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THERE'S LIFE IN ANNUITIES YET

Annuities seem to be constantly in the news and after the pension freedoms announced by the Chancellor, and the findings of the FCA's thematic review into annuity sales practices, you could be forgiven for thinking that the product no longer has a place in future retirement income planning. But as we heard at TISA's recent pension reforms seminar, talk of the demise of annuities is premature.

L&G's director of strategy, individual retirement, Tim Gosden explained that there is still a key role for annuities; however providers are going to have to innovate to develop propositions that better meet people's needs.

Gosden split the market into three broad groups and looking ahead to next April outlined how he saw behaviours changing in response to the introduction of the new pension freedoms. The less affluent with smaller size pension pots and who will be relying on the State pension as their main source of income will be more likely to take the cash, although some, either through inertia or choice, will still buy an annuity. The group he termed 'Middle Britain' with pots of around £150k and with other savings and investments and who are largely debt free will change the most. Rather than relying on an annuity alone, this group are more likely to want a mix of products. For those in the most affluent group and with £250k in their pots the approach is unlikely to change that much, however tax planning will probably be more of a priority.

So what would a retirement mix for the Middle Britain group look like? According to Gosden the important ingredients will be the ability to access funds and to dip in when necessary, more income in the early years of retirement, income growth but probably with not a lot of risk to achieve it and the certainty of covering basic living costs. Ideally this will all be wrapped up in a simple solution that can either be easily managed, or doesn't need managing at all and with the flexibility to make alterations if circumstances change. Of course the overriding consideration is not to run out of money! People will want an income that lasts for their life and that of their spouse or partner. We could see an income layering comprising state pension, DB and lifetime or fixed term annuity covering essential spending or 'Bedrock Income' with any excess in simple inexpensive drawdown. This would more easily meet spending patterns where more income is drawn down in the early years for desirables like holidays and again later to meet care funding.

This calls on some radical thinking by providers to develop the products that will meet these new needs. To give us a flavour of what this might incorporate Gosden looked at examples from abroad. In Australia an income layering approach based on the bedrock income required for life and including an age pension, lifetime annuity, account based pension and term annuity aims to help people match income and meet their goals over time. In the US a longevity insurance product has just been introduced. As an example a retiree at 65 might elect to use 10% of their assets to purchase a guaranteed future income annuity to provide their income from age 85. The balance would be invested in a traditional portfolio that would be spent down between 65 and 85. The key advantage with this approach is that money can be spent in the first 20 years without the person needing to be concerned about how long they might live.

Whatever the approach, innovative solutions will breathe new life into the annuity market. As their popularity grows it will act as another incentive to encourage the UK population to save more – and that's got to be good news.

Slides from the seminar *Pension Reforms: The impact on providers and customers* are available on the TISA website here.

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