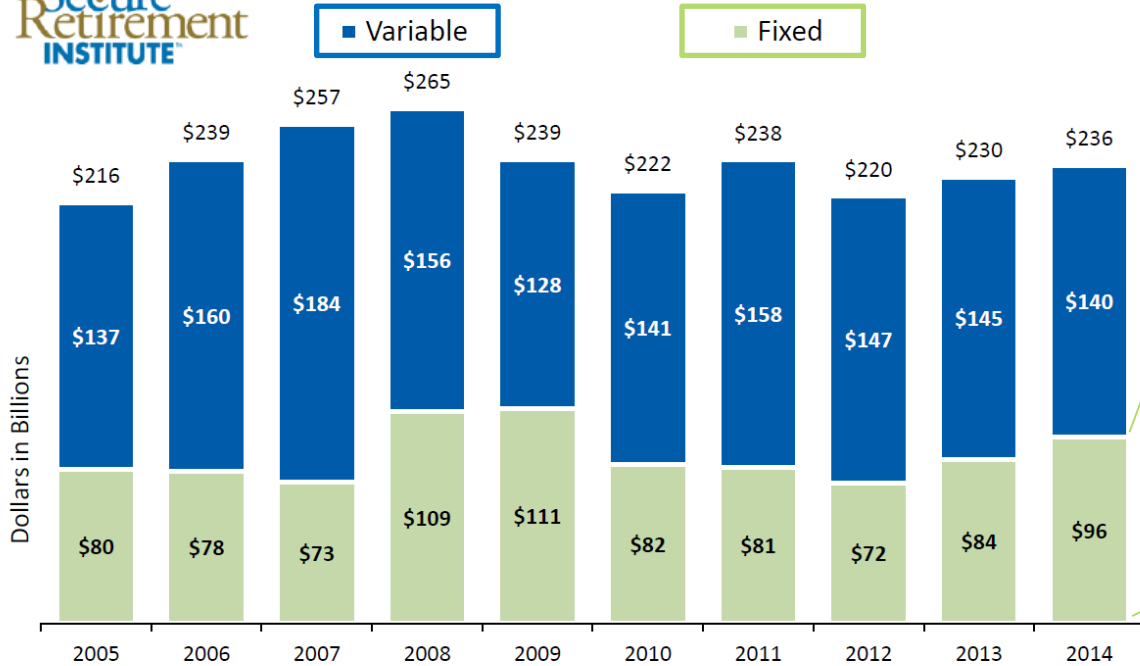
Retail longevity protection

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US retail retirement market



U.S. Individual Annuity Sales - Annual



Fixed products (2014 \$bn)

Fixed (accumulation)	77.9
Immediate income	9.7
Deferred income	2.7
Structured settlements	5.4
Fixed total	95.7



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Genesis of the DIA in the US

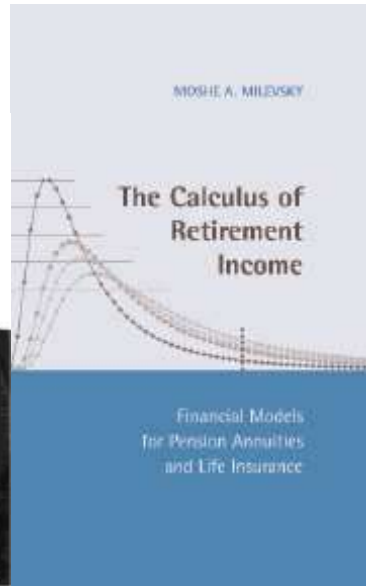
EVALUATING THE ADVANCED LIFE DEFERRED ANNUITY

An annuity people might actually buy

Guan Gong and Anthony Webb

CRR WP 2007-15

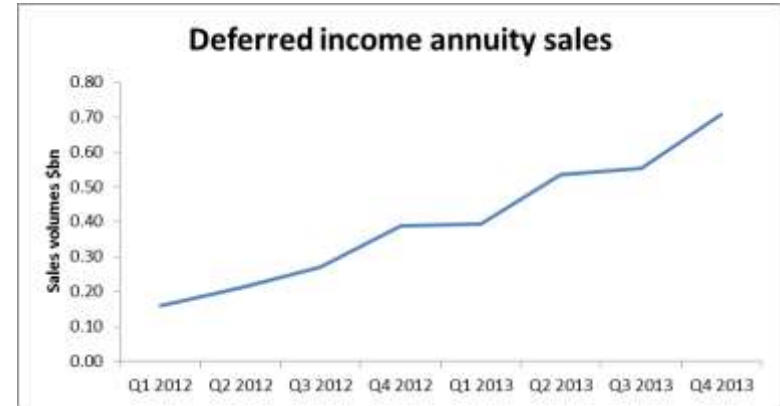
“The ALDA’s attractiveness is that it provides a lot of longevity insurance at a relatively low cost. It also makes decumulation much simpler during the period before the ALDA payments commence.”



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US Deferred Income Annuities

- Initial market offering pre 2011:
 - “**Longevity Insurance**” or “**Advanced Life Delayed Annuity**” ~\$50m pa market
 - “Vanilla” long deferred annuities bought at retirement vesting ~age 85
- New York Life launch Nov 2011:
 - “Guaranteed Future Income”
 - Widened target market to those **pre and nearing retirement**
 - **Shorter deferred periods** more popular
 - Increased product flexibility & features – **RoP popular**
- Rapid growth to 2014:
 - New York Life dominate (USD 2bn* reached Oct 2014)
 - ~15 companies now active
 - General adverse impact of yields Q4 2014



NYL Guaranteed Future Income (GFI)

• Options at PoS:

- Single or joint life (**40-99%** reversion)
- Benefit increases: **1-3% pa** fixed
- Deferral **2-40** years subject to age
- Death benefits pre vesting: **RoP** or **Nil**
- Income payment post vesting:
 - Lifetime only
 - Guarantee period (10-30 years)
 - Cash/Instalment refund

• Options beyond PoS:

- **Additional premiums**
 - No future guarantee/RMD constraints
- **Accelerate** or **Defer** vesting – **RoP version - once only**
 - Accelerate to **13 months** from **last premium** or later
 - Defer up to **5 years** from original choice

Rates vs. Immediate:

Rates effective as of 02/23/2015¹

Issue Age	Deferring Income Start Date	Annual payout rate on income start date
55	5 years	6.30 %
	10 years	8.80 %
60	5 years	6.90 %
	10 years	10.20 %
65	5 years	7.80 %
	10 years	12.10 %

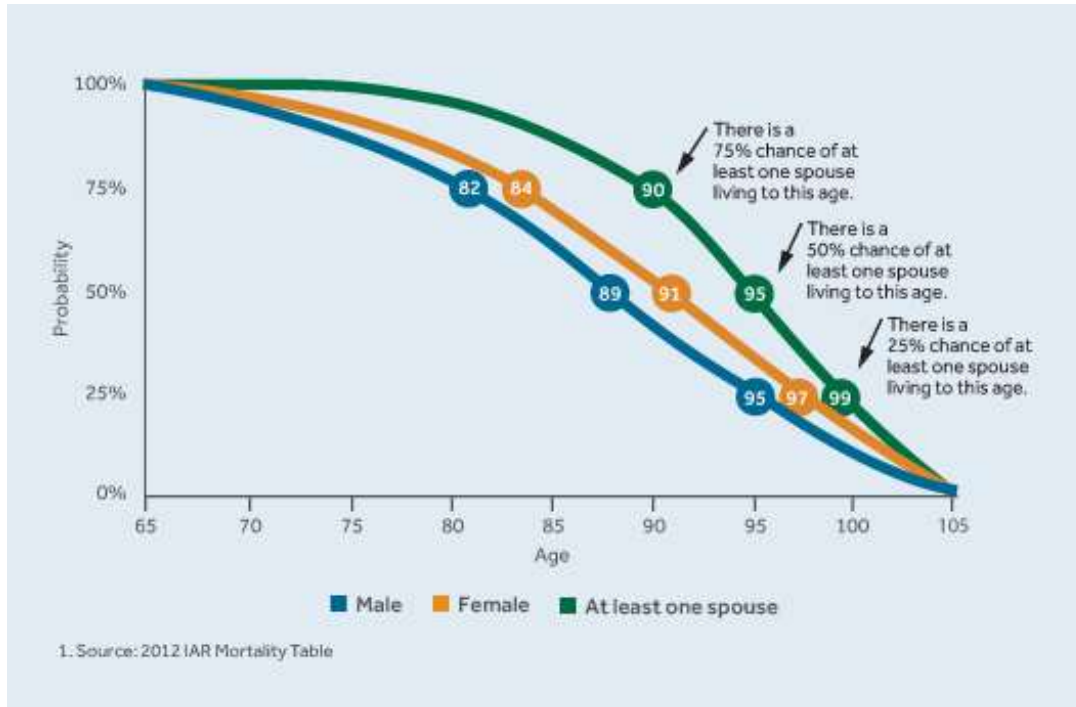
Rate effective as of 02/23/2015²

Issue Age	Current Annual Payout Rates
65	5.80 %
75	6.80 %
85	7.70 %



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NYL Guaranteed Future Income (GFI)



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Birth of the QLAC

- IRS Required Minimum Distribution (RMD) rules for 401(k) & IRAs
 - Must commence withdrawal shortly after age 70.5 (by 1st April in year following)
 - Minimum amounts based on age & fund value which are generally taxable
- Legislative boost in July 2014:
 - Effective removal of fiscal barriers within 401(k) & Individual Retirement Accounts
 - AIG launch first **Qualifying Longevity Annuity Contract** “American Pathway” Nov 2014
- QLAC status & key requirements:
 - QLAC excluded from RMD calculations
 - Maximum 25% of fund up to \$125k
 - Deferral period from 12 months up to age 85
 - **No commuted lump sum or cash surrender benefits**
 - Scope to offer specified death benefits e.g. RoP, spouse or beneficiary annuity
 - No investment linkage (but can inflation link)



AIG American Pathway DIA

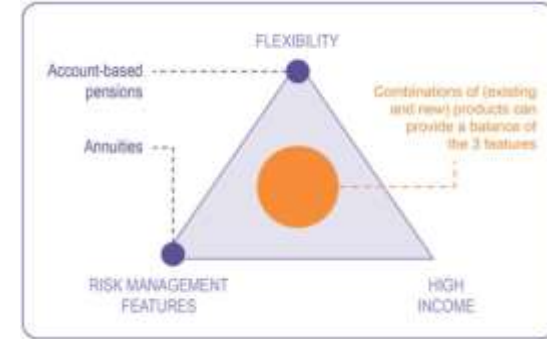
- Available both as QLAC and in other forms
- **Options at PoS (QLAC):**
 - Single or joint life (spouse)
 - Benefit increases: **CPI** or **1-5% pa** fixed post vesting
 - Death benefits pre vesting: **RoP** or Nil
 - Income payment post vesting: Lifetime only, Lifetime with cash refund
- **Options beyond PoS (QLAC):**
 - Accelerate or defer vesting **within 5 years of original choice** (subject to QLAC rules) - once only
- **Other features (non QLAC):**
 - Post vesting fixed term, guarantee periods & instalment refunds
 - Post vesting **advance payment** of next **6 months - twice only**



Australia

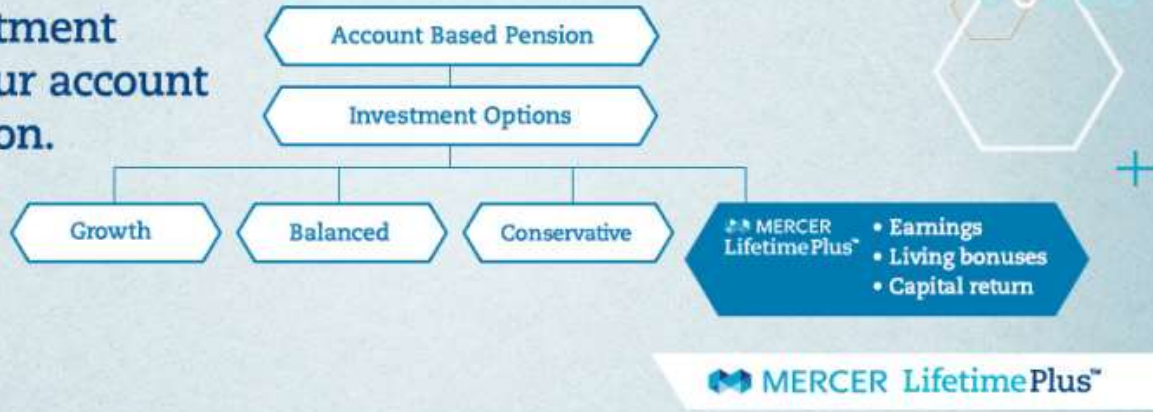


- Account-Based Pensions (ABP) dominate currently
- Very modest lifetime annuity market: Challenger, Commlnsure + little else
- Deferred Life Annuities (DLA) development subject to adoption of potential tax rule changes:
 - To level the playing field between superannuation assets and DLA's wrt investment earnings
 - See “Longevity: A reinsurers perspective” Leas/McMahon (May 2013)
- Financial System Inquiry recommendations Dec 2014 (inter alia):
 - Require superannuation trustees to pre-select a comprehensive income product for members (**CIPR default option**)
 - CIPR vision: a combination of products enabling retirees to balance high income, risk management and flexibility
 - **Impediments to product development should be removed**
 - Key new longevity components considered DLA and pooled Group Self-Annuity (GSA)



MERCER LIFETIMEPLUS™

It's an investment option in your account based pension.

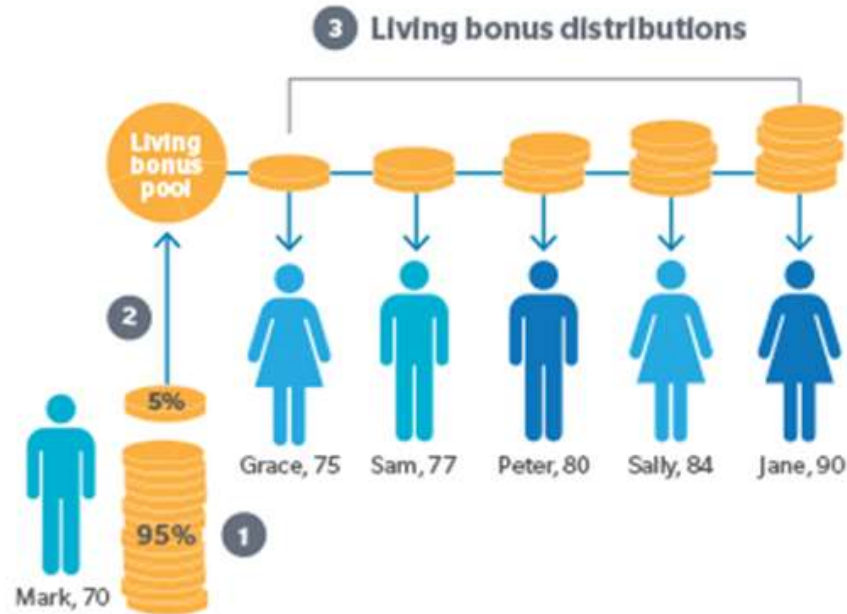


MERCER LifetimePlus™



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MERCER LIFETIMEPLUS™



- 1 Mark exits Mercer LifetimePlus and leaves 5% of his initial investment in Mercer LifetimePlus. The remaining 95% is paid to his beneficiaries.
- 2 The 5% that is left behind forms part of the living bonus pool that comprises of Mark's 5% and deductions from other investors who have left.
- 3 Each active investor receives a share of the living bonus pool based on their age, sex, amount invested and duration of their investment. The living bonus pool is distributed in full to all active investors every six months.





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The case for UK DPA's

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Already here?

DEFERRED CARE PLAN

A regular income to help pay care fees from an agreed date in the future

The Deferred Care Plan is a long term insurance product which will pay a regular, tax-free* income to your registered care provider from a selected date in the future. The amount you will receive is agreed at outset and once payment has begun, will continue for the rest of your life, regardless of how long that is.

You can choose how long you want to defer receiving the income for – anything from 1 year to 5 years. The longer the deferment period, the lower the cost of the Care Plan. However, when deciding whether or not to choose a deferred plan, you should consider that if you die after the first six months but before the end of the deferred period, your estate will not get back any of the money you invested in your plan.

If, once the payments have started, you leave care at any point the income will be paid directly to you. In this situation the income would lose its tax-free* status. However, it can be converted back to being tax-free should you return to the care of a registered provider again at a later date.

A KNOWN INCOME TO HELP COVER THE COST OF CARE IN THE FUTURE



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*Source: Partnership Assurance

Here ages ago?

Longevity Income Plan

“... the unique feature is that **surviving policyholders benefit from the deaths of other policyholders**. An individual who does survive to age 95 can achieve an extra return equivalent to +5% pa, according to Life Trust, which should certainly help to pay for a glass of port or two in extended old age.”



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Stakeholder perspectives

- **Customers**

- Lifespan is highly unpredictable
- Guarantees are valued
- DPA is a relatively cheap way to buy an absolute old age income guarantee
- DPA is a simple “insurance” concept
- Flexibility to buy in small highly affordable chunks & to stop/start if circumstances/inflation change
- Added flexibility with the large majority of their remaining pension pot

- **Advisors**

- Residual pension pot fully flexible with clear planning horizon
- Increased scope for innovative investment solutions, inheritance planning & advice - and fees!
- Fewer active decisions required during older age retirement



Stakeholder perspectives

- **Customers**

- Lifespan is highly unpredictable (but awareness is low and expectations are generally unrealistic)
- Guarantees are valued (at least before a lifetime annuity quote!)
- DPA is a relatively cheap way to buy an absolute old age income guarantee
- DPA is a simple “insurance” concept (but getting nothing back is still a potential barrier)
- Flexibility to buy in small highly affordable chunks & to stop/start if circumstances/inflation change
- Added flexibility with the large majority of their remaining pension pot

- **Advisors**

- Residual pension pot fully flexible with clear planning horizon (but will need help choosing vesting age)
- Increased scope for innovative investment solutions, inheritance planning & advice - and fees!
- Fewer active decisions required during older age retirement

- **Some behavioural barriers that may take time to overcome**



“Vanilla” DPA

- Aimed at “Middle Britain” segment
 - with DC pots > £30k and who may own their own property and are unencumbered
- Deferral period options:
 - chosen to limit cost to [10-15%] of **pension pot**, or
 - target [50-100%] supplement to **single-tier State pension** (£148.40 pw*), or
 - fixed **term** or **age** based e.g. age 75 **IHT** threshold or wide range of personal choices [60-85+]
- Low cost “vanilla” product with limited options/variations:
 - level income (inflation linked option or target inflation to vesting)
 - no reversion
- Single purchase premium or **phased instalments** for greater flexibility
- Streamlined initial u/w with fuller process for impaired



Other potential features?

- **Investment link** in deferral - to protect & grow real value
 - aimed at “mass affluent & HNW” segments with DC pots > £100k
 - index based but with protected capital feature
- Further features selected at PoS:
 - RPI linked pre & post vesting
 - reversion & guarantee periods
 - protected value & other pre vesting death benefits
 - LTC uplift/acceleration or lump sum additional benefit
- Post sale optionality:
 - event based options to flex form/timing of vested annuity post sale?
 - reversion & escalation amendments
- Packaged **platform** solutions



Crude basis vs. market immediate annuities

Market rates comparison*	Age				
	55	60	65	70	75
Level Lifetime Annuity for £100,000 purchase price*	£4,613	£5,078	£5,746	£6,595	£7,809

vs. £7,738 State

*Source: Hargreaves Lansdown 28 May 2015 (<http://www.hl.co.uk/pensions/annuities/annuity-best-buy-rates>)
Non impaired



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Crude basis vs. market immediate annuities

Market rates comparison*	Age				
	55	60	65	70	75
Level Lifetime Annuity for £100,000 purchase price*	£4,613	£5,078	£5,746	£6,595	£7,809
PL Re crude basis	£4,551	£5,038	£5,716	£6,633	£7,960
Ratio PL Re / Market	99%	99%	99%	101%	102%

Not a perfect match but OK as a basis for some rough comparisons

- Older age segment less competitive/different providers?
- Differences in yield, capital, gender mix, expense loadings etc...

*Source: Hargreaves Landsdown 28 May 2015 (<http://www.hl.co.uk/pensions/annuities/annuity-best-buy-rates>)
Non impaired



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Cost DPA vs. lifetime annuities

Relative cost vs. lifetime	Vesting age	Purchase age				
		55	60	65	70	75
Single life* level	60	79%	100%			
	65	61%	77%	100%		
	70	45%	57%	74%	100%	
	75	32%	40%	52%	70%	100%
	80	21%	26%	34%	45%	64%
	85	13%	16%	20%	26%	36%
	90	7%	8%	10%	13%	17%
	95	3%	3%	5%	5%	6%


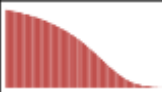
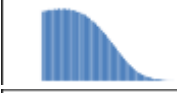
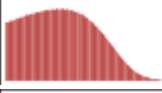

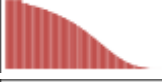

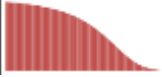
~15% of lifetime cost	Approx. vesting	84	85	87	89	91
	Deferral (years)	29	25	22	19	16

Male single life – assumes no return of premium on early death, guarantee period or protected value



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Cost DPA vs. lifetime annuities

Relative cost vs. lifetime		Purchase age			
Type of annuity	Vesting age	55	65		
Single Life Level	75	32%	52%		
	90	7%	10%		
Single life 3% escalation from purchase	75	47%	62%		
	90	13%	16%		
Single Life 5 year guarantee*	75	34%	55%		
	90	12%	18%		
Joint life 50% reversion level	75	37%	56%		
	90	10%	14%		

Joint life assumes Male with Female spouse 3 years younger



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Pricing & risk considerations

- Current low yield environment and solvency II not helpful
 - Still cheaper than full lifetime annuity one off purchase
- Smaller purchase blocks with have an economic floor vs. costs & commission/fees
- Self selection behaviours uncertain – choice of the healthy only? “binary” impairments?
 - Impact of underwriting approach (fair value vs. ease of purchase)
 - Pre vs. near vs. @ vs. after retirement
- Price may be gender neutral (but life expectancy isn't)
- Same trend tail risk as before but tracing in deferment harder?
- Tax & contractual considerations:
 - Payment frequency less than annual a potential qualifying issue
 - Source of premium – potential purchased life annuity
 - Group vs. individual structures



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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Conclusions

- “One size fits all” solutions won’t work
- Successful products will “dovetail” with other emerging innovations
- Needs “**insurance**” as well as “savings” mind-set
- **Deferred Payment Annuities are a key piece of the jigsaw**



Appendix

- **Title:** What happens when the money runs out?
- **Description:** In the rush to serve up solutions allowing DC retirees to embrace their new found freedoms the risk of outliving your savings remains a thorny irritation. Perhaps a change of mind set is required to view the increasing potential to live to extreme old age as a risk that should be directly insured? The talk will look at developments in other markets including the US where deferred income or "longevity" annuities have begun to gain a foothold and ask to what extent these sorts of "insurance" solutions might work in the UK. The talk will also consider the implications for advisors in recommending such a product and the risks considerations that would drive the appetite and pricing of providers.
- **Speaker:** Ian Collins (Pacific Life Re)
- **Level:** No prior knowledge required

