

Annuities 2020 – The Future of Annuities in Financing Retirement

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Tokyo, January 2009



Annuities 2020



Key questions

- What will the global annuities market potentially look like in the year 2020 and beyond?
- What are the implications of the financial crisis for how we think about annuity provision?
- Are the designs and structures available the right ones for meeting social and business needs?

FT/WW 2020 Survey – Spring 2008

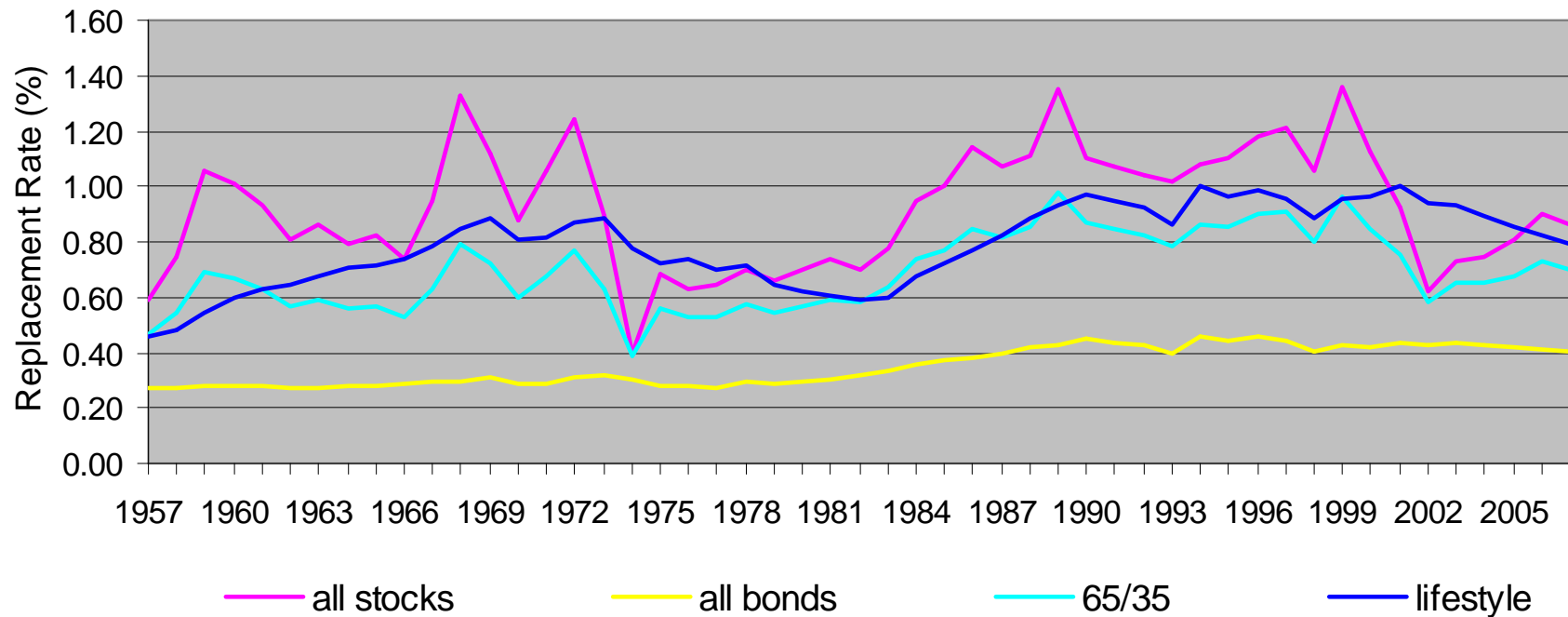


WW/ FT Expert Opinion Survey Biggest concerns

- 1st DC under-delivers for many DC members
- 2nd Too much short-termism
- 3rd Regulation becomes unduly burdensome
- 4th Complexity in product proliferation

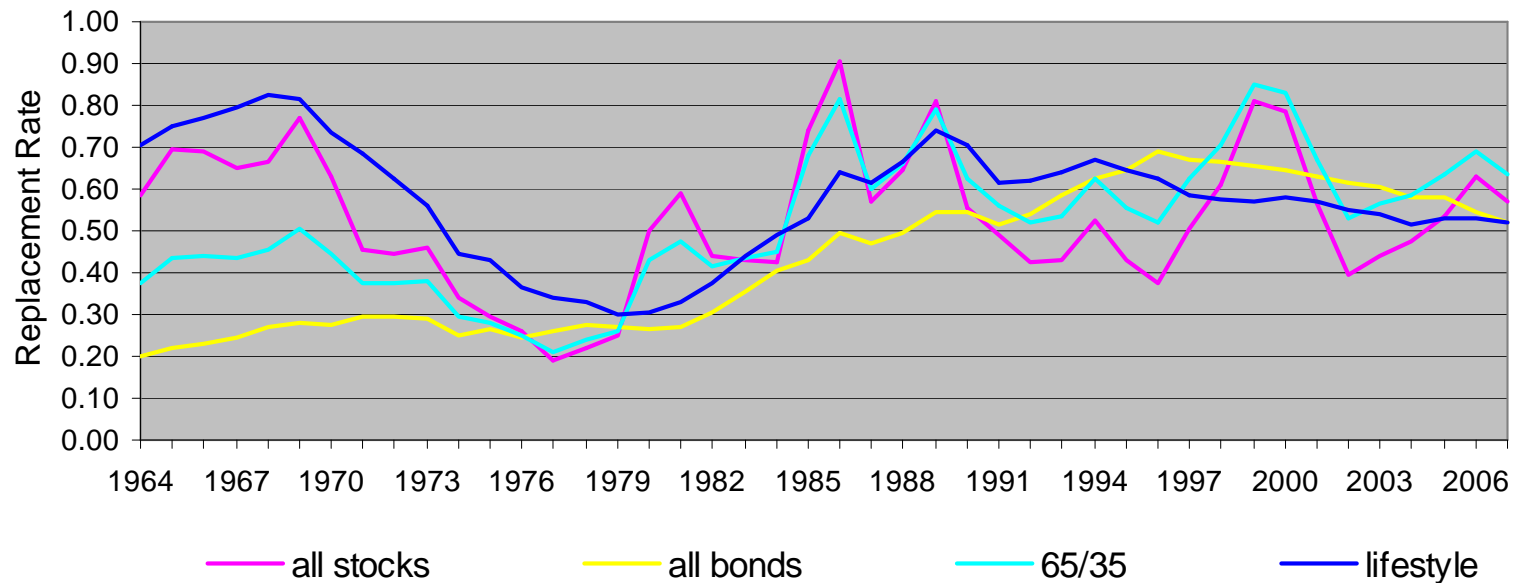
Under-delivery of DC

UK: Replacement Rates for Representative Retirees according to four different investment strategies 1957 - 2007

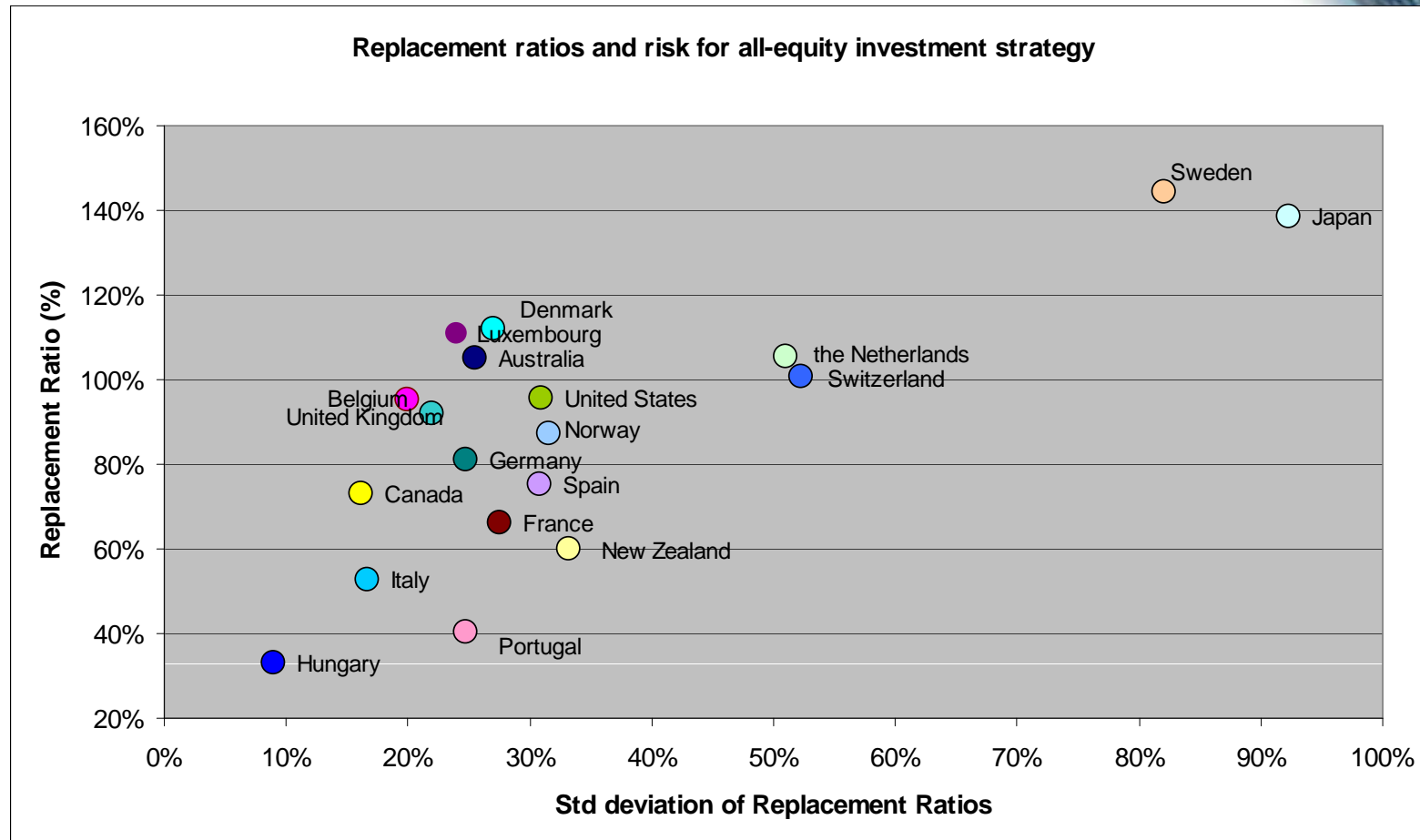


Under-delivery of DC

Italy: Replacement Rates for Representative Retirees according to four different investment strategies 1964 - 2007



Under-delivery of DC



Common Themes Today

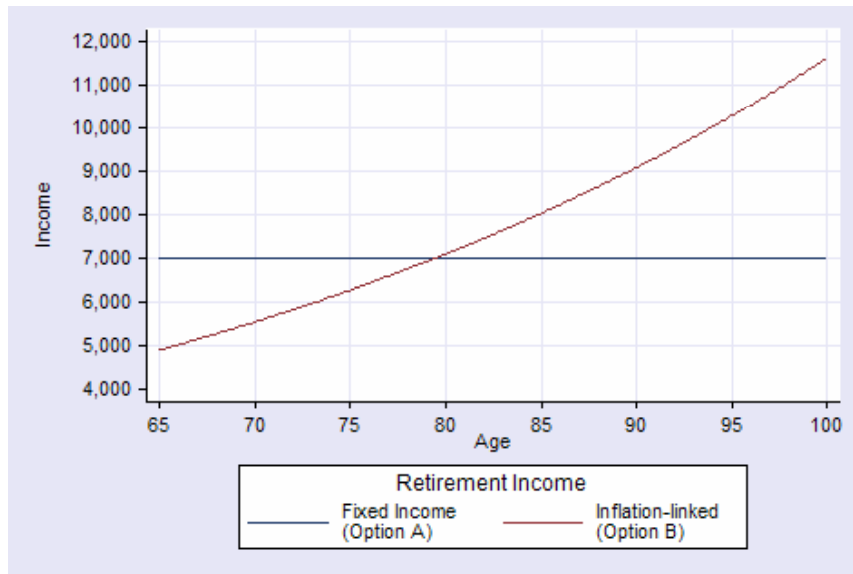


Common Themes Today



- Behavioural issues matter a lot – lack of financial education
- Antipathy to annuitisation
- Complex and equity-linked products have failed to take off

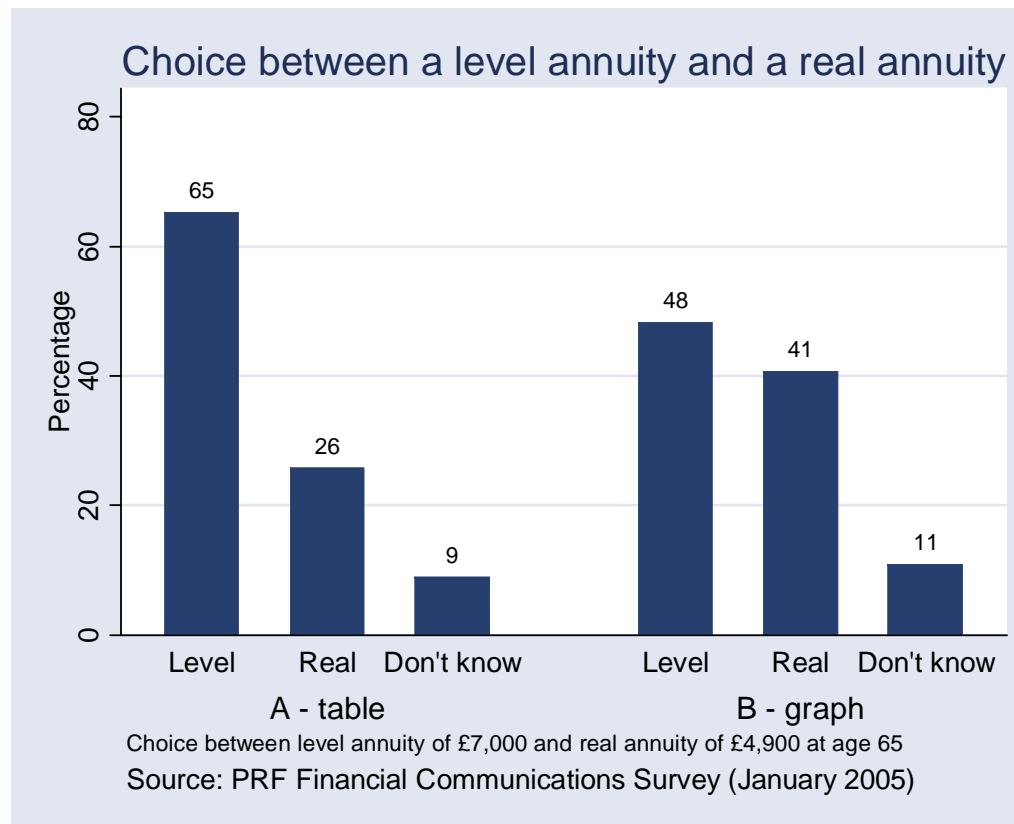
Visual presentation matters



Age	Level Annuity	Inflation-linked Annuity
65	7,000	4,900
70	7,000	5,500
75	7,000	6,300
80	7,000	7,100
85	7,000	8,000
90	7,000	9,000
95	7,000	10,300
100	7,000	11,600

- Choice between real and level annuity in a 2005 Pension Research Forum survey
- Details presented either by table or graph

The results

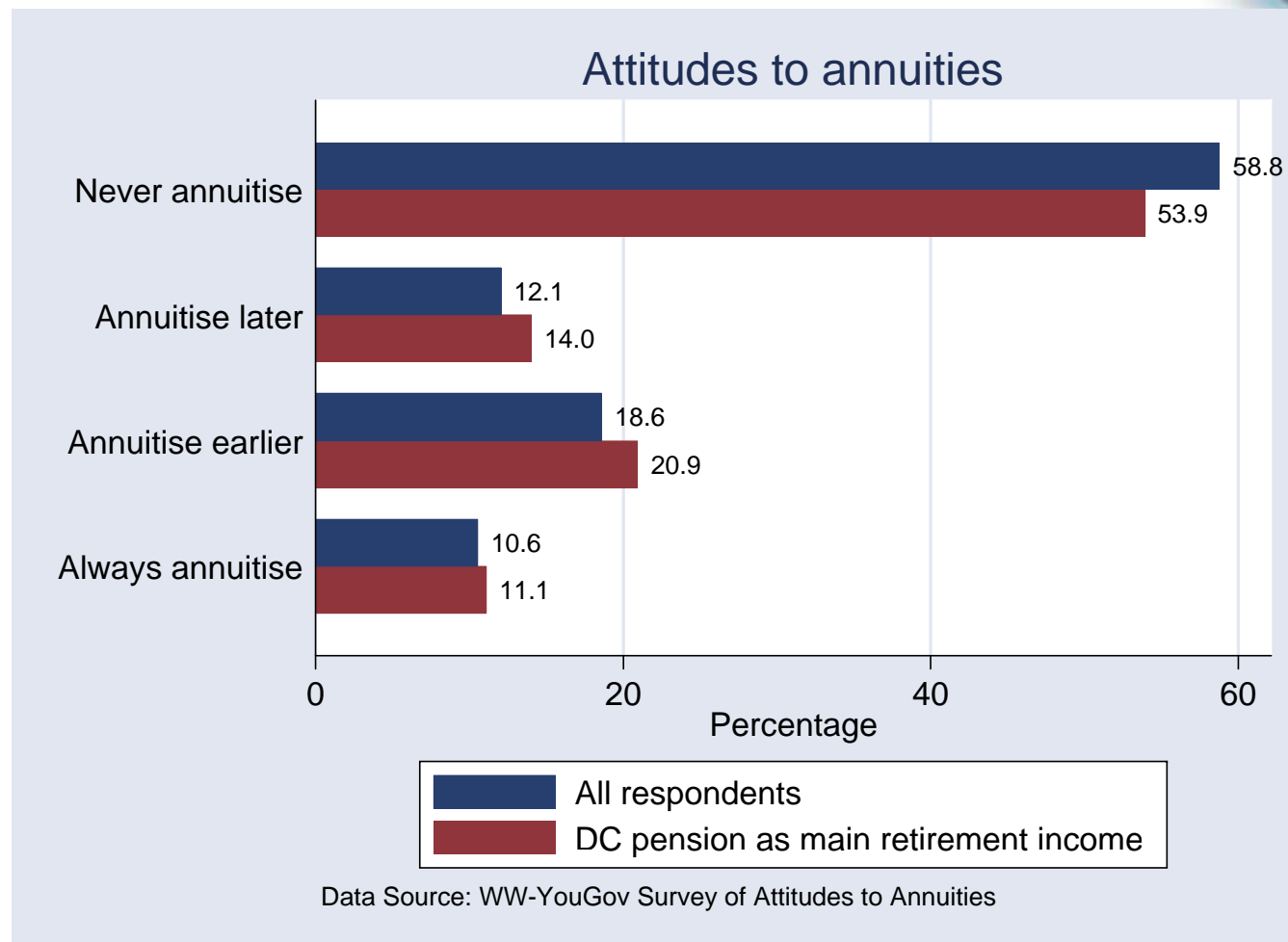


WW Survey: Who Will Buy an Annuity

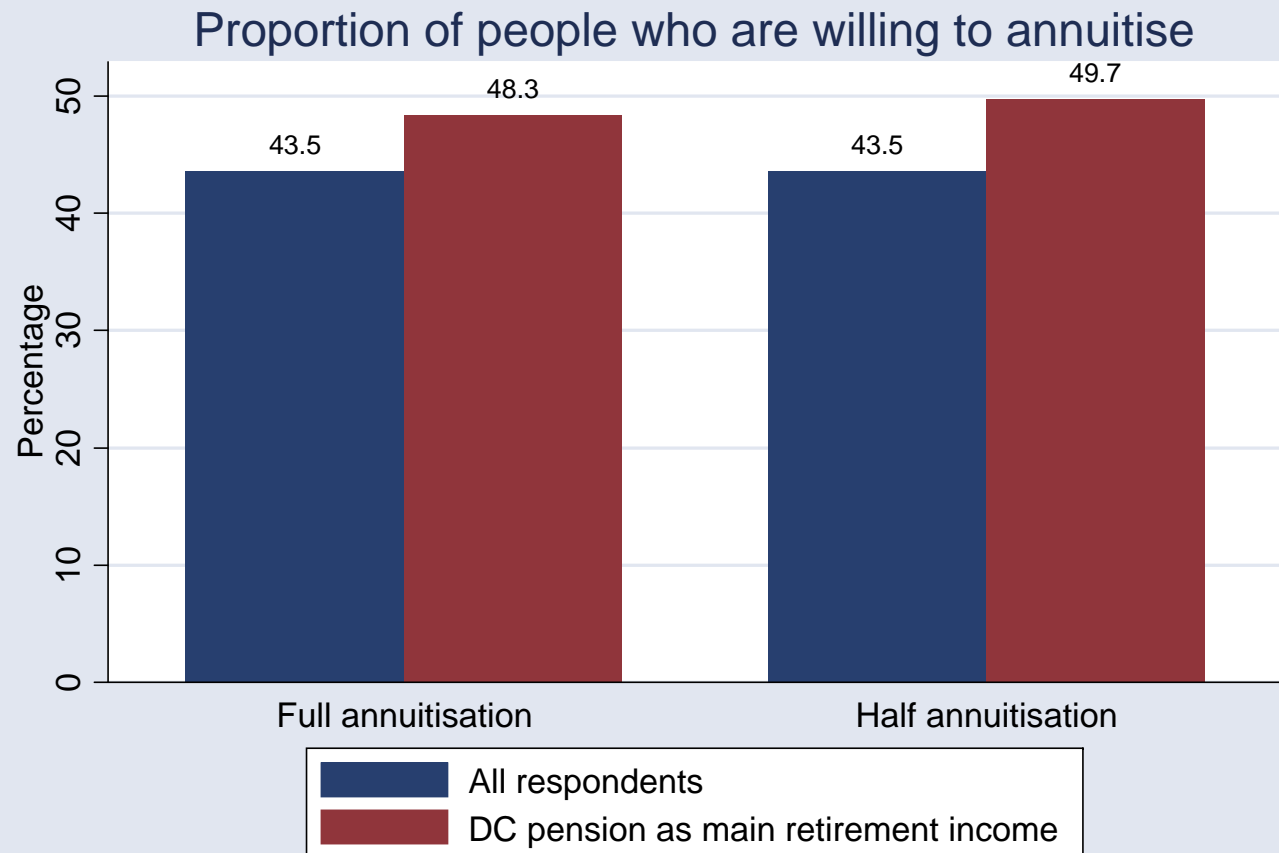


- **Annuity versus lump sum:** buy an annuity (or partial lump sum) versus keeping lump sum
- For those who wish to annuitise, at which age (based on realistic annuity rates)
- Sample: 3511 individuals 50-64, 33% fully retired, 11% out of work.

Attitudes to annuities



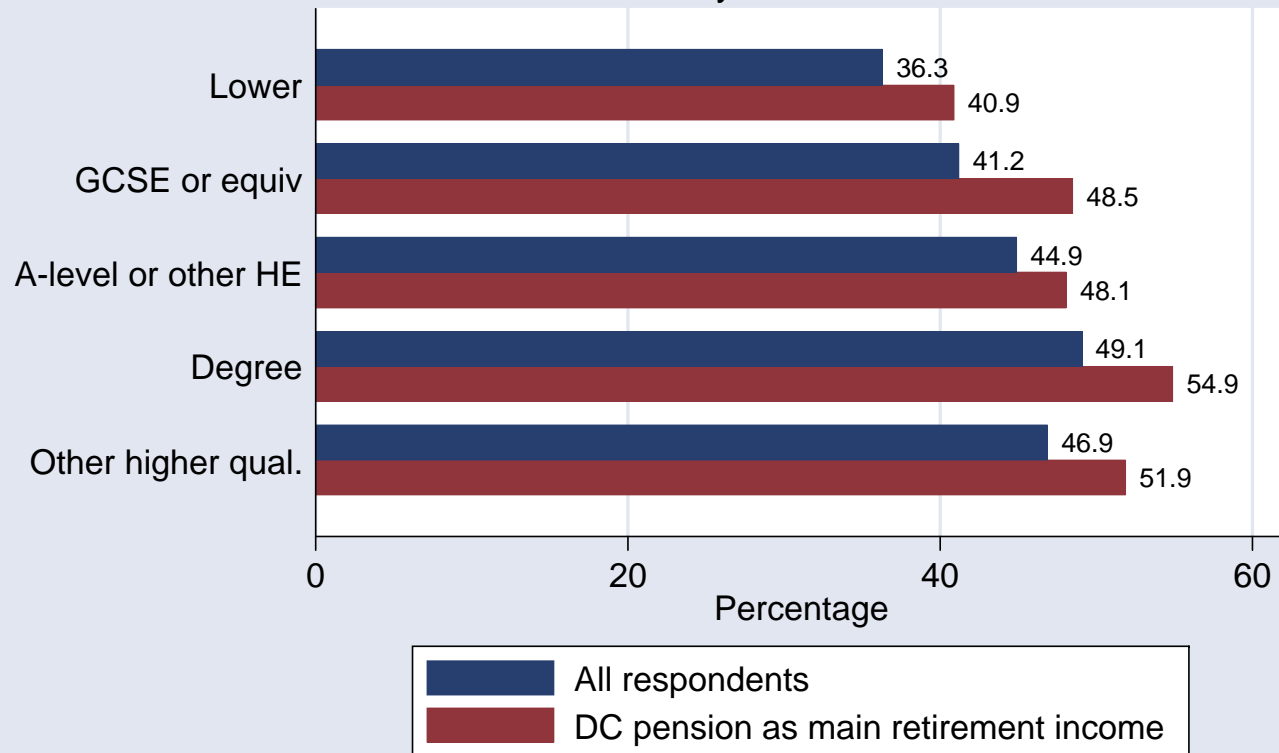
Willingness to Annuitize



Data Source: WW-YouGov Survey of Attitudes to Annuities

Annuity Decisions

Proportion of people who are willing to annuitise
By Education

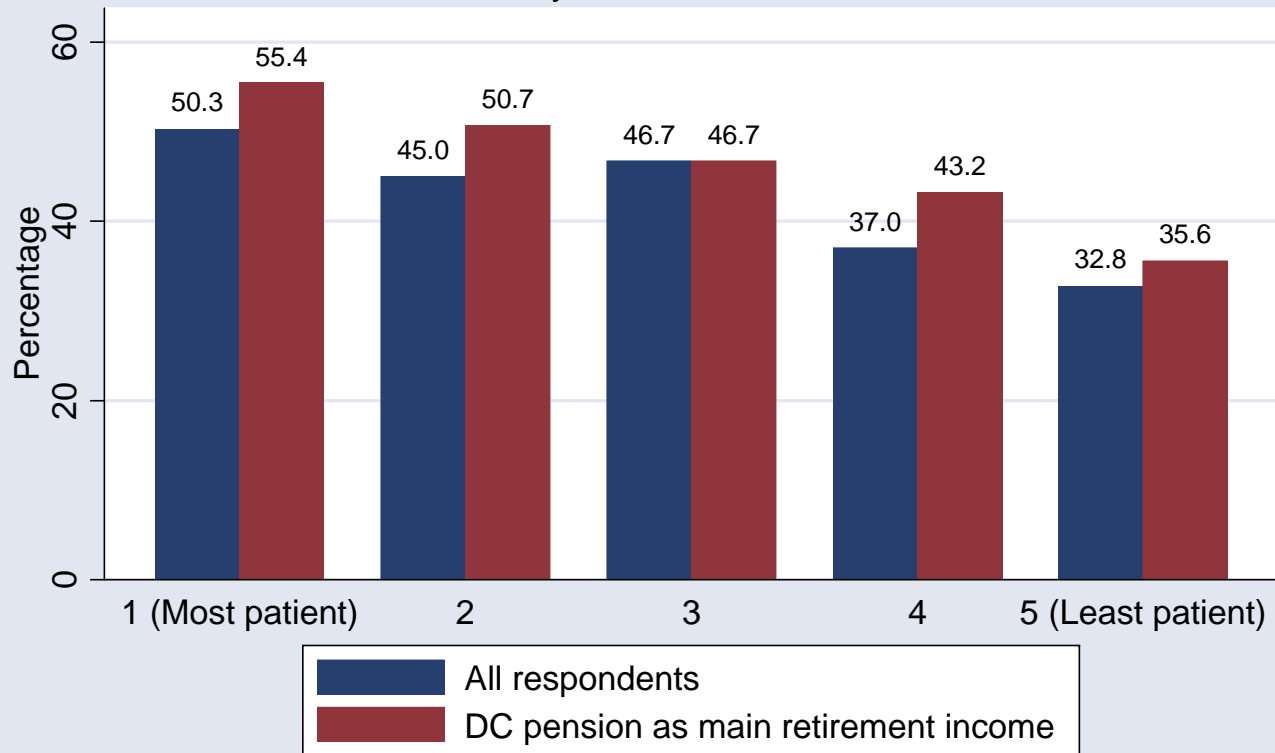


Data Source: WW-YouGov Survey of Attitudes to Annuities

Time Preference



Proportion of people who are willing to annuitise
By Time Preference

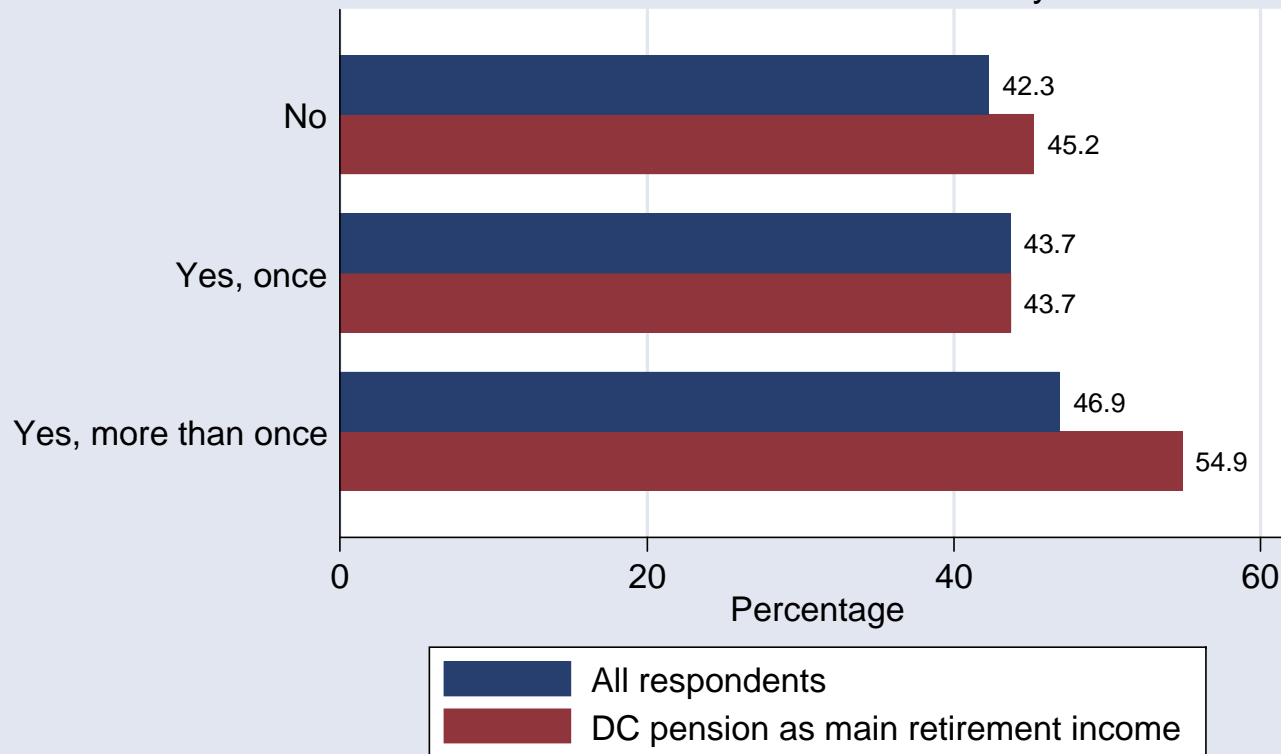


Data Source: WW-YouGov Survey of Attitudes to Annuities

Financial Advice



Proportion of people who are willing to annuitise
Whether have seen IFA in last 2 years?

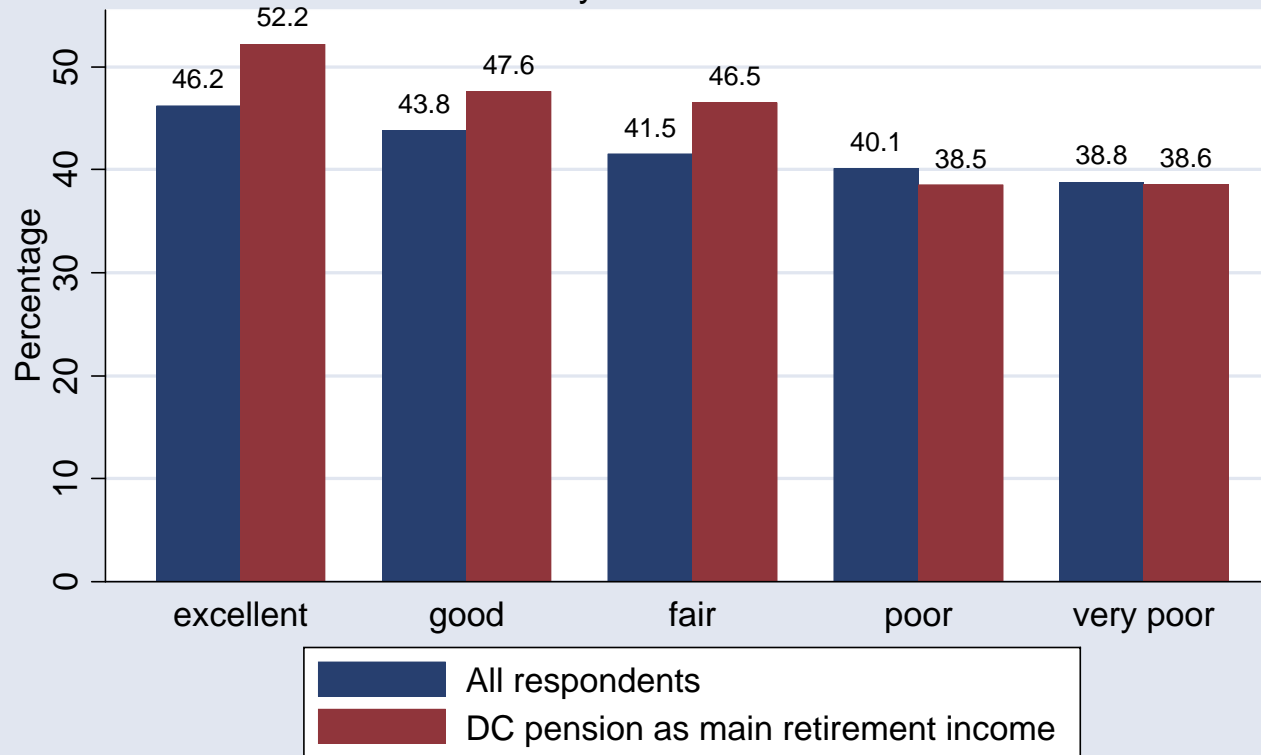


Data Source: WW-YouGov Survey of Attitudes to Annuities

Health Status



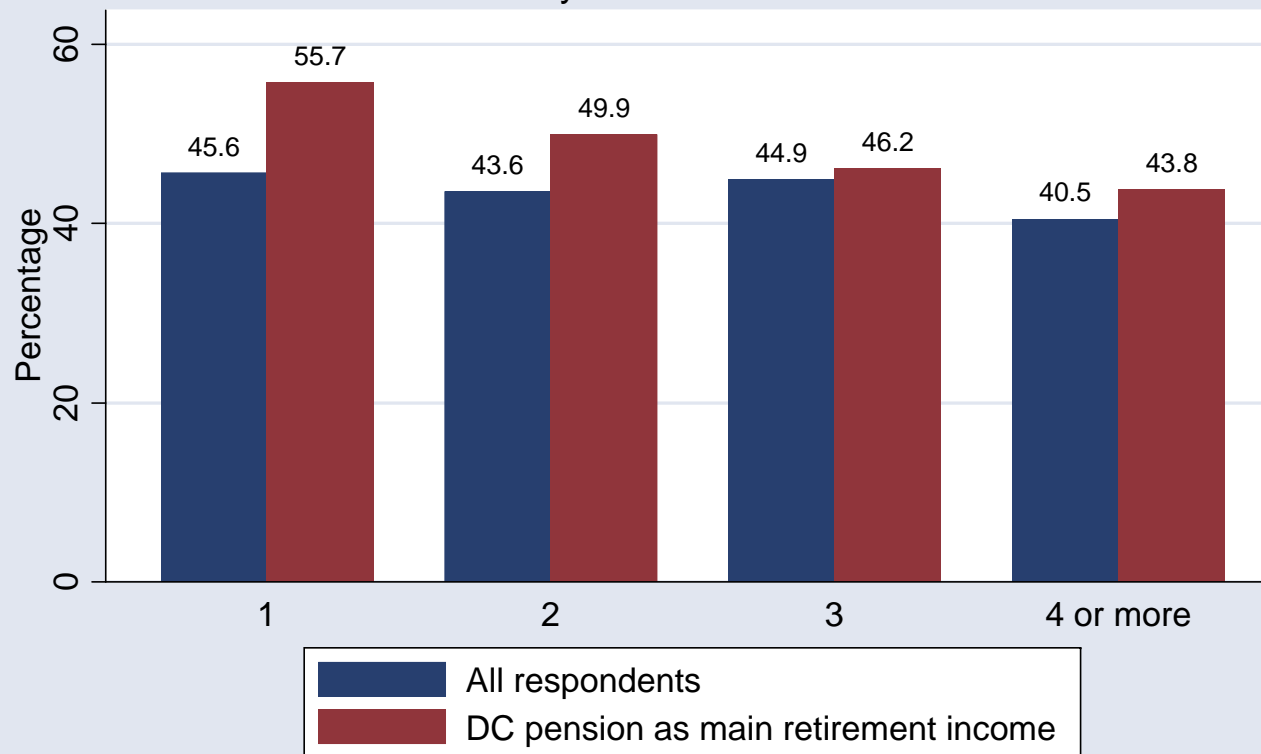
Proportion of people who are willing to annuitise
By Health Status



Data Source: WW-YouGov Survey of Attitudes to Annuities

Household Size

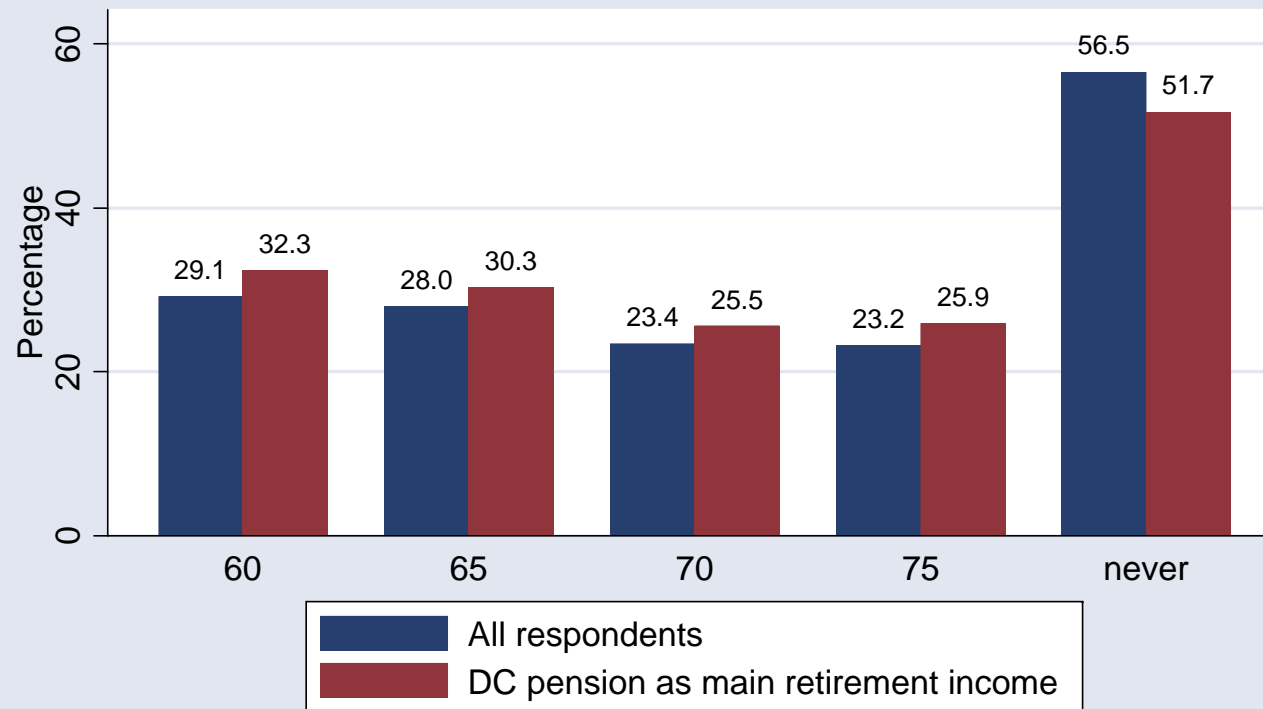
Proportion of people who are willing to annuitise
By Household Size



Data Source: WW-YouGov Survey of Attitudes to Annuities

When to Annuitize?

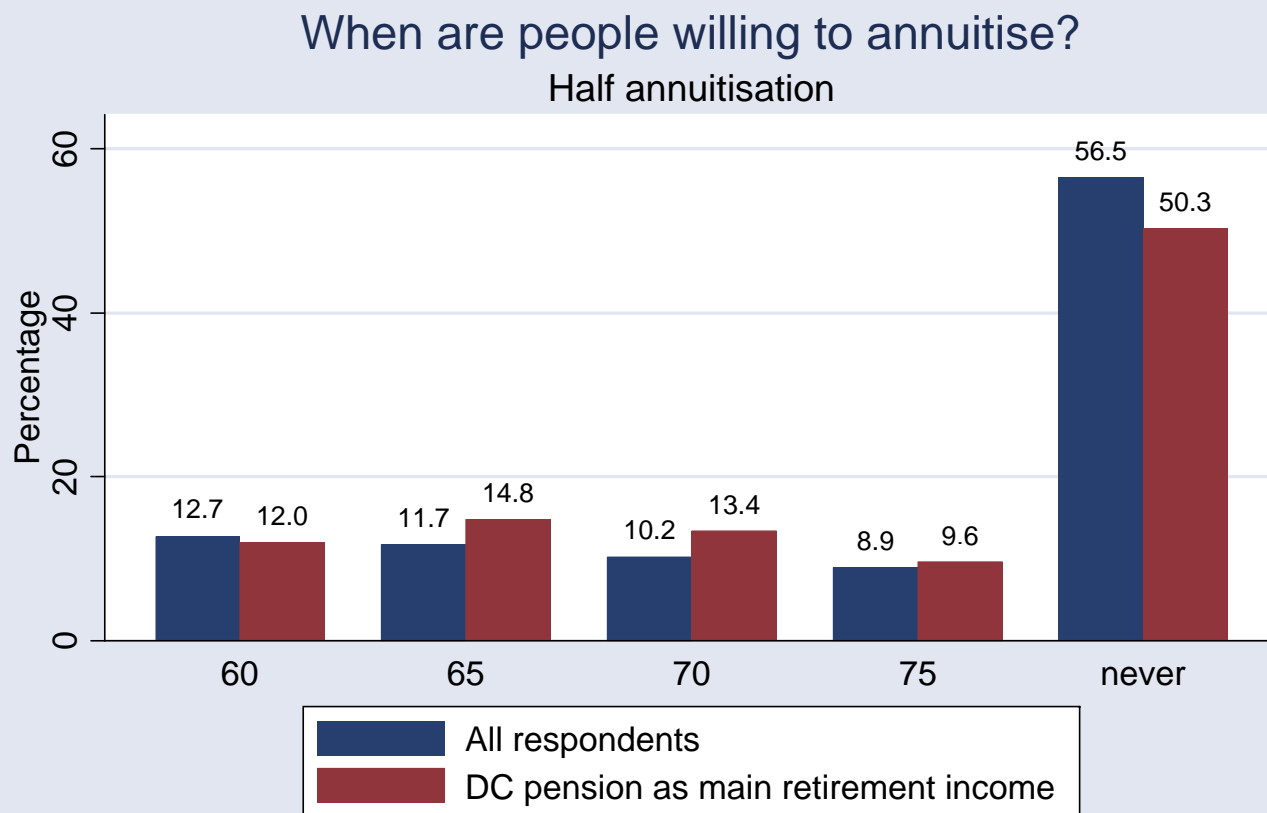
When are people willing to annuitise?
Full annuitisation



Data Source: WW-YouGov Survey of Attitudes to Annuities

Answers do not sum to 100% as independent 'yes/no' questions

When to Annuitise?



Data Source: WW-YouGov Survey of Attitudes to Annuities

Answers sum to 100% as respondents chose their preferred option

Dynamic Theory



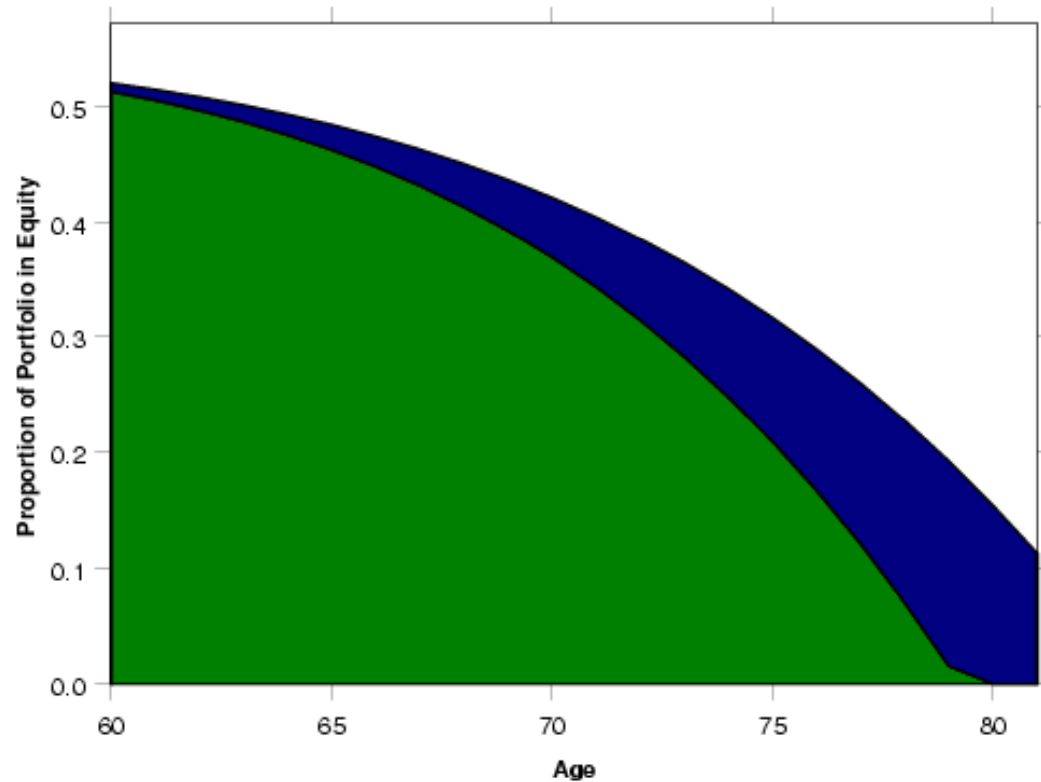
To simplify :

- no bequest motive (e.g., pensions only for income in retirement, $\lambda = 0$)
- two assets (equity (income drawdown), annuities (bond-backed))

Note:

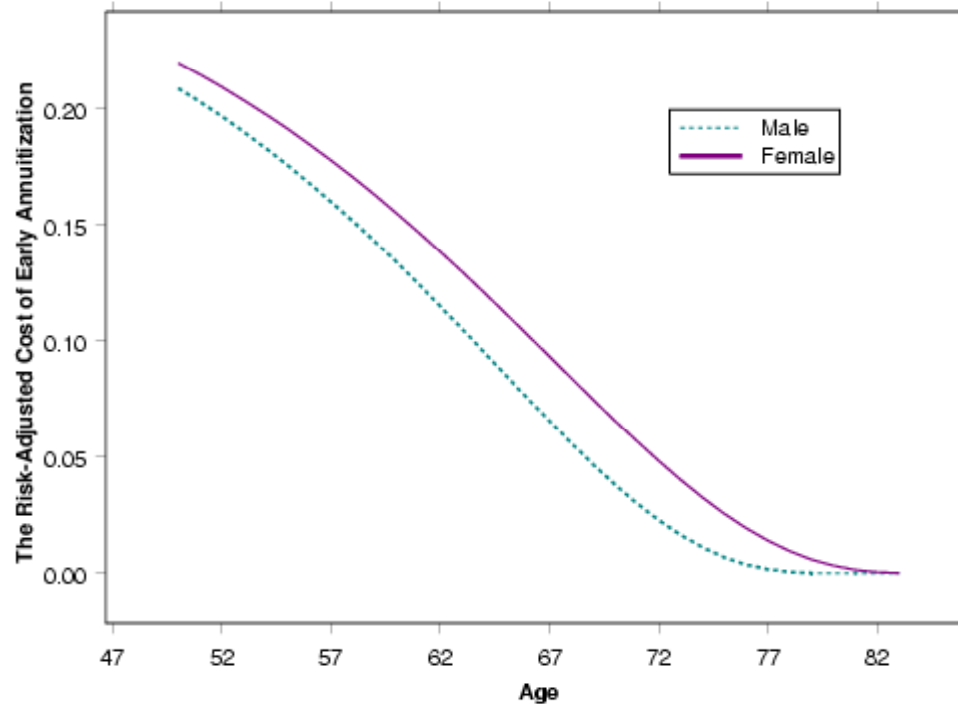
- Continuous time Merton-style model for annuities
- Consumption chosen optimally by individual.
- Portfolio chosen optimally by individual.

Optimal Equity Shares



Mandatory annuitisation age **independent of preferences** and **only** depends on asset returns and demographics.

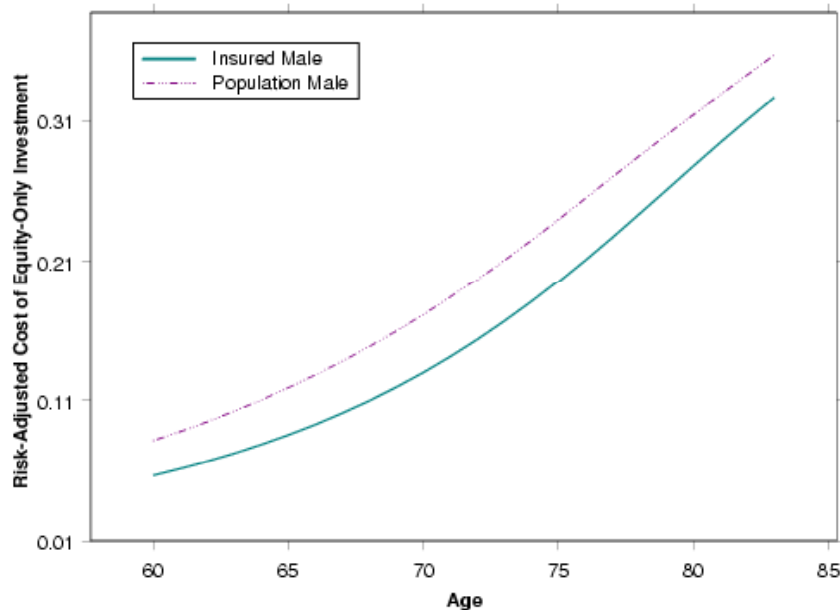
Cost of Mandatory Annuitisation



- Women suffer more from mandatory annuitisation.
- Loss from mandatory annuitisation disappears after age 80 or so.
- Women are all in annuities later than men.

Costs of No Annuities

Method: find level of assets under no available annuitisation that makes individual equally well off as with annuities available.

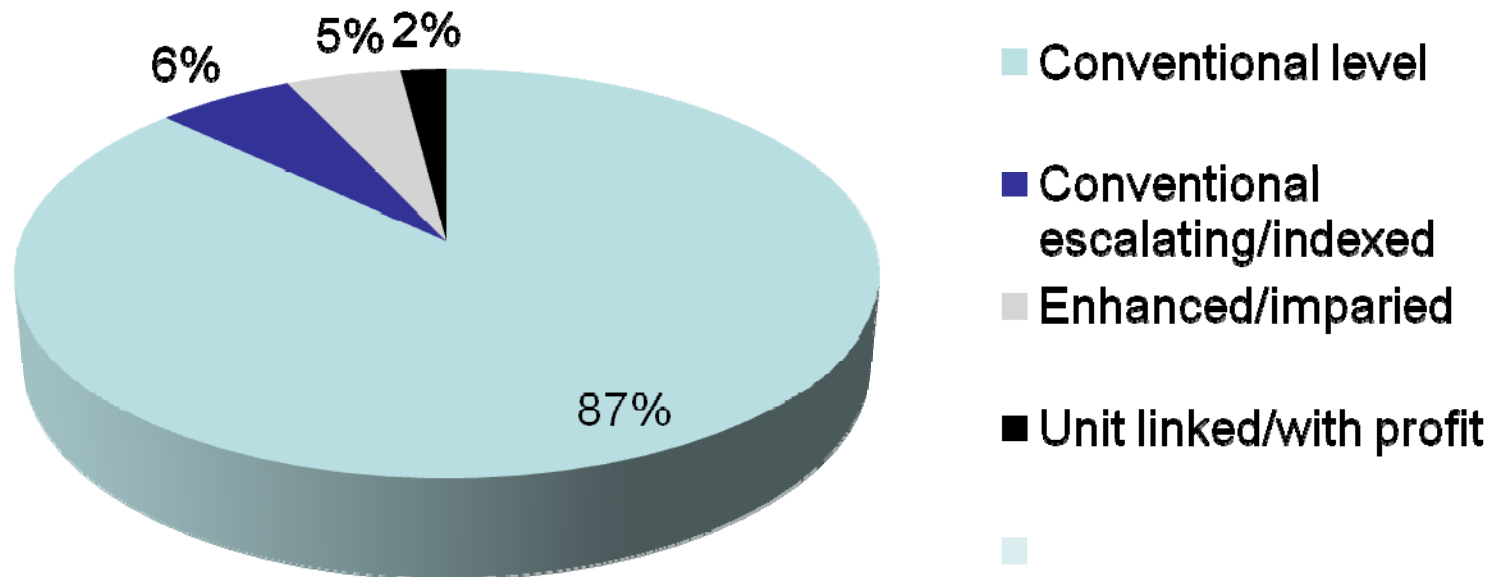


Equity investment less costly to well-off and women but costs to very elderly not annuitising as much as 1/3 of their wealth.

UK Annuity Volumes



Volume



Annuities 1998 – The Past as a Window Onto the Future

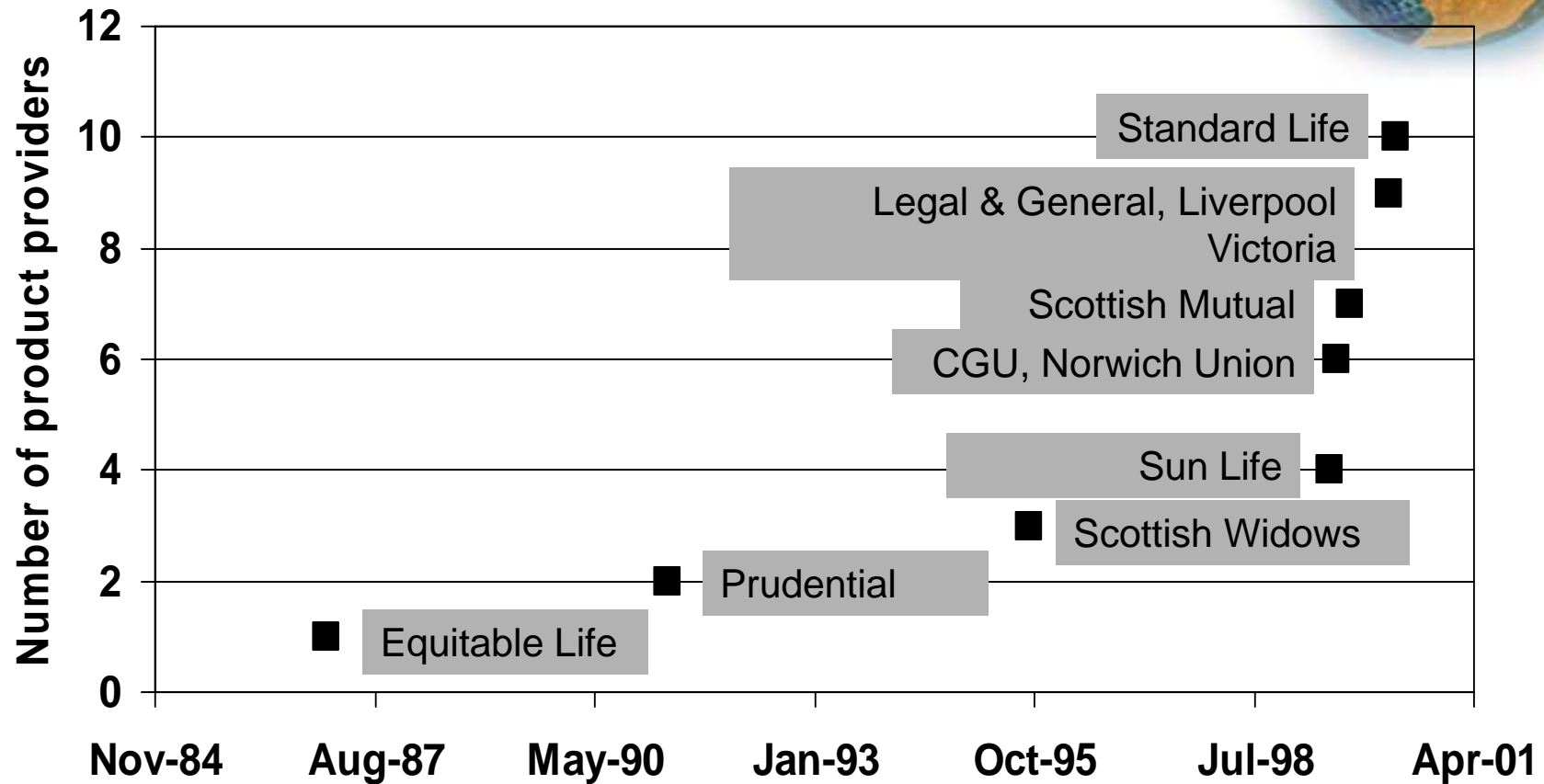




Key Problems in 1998

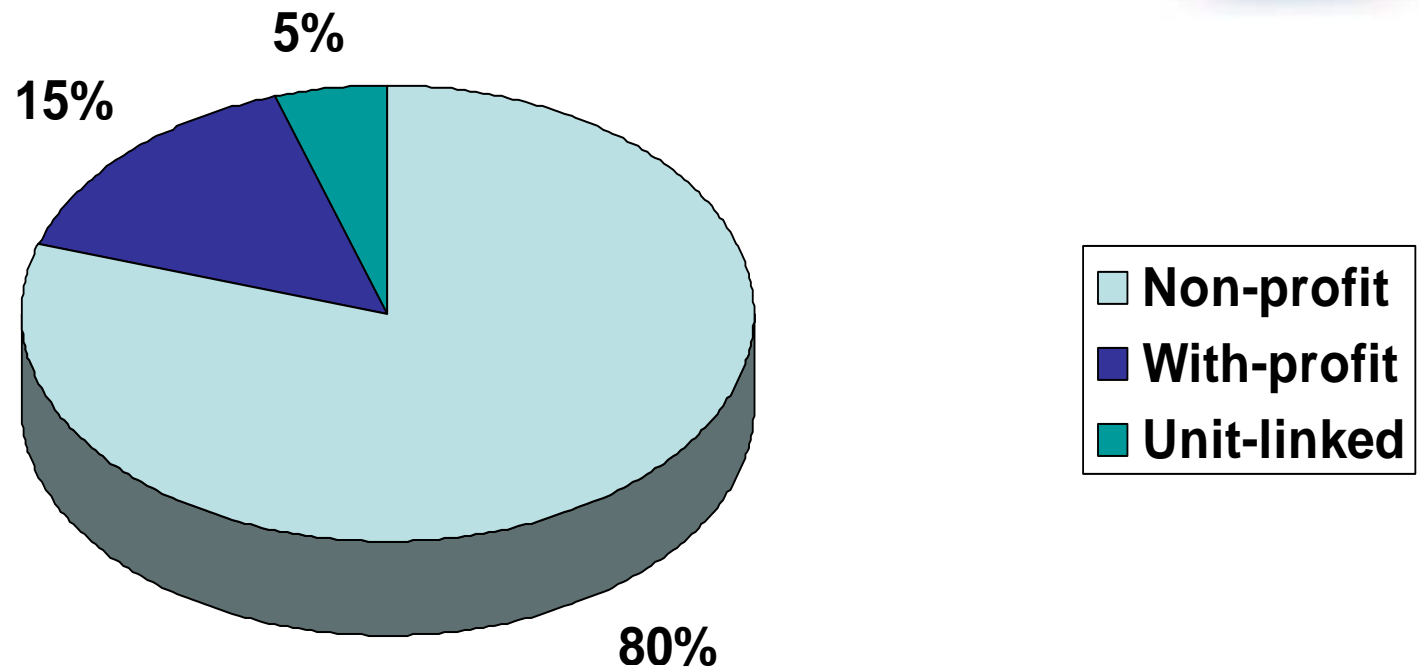
- Behavioural issues matter a lot – lack of financial education
- Antipathy to annuitisation
- Complex and equity-linked products have failed to take off
- One explanation at the time was cost /value of annuities

With-profit linked annuity launches



Source: Money Management Magazine October 2000

UK Annuities 2001



* annuities placed externally to accumulation product provider

Source: Association of British Insurers

Future Growth of the Annuity Market

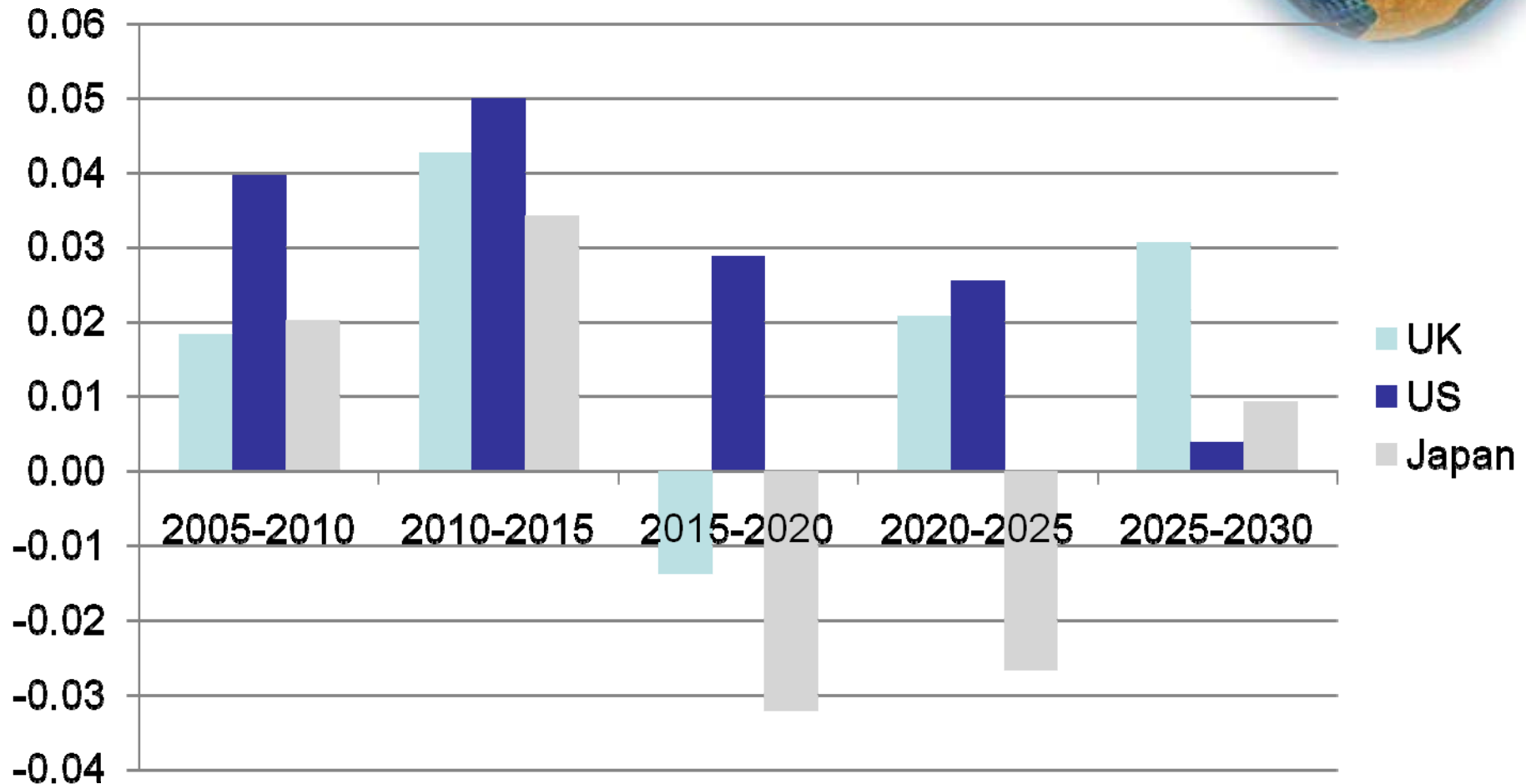


Growth Rates of Annuity Market

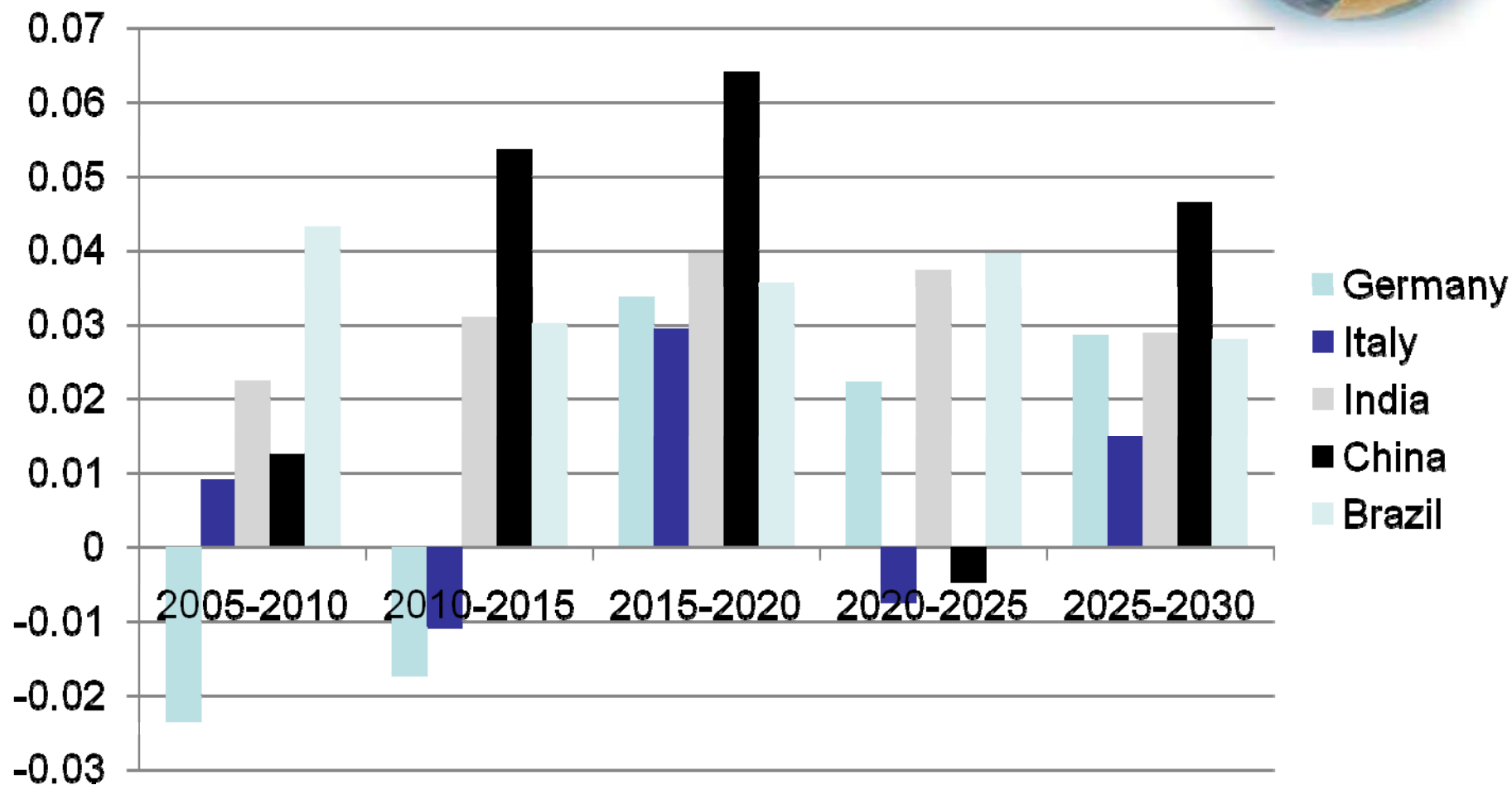


- Growth rates in population retiring
- Growth rates in coverage
- Growth rates in contribution rates
- Growth rates in wages

Putative Annuity Growth Rates Based on Demographics



Annuity Volume Growth Due to Demographics

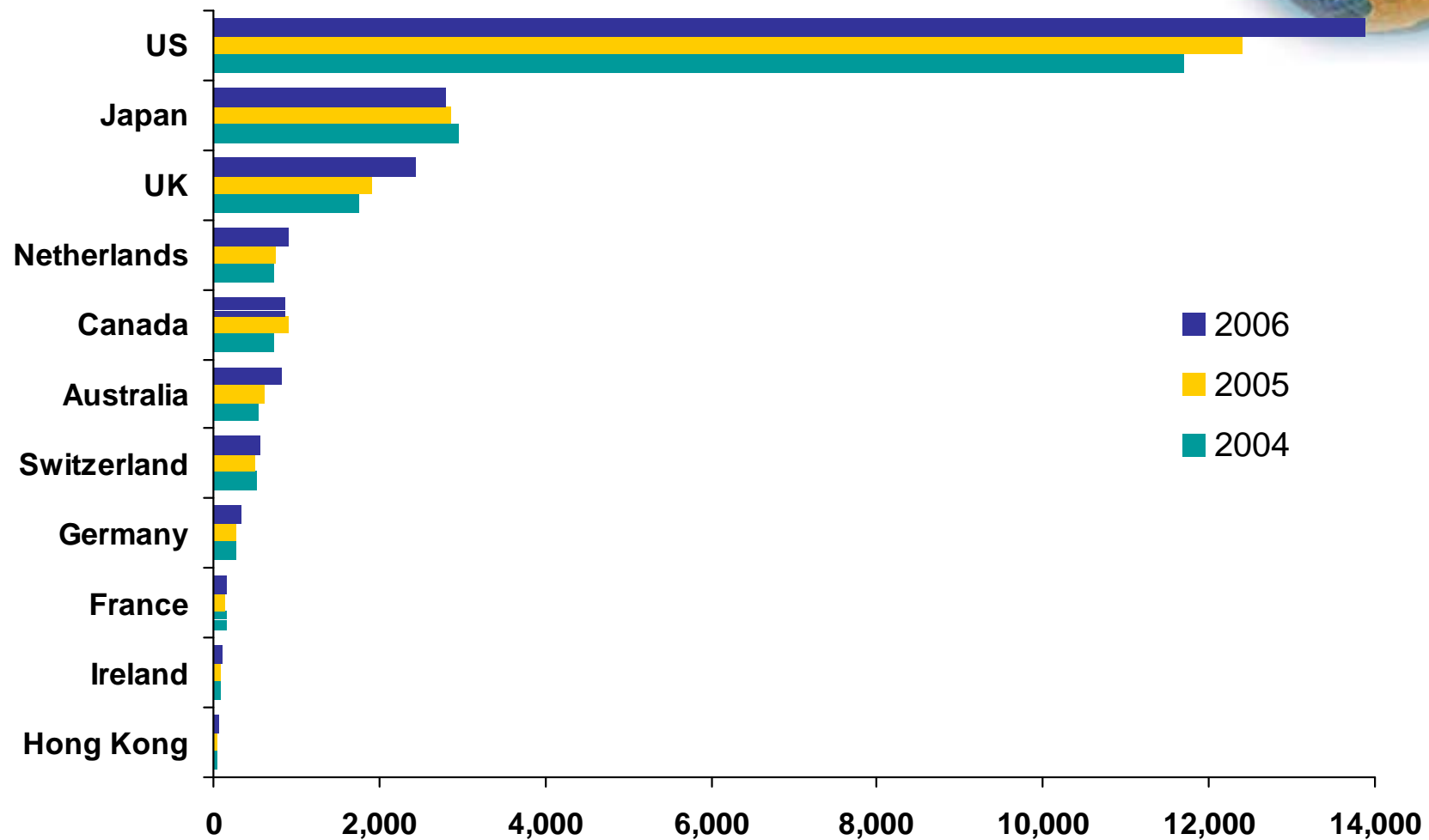


Unpleasant Annuity Arithmetic



PENSION FUNDS - Total assets and their growth

USD bn



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USD bn

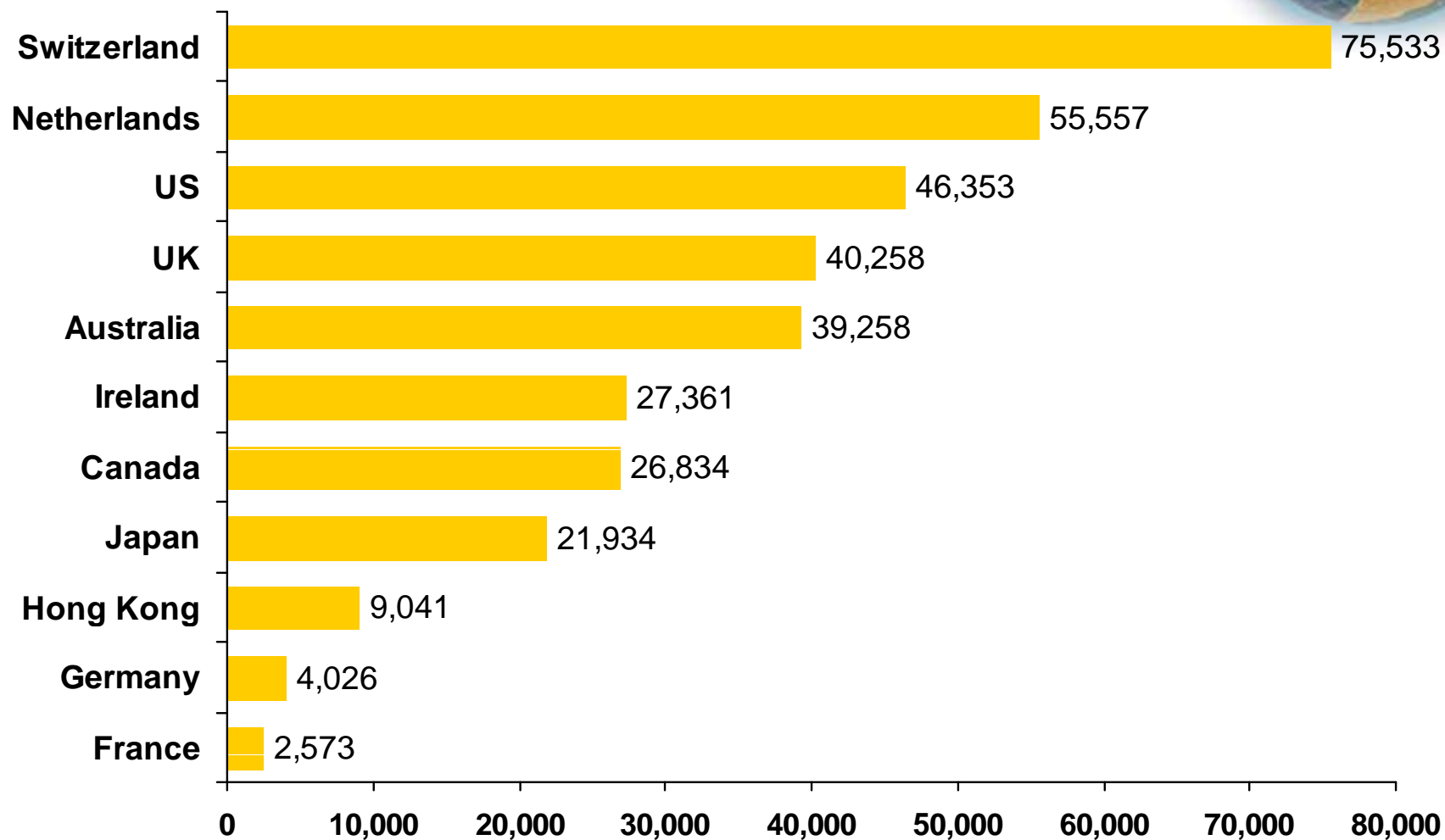
- Pension assets have grown over the period in most countries
- Australia is the country that show the highest growth (13.48%), followed by UK with 11.59%
- Japan is the only country where pension assets decreased ; -1.74% CAGR

	Total Assets			CAGR 3 years
	2004	2005	2006	
Hong Kong	46.31	53.00	62.47	10.49%
Ireland	85.05	92.31	115.85	10.85%
France	148.81	131.96	157.89	1.99%
Germany	283.11	277.64	331.65	5.42%
Switzerland	530.32	501.71	565.29	2.15%
Australia	553.48	618.17	808.91	13.48%
Netherlands	739.66	740.07	908.13	7.08%
Canada	720.11	908.63	875.40	6.73%
Japan	2,953.87	2,869.63	2,802.48	-1.74%
UK	1,755.33	1,917.48	2,439.12	11.59%
US	11,689.80	12,396.00	13,878.10	5.89%

UK data does not include Personal and Stakeholder accounts
US data includes IRAs

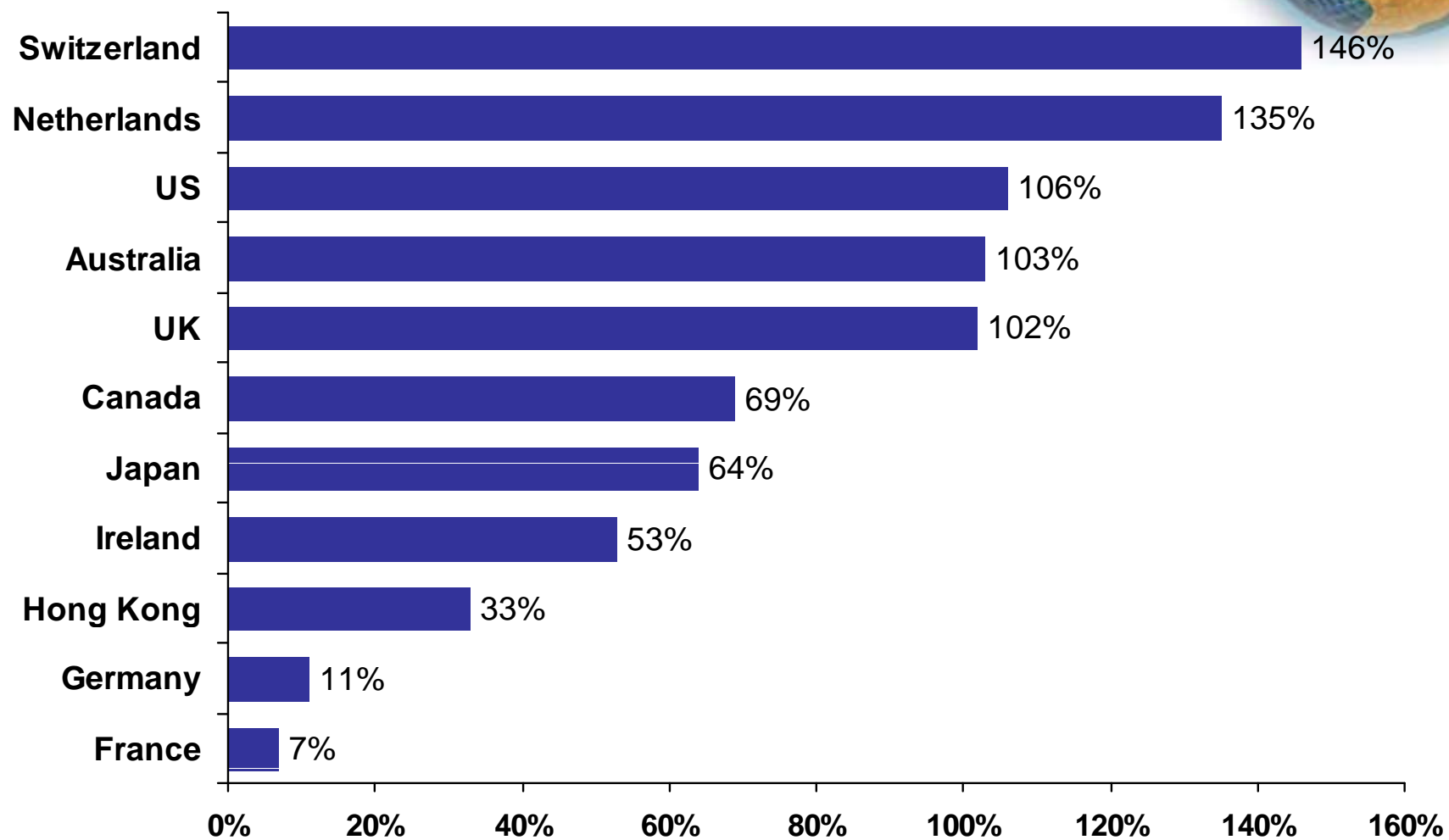
PENSION FUNDS - Assets per capita

USD - 2006



PENSION FUNDS - Assets as percentage of GDP

2006



What if all saving were in DC?



- % of retirees in population – 30% or more
- % of total funds in insurance companies for annuities – 40% or more
- Current pension/GDP ratio: 100% and needs to grow significantly
- What if 50% or so of GDP or more were tied up in conventional annuity products?

Fluctuations in Annuity Obligations



- Subprime/GDP: 5%
- % of GDP potentially in Annuity Obligations -50%
- Unhedged risks to economies can be quite significant because of scale of obligations and strength of guarantees
- Maybe buying an annuity is not such a good idea after all!

Guaranteed Annuity Rates



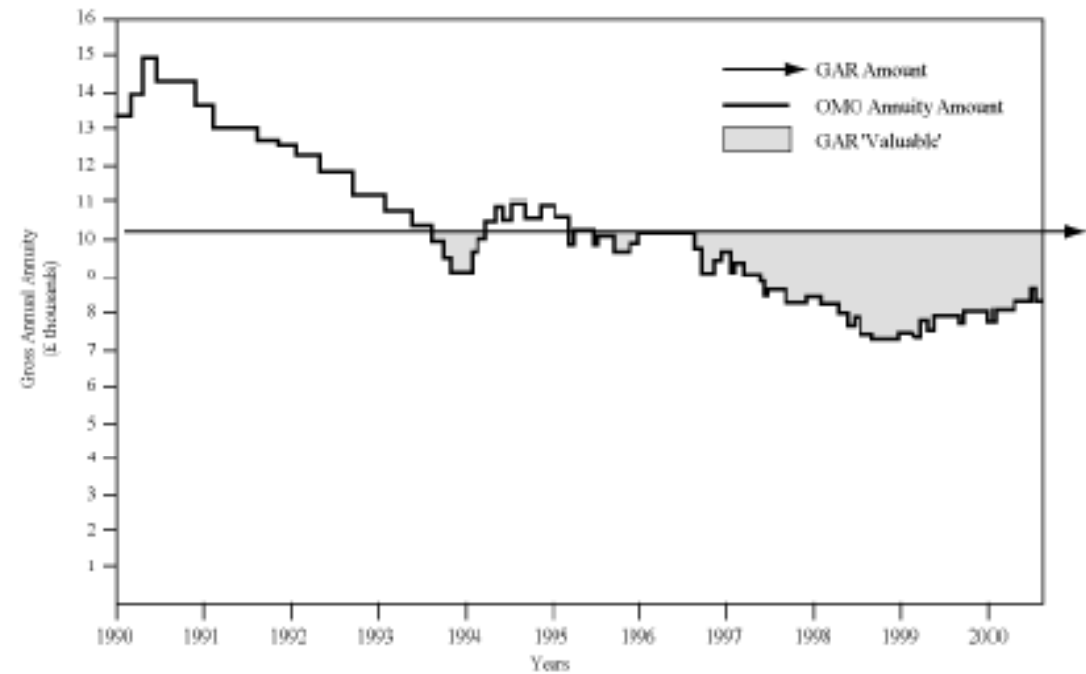
- Before the 1990s many insurers wrote contracts which guaranteed annuity contracts
- Contracts date back to 1950s
- Many types of contracts:
 - Premium to annuity conversion rate guaranteed
 - Fund to annuity conversion rate guaranteed
 - Conversions to other annuities
 - Future business at guaranteed rates

Evolution of Guarantees

Annex 1

- Contracts written until 1988
- In 1993 rates on annuities fell below guaranteed rates.
- Reduced terminal bonus for those with guarantees
- House of Lords ruled against Equitable
- Equitable closed to new business in Dec. 2000

Open Market Option & Guaranteed Annuity Rate History



(Source: The Annuity Bureau Ltd).

Impact of the Financial Crisis



Financial Crisis Impact on Annuities



- Tighter regulation -> higher capital requirements
- More focus on solvency of financial institutions -> more consumer worries about buying annuities
- Lower solvency levels -> less capital for underwriting guarantees
- DC and DB delivery issues -> more focus on new design approaches
- Guarantees may become less common but government will also probably become involved more in financial innovation



Annuities in 2020

- **Possibility 1:** The name annuity is not used anymore
- **Possibility 2:** Minimum risk products instead of absolute guarantees
- **Possibility 3:** Increased focus on annuity designs for the pre-retirement group

Annuities 2020



Key questions

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- What are the implications of the financial crisis for how we think about annuity provision?
- Are the designs and structures available the right ones for meeting social and business needs?