



The Actuarial Profession

making financial sense of the future

consultation response

Meeting the needs of maturing pension policyholders

**A response from the Actuarial Profession to
the *Thoresen Review of Generic Financial
Advice***

June 2007

Meeting the needs of maturing pension policyholders

Background

In meeting the needs of consumers with maturing personal pension (or stakeholder) policies, a number of issues arise because the needs of adviser to be fairly remunerated, customer to access relevant advice and product provider to supply profitable and competitive products are often incompatible. The consequence is that most consumers don't have access to the advice they need with the consequence that sub optimal purchases may be made.

The paper focuses on the specific issue of annuity purchase and highlights that the areas of greatest detriment are likely to be buying the wrong type of annuity (failing to provide income for the spouse or other dependents or to protect against inflation) or the failure to secure enhanced terms according to lifestyle/state of health. What the paper doesn't cover is other important advice issues on retirement such as

- use of tax free cash
- identifying other sources of income such as State pension/other benefits or from continued employment and impact on overall financial situation
- inheritance planning & associated tax issues
- planning for care needs

Consumers

Most consumers are faced with a number of decisions about the type of annuity, shape of annuity, annuity guarantees, protected rights, impaired options etc

Without an understanding of these issues, the consumer is liable to make a sub-optimal decision. This is particularly worrying because any decision made at retirement is irrevocable. Some form of help or advice must be beneficial to most consumers.

What information is available to consumers?

All maturing policyholders generally receive written details that can extend to between 10 and 15 pages of explanation. Additionally consumers can access plenty of website information, including FSA Comparative Tables, annuity websites, consumer websites etc. For the confident, financially sophisticated consumer, there is enough *written* information available to make an informed decision. Unfortunately most consumers find the issues too complex to comprehend and prefer to *talk* to somebody before making a decision. In the ideal world, this would be a financial adviser.

Financial Advisers

The "advice" models that are currently delivered tend to be

1. Self select (customer knows what they want and the "adviser" gets the best rate and does the admin). The customer is expected to have made all the decisions and the transaction is "execution only". No regulated advice is given. Annuity Bureau and Annuity Direct are examples of this service.
2. Limited annuity advice (treated as regulated but limited to annuities). The "adviser" will advise only in the context of needing to buy an annuity and make a limited recommendation. This is regulated advice.
3. Full advice (covering annuities, drawdown etc). This is full holistic financial advice covering all aspects of retirement advice.

For higher net worth consumers, existing advice processes serve them well. Full and limited advice is readily available for such people.

For the mass market, existing advice services are unlikely to be accessible. 65% of PPP funds are below £20,000 and nearly 90% are below £50,000¹. Even allowing for the fact that some policyholders may have more than one policy², the commercial reality is that few advisers want to provide regulated advice below about £50,000 without charging a fee³. Unfortunately the level of fees required for both limited annuity advice and full advice often makes it unviable for the consumer (the cost of advice being potentially greater than the benefits gained from seeking that advice).

This means that most consumers are effectively faced with some form of “self select” option and any decision on annuity type, annuity shape, accessing enhanced terms etc is left to the consumer with minimal support. It is interesting to note that the average fund size of consumers using a “self select” adviser tends to be relatively high suggesting that consumers with small funds don’t generally access advice. Consequently, the likelihood is that many consumers will make sub-optimal decisions.

Consumer Data

- Annuities sold outweigh the number of income drawdown products sold by around 25 times⁴
- About 1/3 people take an OMO and about 50% are believed to shop around⁵.
- Anecdotal data suggests that 70% buy annuities from the leading 5 providers and for smaller funds (under £20,000), the OMO is frequently insufficient to secure a better annuity than the PP provider has offered (most of this data is likely to ignore those people who would benefit from enhanced rates but have not been made aware of this possibility).
- It would be interesting to know the average OMO purchase price to see whether it tends to be the larger funds that take the OMO. HMT report on the Annuity Market⁶ confirms that ABI, DWP and others are investigating the operation of the OMO. Anecdotal data suggests that average OMO purchase prices are higher, but not much higher, than the average annuity purchase price where an OMO has not been taken.
- There is not much variation (up to around 15%) between best and worst rate on FSA Comparative Tables. A greater variation exists if all annuity providers are included⁷.
- FSA should have data relating to where advice is given and where it is not. Providers have to report Policy Sales Data to the FSA on all sales of annuities and one of the data fields that has been required to be supplied since July 2006 is whether advice was given at the point of sale.

¹ ABI Stats 2005

Number of pension plans people have – excluding final salary schemes	Estimated number of people with this number of pension plans
One	9.38 million
Two	4.52 million
Three	1.74 million
Four or more	347,500

Source: Based on research by YouGov plc with 2,235 people interviewed in Britain between 20th and 22nd June 2006. A large sample size is used that reflects the demographic profile of Britain, which enables the figures to be extrapolated for the entire country within appropriate confidence intervals. It should be noted that the accuracy of this data was dependent on the respondents’ ability to know how many pension plans they own. Anecdotal evidence suggests that many people are unable to recall accurately the number of plans they own.

³ Commission of between 1% or 1.75% of the annuity purchase price is often insufficient to meet the adviser’s costs

⁴ ABI figures of policies sold 2005

⁵ ABI figure 2005

⁶ Annuity Market HMT December 2006

⁷ Money Management survey Oct 2006

Published data tends to concentrate on annuity rates, whereas there is potentially a greater risk of detriment if the consumer buys an inappropriately *shaped* annuity (escalation, guarantee period, spouse pension) or is unaware of the possibility of enhanced rates for smokers and impaired lives. It may be difficult to quantify the amount of detriment caused by consumers' buying inappropriately shaped annuities, but intuitively it seems reasonable to suspect there is a potential issue since advice on annuity shape is generally difficult to access unless full financial advice is being given.

OMO – practical issues

Taking the OMO often results in uncertainties and delay. Uncertainty is created because annuity rates are guaranteed for a relatively short period (to ensure competitiveness) whereas payment of the OMO is often delayed beyond the guarantee period. Many consumers don't want this uncertainty. Moreover, buying an annuity from the PP provider normally results in benefits being paid at retirement. The OMO usually results in benefits being paid late because of the deficiencies in the process.

Product Providers

Since most maturing policyholders will take an annuity⁸ (rather than income drawdown), the pension product provider has to decide whether to

- (a) provide an annuity (in order to retain maturity monies) and
- (b) provide advice.

In providing an annuity, the pension product provider will be faced with potential issues if the annuity products are uncompetitive or the needs of impaired lives and smokers are not reasonably met.

The issue of impaired lives and smokers is difficult for many annuity providers. The annuity market divides into those that offer both normal and enhanced rates⁹, those that offer a single set of rates (the majority) and those that specialise in offering enhanced rates (market information is shown in the Appendix).

Those that offer only one set of rates cross subsidise "normal" lives against "impaired/smokers". In effect this means that "normal" lives get a better rate at the expense of "impaired/smokers". The issue arises if "impaired/smokers" decide to seek better rates in the market, because the annuity provider would be left with only "normal" lives. This would result in reduced profitability, a worsening of the rates or a requirement to offer two sets of rates. This suggests that it is not in these annuity provider's interests to encourage "impaired/smokers" to seek better rates.

Perhaps it is not that surprising that most annuity providers either offer a single set of rates or specialise in enhanced rates. The office that offers both sets of terms has the biggest problem regarding the mortality basis on which to price the standard annuity whilst maintaining a competitive position.

Of course, not all pension providers want to write annuity business and (post depolarisation) we have seen deals to offer maturing pension customers annuities from leading players, rather than offer an in-house annuity that would be priced uncompetitively.

For those pension providers who also offer annuities, in deciding whether to provide advice, the provider has exactly the same profitability and regulatory issues as an IFA firm. What may be different, however, is the opportunity for the provider to provide *verbal* generic advice as

⁸ In 2005, there were 292,000 annuities and 12,000 income drawdown products sold (ABI)

⁹ 3 out of 10 providers appearing in the FSA comparative tables

part of a customer service to maturing policyholders, delivered completely separately from their normal regulated advice processes. This is an opportunity to deliver much needed generic advice as part of a customer retention programme. This is currently being piloted by at least one provider at the moment.

Generic Advice

If consumers need some form of assistance in the typical scenario:

“I would like somebody to help me decide what annuity is best for me. I’m happy to make the final choice but I need some help understanding all the different options and how the different shapes of annuity work and how they might impact on the amount of annuity payable”.

Currently this is treated by advisers as regulated advice. Can it be delivered as generic advice and can it be delivered cost effectively with minimum regulatory and reputational risk to the adviser?

The FSA, Resolution Foundation and others recognise the important need for consumers who can’t access full financial advice to be able to access “generic advice”. The report “Generic Financial Advice: Evaluating commercial approaches¹⁰ refers to the need for a "trusted sense maker", an expert who helps consumers make informed decisions but acts in a non regulated environment.

In the context of maturing PPP/stakeholder policies, the "trusted sense maker" will explain the options (annuity type, impaired/smoker rates, annuity shape) to a consumer and then help the consumer find the best market rate or find a financial adviser. If this can be delivered as “generic advice” and the consumer then makes an informed choice, the consumer will be well served.

Squaring the Circle

At present, current market practice dictates that most of the *verbal* assistance required by consumers will constitute regulated advice. This means that most types of advice are only accessible to a small minority (those with larger funds or those with a financial adviser that is happy to provide advice on a less commercial basis).

The solution for the poorly served consumer must lie in allowing generic advice to include certain activities that are currently treated as part of a regulated process. Critically can this be delivered using the spoken word rather than relying (as at present) only on the written word?

The ideal generic advice would include a more engaging process of explaining annuity types and shape options, explaining the processes (OMO or otherwise) and sign-posting the routes to further information, implementation or regulated advice. If this is what a consumer needs (but can’t access), the industry has to find a means of delivery. An opportunity exists for the Thoresen Review to design an acceptable process that not only meets the needs of maturing pension policyholders now but also provides a framework for delivery to a wider population when pension proposals for 2012 come to fruition.

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¹⁰ Resolution Foundation Dec 2006

Appendix

Minimum OMO accepted

Aegon £5,000

AXA £60,000

Canada Life £35,000

Friends Provident £10,000

GE Life £5,000

Just Retirement £5,000

L&G £5,000

Prudential £10,000

Scottish Widows £10,000

Standard Life £5,000

Who offers smoker/non-smoker rates?

GE Life (Tomorrow)

Just Retirement

Reliance Mutual

Prudential

Who offers 'enhanced rates'?

Partnership Assurance

Just Retirement

GE Life (Tomorrow)

How frequently do the top five players change their rates?

This varies over time. The main driver for a rate change is a change in bond yields. If bond markets are volatile there could be a few changes in close succession. If markets are flat there will be fewer changes. Occasionally changes are made when a player repositions itself. Typically, there might be around 10 changes per provider per annum.

How do the top players move relative to one another?

Currently there are only 6 (non-impaired) annuity players who are competitive on price. Hence, there is only limited movement in or out. However, there does tend to be quite a lot of movement in the relative positions from one rate change to the next. Within this, one provider can be top at some ages or purchase price bands, but less competitive at others.