Reinventing Annuities:

‘Mix and Match’ innovative retirement income

GBST

Simplify Consulting

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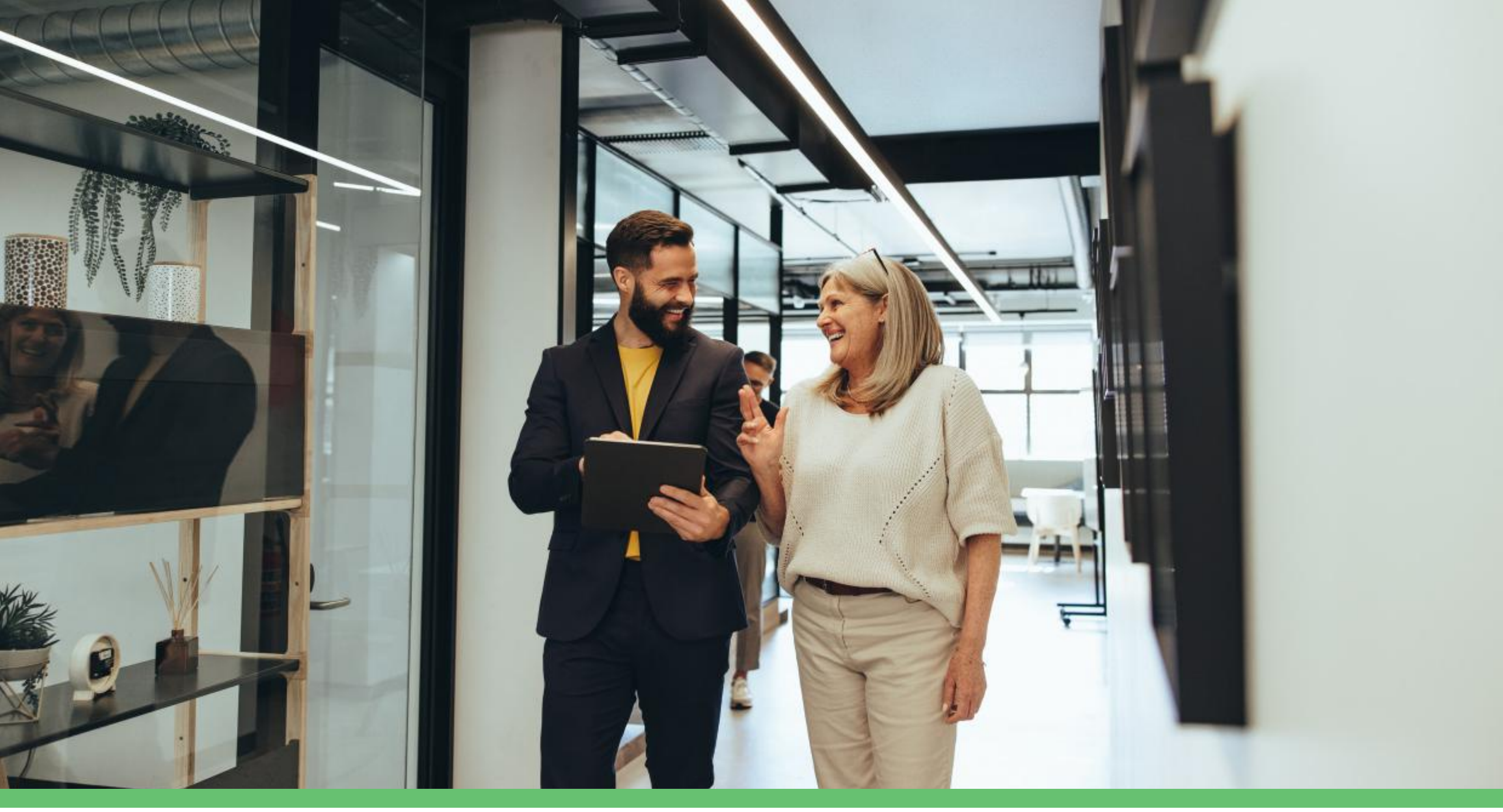


Summary

There is much for us to learn from this Mark Twain quote “The reports of my death are greatly exaggerated”, written in a letter to a reporter who had printed his obituary in an American newspaper. It has been played over time and time again since 1897 whenever a predicted demise overcomes the odds to make a resurgent come back, surprising all with a vibrant return, showing that all is fit and well in the world.

It seems difficult to recall that only 10 years ago the vast numbers of retirees only had one practical choice for a long term solution to providing a retirement income: The annuity! That their future was put so profoundly in doubt by the announcement of Pensions Freedoms, which brought upon the ability to manage and flex your retirement incomes needs now seems like ‘old news’ in the context of the market today. Remarkably we have seen a 61% increase in annuity rates from Apr ’22 to June ’23 and new sales are surging with new innovative guaranteed income solutions slowly coming to market. In addition, the backbone of certainty and simplicity of an annuity plays a large part in meeting consumers objectives with their retirement income, but flexibility is still massively important.

This paper explores the idea that a ‘Mix and Match’ approach to retirement income seems to be an optimal solution for the majority of the population and should be the default offering. Where a retiree can ‘Mix’ income from one or both of annuities and flexible access drawdown to ‘Match’ their personalised income needs at different life stages in retirement.

If this assurance around a level of guaranteed income complemented with the ability to adjust retirement income needs using drawdown seems an obvious approach, then how does the industry support the majority of clients who are currently and will face these important decisions on how best to use their retirement pot?

There are just not enough annuity providers offering drawdown alongside their guaranteed income solutions in a way where a retiree can manage these two products seamlessly in one experience and adapt their income needs when required. Annuity providers should be broadening out their thinking to ensure their platform technology enables the seamless delivery of all product wrappers and not just annuities. Conversely, not enough advised platform and D2C providers offer the ability to purchase and manage term based annuities alongside flexi access drawdown. In simple terms, an annuity sitting inside a SIPP wrapper should be a standard offering to retirees across all distribution channels to improve customer outcomes.

Platform technology exists today to administer annuities alongside income drawdown for the same customer record, simplifying back office processes and automating cash movements from the annuity into the drawdown wrapper or to purchase more annuity from your drawdown for example. A single underlying platform is a massive advantage in having the foundations to offer these different products in a seamless and cost effective way.

Annuity providers need to look at modernising their annuity policy administration system, processes, and customer experience to ensure they are fit for purpose for the future as the sale of annuities are not going away. The removal of risks around running legacy technology, the ability to easily accommodate change and to maximise the opportunity for innovation through an API enabled SaaS platform are going to be essential for continued growth and long term success.

A modern annuities administration system should not be looked at in isolation, as we see in this paper, annuities form just one part of an overall retirement income strategy for the majority of the population. Administering annuities alongside income drawdown, ISAs, general investment accounts and investment bonds on the same technology and across the same operational teams and processes brings a huge advantage to the service and experience delivered to the adviser and investor and drives down costs to deliver the service.

In addition, a big increase in customer engagement alongside the ability to help the mass market model the right balance of income at different life stages and dynamically adapt when needed isn't there yet. An adviser is playing a large part in these recommendations but with 93% of individuals not accessing professional financial advice then only a few will benefit. Technology needs to play a huge role in acting as a financial buddy for the vast majority of the population who need help in determining what products are the most suitable in retirement and when. Using AI based on large data sets to spot patterns and provide recommendations to an individual based on their personalised circumstances and needs has to be the answer to achieving better retirement income outcomes for the mass market. The ability to maximise the opportunity to align retirement income to an individuals needs from their hard earned savings during their working life has to be the responsibility of the industry.

"The industry has needed investment, into both products and technology, and it's positive to see these launching with the potential to simplify and provide great outcomes for the consumer. Innovative products and technology combined will hopefully help to address the consumer engagement challenges. The key will be to implement without over complicating an already complex market and having any negative impact on consumer engagement."

Carl Woodward
Director, Simplify Consulting

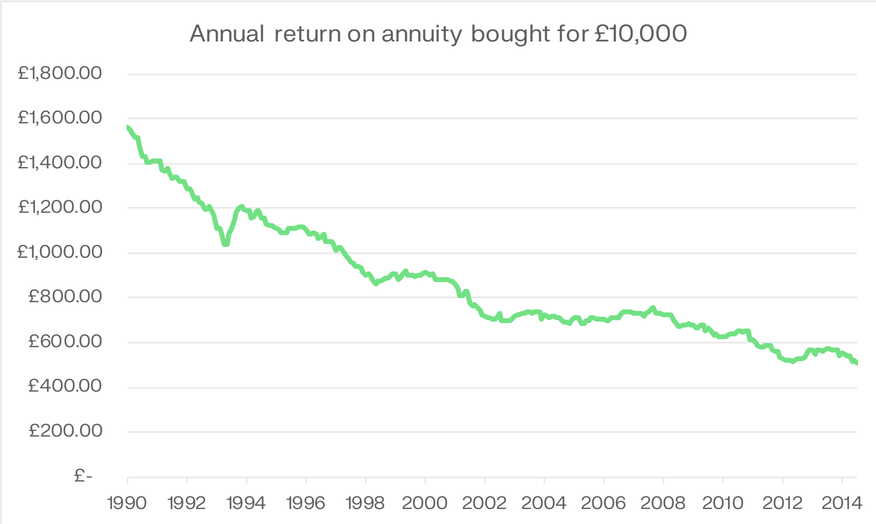
Simplify Consulting

1

Pension freedoms and the 'death' of annuities

When the pension freedoms legislation was enacted in April 2015, it removed many of the restrictions around taking income from defined contribution (DC) schemes and gave people greater flexibility to access and utilise their pension savings.

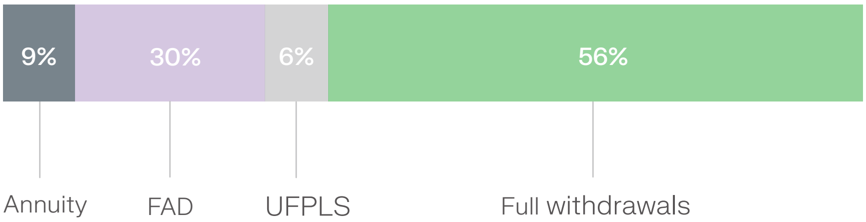
Before pension freedoms, most people used their pension pot to buy an annuity when retiring, with income drawdown only really an option for those with large retirement funds. Yet for many consumers, annuities did not offer good value for money: a 2013 report by the Financial Services Consumer Panel states that at that time annuity rates had been falling steadily for 20 years due to increasing longevity and declining gilt yields [1]. From the chart below showing return from a purchased annuity we can see this remarkable decline. In 1990 a 65 year old male would have received around £1,500 per year until death on an annuity purchased for £10,000, whereas at the point when pension freedoms were introduced this had fallen to around £500. 6 years 8 months versus 20 years just to even get your initial capital back is a stark difference and one that rightly put annuities out of favour.



Source: Based on male aged 65, single life, no escalation. The Annuity Project [2]

With the announcement of pension freedoms, annuities became spectacularly unattractive when compared to more flexible new alternatives, leading to a collapse in sales. According to the Financial Conduct Authority's (FCA) Retirement Outcomes Review, over 90% of pots were used to buy annuities [3] before pension freedoms. The Regulator's latest retirement market income data for 2021/22 [4] shows that this figure is now only 9%, with 30% of people opting to enter flexi-access drawdown (FAD), 6% took an uncrystallised funds pension lump sum (UFPLS) payments, and 55% were fully withdrawn.

What choices retirees made with their pension pots:



Source: Retirement income market data 2021/22, FCA [4]

Annuity technology = Legacy technology

But along with annuities, the death of the administration systems that supported them had been evident for some time, with old technology in a state of steady decline, exacerbated by the lack of new entrants into a dying part of the retirement ecosystem. Even back in 2015, these systems were generally considered as legacy technology with green screen mainframe systems or dated windows client server technology. The requirements of traditional annuities as a 'one and done' style product gave little justification for switching to modern technology that could provide greater ongoing functionality for advisers and the end client. As a result, innovation was absent and agility was non-existent.

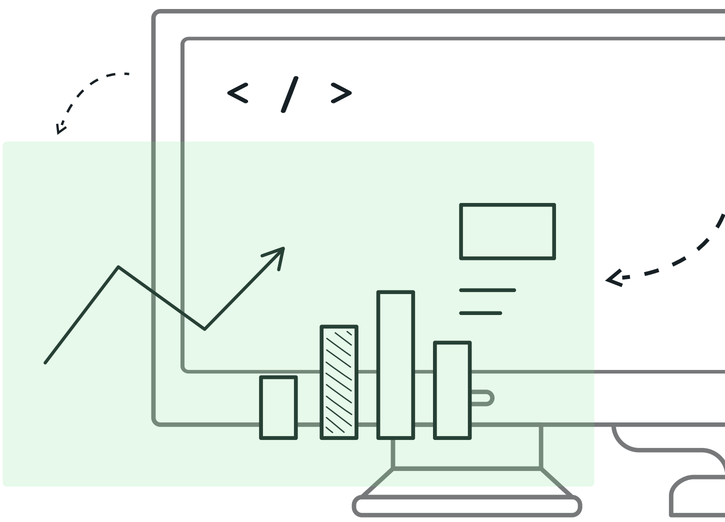
Providers struggled to understand and justify suitable action to mitigate the increased risk, inefficiencies, and rising cost of ownership they faced from maintaining a dwindling book of annuities. Many decided to close operations and sell their annuity back book to derisk. Only a handful remained open for new business. Those providers were left with difficult decisions around the maintenance of their annuity policy administration systems, battling increasing costs to remain operational and compliant, but ultimately still in containment mode.

Many of the legacy annuity technology solutions have been dressed up to feel modern, with new user interfaces and some integration capability, but the core of the system is still old tech and the problems associated with running it haven't gone away, they've just tried to be hidden. Things are changing though and there are now new and more compelling options for annuity providers. GBST's Composer, a leader in providing retail wealth investment platform technology, extended their support for a broad range of annuity administration capability in 2021. This was completed and made available on its API enabled SaaS delivered modern technology stack, a game changer for the next generation of annuity administration.

"There's still a lot of operational friction in the annuity process today. There aren't many easy or seamless ways in which you can transition your accumulation pot into a decumulation pot. Much of the technology that underpins annuity products has lacked innovation and investment for some years. That has resulted in a lot of manual, offline, paper-based processes and quotations that break the journey from the adviser and end-client perspective, which doesn't help with completing the decision process."

David Simpson
Head of EMEA, GBST

GBST



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The changing shape of retirement

When the pension freedom rules were introduced, the average age of the baby boomer generation (those born between 1946 and 1964) was 60, making them the first age group to benefit from more flexible pension access. Even before pension freedoms, the shape of retirement looked different for this demographic, for several reasons.

The baby boomers could expect to live longer than their parents and grandparents. According to the Office for National Statistics (ONS), when the first boomers were born, the average life expectancy was 63 years old. Today, baby boomers can expect to live to almost 79 years.

They were also likely to work longer, not least because of a change in the State Pension Age (SPA). From 1948 the State Pension age was 60 for women and 65 for men. The Pensions Act 2011 introduced the equalisation of State Pension age for men and women, with women's pensionable age increasing to 65 in 2018. In 2020 it was increased for men and woman to 66, with plans to increase to 67 between 2026-2028 and then 68 in the mid 2040's.

In addition, according to ONS, employment rates among older people had been rising since the 1990s. Two-thirds (66%) of men between 50 and State Pension Age were working in the third quarter of 1992, compared to 88% in the same quarter of 2012, while women workers rose from 59% to 70% over the same period [5]. These increases also continued into later life, with both men and women still in work beyond SPA rising from 8% to 12% [6].

This trend has been further stimulated more recently, with the Covid pandemic followed by the cost-of-living crisis changing the way people think about retirement. While initially ONS saw an increasing trend of older people leaving work throughout the pandemic, most frequently to retire [7], its latest labour stats show record levels of employment among those aged 65 years and over [8]. As well as working longer, this generation expected to be retired longer, with latest ONS figures showing that most people will expect to live for approximately 20 years post-SPA.

At the same time, the wealth of baby boomers in later life has improved dramatically compared to previous generations, thanks to the UK's post-war economic success, access to generous workplace pensions and an ability to buy affordable housing. According to the recent UK Poverty guide, in 1990 the pensioner poverty rate was around 28% and now it's down to around 15% in 2021 [9].

Spending the kids' inheritance

Enjoying longer, wealthier, healthier retirements led to a change in attitudes around how retirement should be spent. With people's attitudes surveyed at the onset of pension freedoms to test the water, nearly 70% of UK adults planned to use their wealth to enjoy later life according to 2015 research by wealth manager Brewin Dolphin, spending their retirement savings on luxury travel (26%), once-in-a-lifetime adventures (12%) and buying property abroad (9%) [10].

The pension freedoms legislation facilitated the baby boomers' desire to make the most of retirement. It led to significant numbers of defined benefit (DB) pension scheme members transferring into more flexible defined contribution (DC) schemes, with FCA data showing that nearly 235,000 members took advice on a DB transfer between April 2015 and September 2018, on transfer values worth over £80 billion in total, with over 70% going ahead with the transfer [11].

FAD is the new FAD

In these circumstances, it's easy to see why Flexible Access Drawdown (FAD) may look more attractive than an annuity for many people making decisions at retirement.

Unlike an annuity, FAD offers consumers the flexibility to take lump sums or a regular income from their pension while leaving the rest of the pot invested with potential for further growth. It also has the advantage of being able to pass any remaining funds to one or more beneficiaries on death.

Added to these advantages is a sense of accumulated wealth staying accessible and available for all manner of requirements. Protected from IHT, there is a tax-efficient option to leave the funds for beneficiaries and at the other extreme if difficult times arise there is always the option of taking all the fund as a single cash sum through UFPLS, an Uncrystallised Funds Pensions Lump Sum. In other words, consumers feel like they still have their large pot at retirement and have not given it all away in a 'one and done' decision to purchase a regular income.

3

FAD isn't always FAB

However, FAD isn't necessarily a silver bullet for retirement income.

An income drawdown pot remains exposed to market risk, meaning it may not grow as planned, taking out too high an income could result in running out of money sooner than expected, as well as potentially raising the possibility of paying a higher proportion of tax on pension income taken. Market volatility last year has shown the problem of relying on stock market investment for retirement income. The FTSE 100 fell nearly 8% in the first nine months of 2022 and the S&P 500 25% [12].

A concern with FAD is that it is possible and very easy to run out of money before you run out of life. When pension freedoms were introduced, many experts feared retirees would 'blow' their entire pension pot and end up relying on the state pension. This prompted the then pension minister Steve Webb to say it was up to individuals how they spend their own money: "if people do get a Lamborghini and end up on the state pension… that is their choice [13].

In fact, what happened is far more mundane, but equally concerning. Research by AJ Bell in 2018, found that of the £17.5 billion that had been flexibly withdrawn from pensions since April 2015, £2.3 billion had been spent on luxury items such as cars, holidays, and home improvements. But £3 billion had been put into low-yielding bank accounts and £1.6 billion invested in other products such as ISAs [14]. When you need to make income last through a 20-plus year retirement, decisions over where to put your money can have a significant impact.

Also, while auto-enrolment (AE) has been enormously successful in driving up the UK workplace pension participation rate in the UK from 47% when it was introduced in 2012 to 79% today [15], it has created a large group of people for whom FAD is unlikely to be suitable. Most pension pots accumulated through AE contributions only are unlikely to be large enough to consider FAD as the primary source of long-term retirement income. According to the Department of Work and Pensions, the average annual pension contribution for those in the private sector was £2,110 in 2021 [16], while the ABI estimates that by the end of 2030, there will be 22 million small inactive pension pots (those worth up to £10,000) [17].

"Post pensions freedoms we were all told that nobody ever needs to buy an annuity again. But how many clients will have an appetite for investment risk in old age? It's one thing to see a drop in your pension pot when you are at the accumulation stage, we know that investments can go up and down, but it's a very, very different story if you're relying on that for an income in retirement. It's not just market volatility that clients need to be aware of, it's also the potential volatility of their income, which is a very different concept."

Cecilia Furner

Distribution Director,
Retail Annuities, Legal & General

Legal & General

Welcome to the three-stage retirement

With the changing shape of retirement, baby boomers are perhaps the first cohort to experience a three-stage retirement: an early active phase enjoying travel and new activities, a slower middle phase spending more time with friends and family, and a frail late phase, often coinciding with ill health and the need for care.

It means that, for many people, a one-off decision around pension income at age 65 is no longer a suitable way to fund a whole retirement. The different stages require a more flexible approach to retirement income planning to meet changing income requirements. While FAD might be appropriate to deliver the higher income needs with continued earned income and tax planning in the first stage, the lower income required in stage two may be better delivered by a guaranteed income covering day-to-day essentials, and stage three may need a different approach again, with the potential need for longer term guaranteed income and perhaps top-ups for care.

Alongside this more appropriate three-stage approach to obtaining retirement income, we need to consider how it can best be implemented in practice, with maximum efficiency and minimum hassle for all concerned – including pension providers, advisers and consumers (both advised and non-advised). The answer, as is often the case in this digital age lies in the use of modern technology to support both the new and the traditional product set – all on one joined up system. Having a single solution in place that enables the straightforward view and administration of annuities and other guaranteed income options alongside an income drawdown solution and all other closed and open retail investment products would allow product administrators, advisers and consumers to manage their hybrid retirement plans alongside all of their other savings and investment plans.

Sounds unlikely or even fanciful, but it is possible with the platforms underpinned by a modern tech stack, that support the traditional retail wealth investment products but also a broad range of term based and lifetime guaranteed income products.

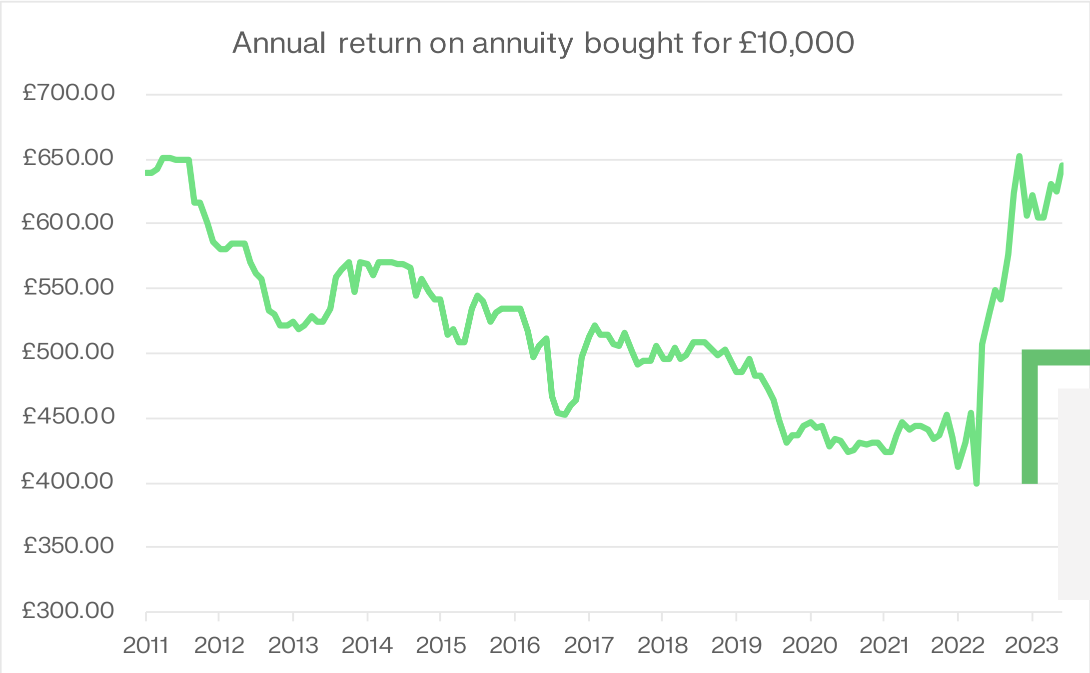
"There are lots of issues in pensions, but the biggest by a long, long way, is having enough money to provide enough ongoing income. It matters to clients we're advising now, but it also matters very, very much for people who in the future are going to be looking at providing an income stream and have really no idea at the moment how much they need to put aside to do that."

Fiona Tait
Technical Director, Intelligent Pensions

4

Annuities are back in fashion

While the current markets are damaging expected net drawdown investment returns, the economic conditions are more favourable for annuities. Thanks to rising gilt yields, annuity rates have increased by 61% in just over a year to June 2023 and their highest level in 12 years.



Source: Based on male aged 65, single life, no escalation. The Annuity Project [2]

With continued global economic uncertainty and the UK predicted by the International Monetary Fund to have the most persistent high inflation in the G7 [18], we are likely to see further interest rate hikes, which in turn will push up the gilt yields and further boost annuity rates. While annuity rates are likely to stabilise and may drop back in the future, the longer-term resting place may be significantly higher than it has been for the last decade.

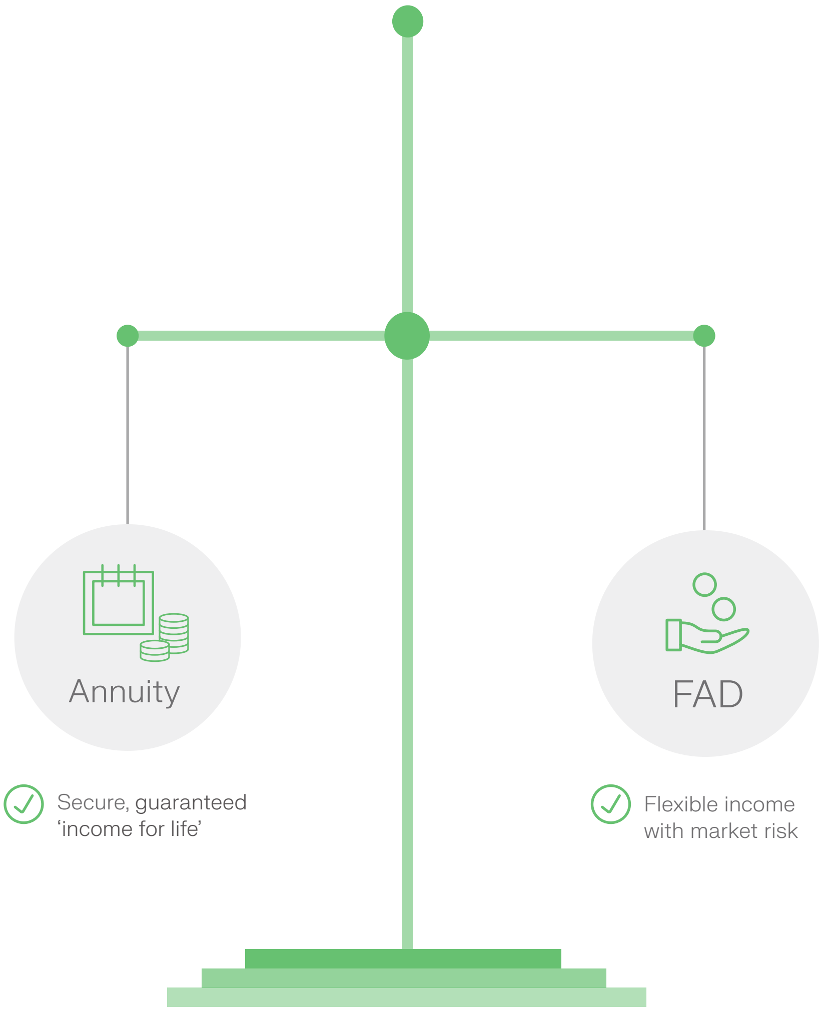
Higher annuity rates coupled with ongoing market volatility are making guaranteed income more attractive for retirees. The latest FCA retirement income market data to the end of April 2022 shows sales rising 13% over the previous year [19]. In addition, more recent anecdotal evidence from annuity providers suggests that demand is increasing, with Canada Life seeing in August 2022 a “20% increase in quote activity compared to last year” [20].

> ***“The rate of income on an annuity is always going to drive purchases to some degree. We’ve seen a 40% increase over the last year, which is a seismic change in the figures. If you extrapolate that over a 30-year retirement, that’s a massive increase in the amount of income that a client can get.”***
>
> **Andrew Tully**
> Technical Director, Canada Life

Due to the jump in annuity rates since the start of 2022, Canada Life calculates that the break-even point, when you would receive your original pension back through income, for a level annuity has fallen from 22 years to 15 [21]. It found that a benchmark annuity of £100,000 at age 65 would now pay a guaranteed income of £6,873 a year, meaning they would have received their original pension back by the age of 80. Given that 2020 ONS figures put life expectancy for 65-year-old men at 18.5 years and women at 21.0 years [22] , at current rates you have a strong chance of getting more than your money's worth from an annuity without the worry of market risk or complexity of managing income drawdown rates.

At the same time, the baby boomers are growing older. By 2025, the average age of the cohort will be 70, with the oldest 79, and approaching the slower middle stage of retirement. In this phase, attitudes are likely to shift towards lower risk and, as residual earned income reduces or ends completely, the need for more certainty of income becomes increasingly important.

It is quite likely that in planning for this phase of retirement, reintroducing a secure, guaranteed 'income for life' product that provides an element of certainty and de-risking income in later retirement will be seen as an essential counterbalance to the 'FAD only' solution.



Regulation favours the (less) brave

In addition, the new Consumer Duty rules place greater emphasis on taking account of customer vulnerabilities. Consumers are more likely be become 'vulnerable' as they age, with the FCA stating that "those aged over 65 are disproportionately likely to be potentially vulnerable" [23]. It could be argued that vulnerable customers in particular would benefit from at least some form of guaranteed income to ensure that essential bills are covered regardless of market movements, as well as being freed of the necessity to take steps (with or without a financial adviser) to try to ensure that a pension in drawdown lasts until end of life. Compared with FAD, a guaranteed income arrangement such as an annuity is simplicity itself, with no need to be managed by anyone.

As well as the changing retirement landscape, regulation is evolving too, placing a significant new set of requirements on providers and advisers. The new Consumer Duty, which comes into force in July 2023, [24] includes four required outcomes for Providers and Advisers:

- Products and Services must be 'suitable' for the target market – and this takes into account any vulnerability such as age, and the need to avoid unnecessary complexity.
- Price and Fair Value – including an assessment as to whether a simpler, less complex, less expensive solution would be a suitable alternative.
- Consumer Understanding – requiring the 'average customer' to be able to understand the product/service, and show evidence to support this.
- Consumer Support – again referencing the ongoing characteristics of vulnerability.

"Most people are going to need a mixture of flexibility and guarantees with their income. Maybe differing ratios at different times during their retirement, but overall, that mix of flexibility and guarantees is going to be appropriate for nearly everybody. Annuities should always be considered, even if they are not appropriate at that particular time."

Renny Biggins
Head of Retirement, TISA

TISA

The rules also include a strengthening of the existing Consumer Principles, requiring firms to evidence that they sought to 'avoid causing foreseeable harm to retail customers'.

Each of the four outcomes may point vulnerable later life consumers with diminishing cognitive capability some way back towards guaranteed income, as a solid backbone to their retirement income planning when compared to the relatively complex management and risk when taking flexible income. If we think about the impact of a significant fall in investment values coupled with the compounding erosion of 'pound-cost ravaging' (when drawing down income from a diminished portfolio) the impact on mental health and emotional wellbeing is being potentially more detrimental to an already vulnerable person. It is therefore possible to conclude that not protecting the essential spend element would not be protecting against potential 'harm that is foreseeable'. All in all, the complexity of FAD, involving the need for active management of retirement income including endeavouring to make it last, clearly presents a specific potential danger to vulnerable consumers by comparison with the simple solution of guaranteed income.

"Drawdown's been around for 30 years or more, but it's easy to forget that the concept of people going to beyond 75, beyond 80, still in drawdown is relatively new. If we go back 10 years people might have gone to 75 before phasing drawdown out and buying an annuity. The implication of having an investment risk in your 80s, with the potential for vulnerability and cognitive decline at that age, is an important consideration. The idea of gradually de-risking a portfolio into annuities at that point will make sense for people, certainly in smaller pots."

Andrew Tully
Technical Director, Canada Life

5

Advised consumers - the few among the many

One of the major problems with retirement income planning is that decisions are often complex and can be irreversible. Getting suitable professional advice is crucial and yet most people don't, which can lead to poor outcomes.

Open Money's The UK Advice Gap 2021 report found that the number of people taking professional financial advice is falling, from one in 10 in 2020 to one in 14 in 2021, and more people would pay for it if it cost less [25].

The growing advice gap, at least in part, is an unintended consequence of the Retail Distribution Review (RDR), introduced on New Year's Eve 2012, which led to a significant shift in advice models. In its 2014 Post Implementation Review of RDR on behalf of the FCA, Europe Economics quotes research from Schroders as finding that 80% of advisers would not service clients with assets below £50,000.

More recently, in the Lang Cat's latest State of the Adviser Nation research, about half (49%) of firms surveyed stated they require no minimum investment assets, but the report's authors caveat this finding by saying, "We don't think this is the same thing as saying that firms are welcoming lots of clients that aren't cost-effective for the firm to service." Of the firms that required a minimum, over two-thirds (69%) will only take on clients with more than £100,000 in investible assets [26]. So over 10 years on from RDR, professional financial advice is still not a feasible choice for the mass market.

In addition, there are simply not enough advisers to service the entire population of retiring UK consumers who will need to make key decisions about their pensions. According to ONS population figures, there are approximately 18.5 million people in the UK over 55 [27] , with just 36,674 advisers to serve them [28].

To help non-advised consumers manage the complexity of retirement decisions, the FCA introduced investment pathways in 2021 where providers offer four ready-made investment options depending on how they plan to use their pension pot over the next five years. However, these pathways risk over-simplifying people's needs, with FCA's own research finding that 25% of consumers want more than one 'type' of income [29].

For the rest of this decade for the baby boomers, and long into the future thereafter for others, the need for an accompanying suite of simpler retirement products, more easily understood by consumers, more easily distributed directly to consumers (with or without guidance), delivering long term income and security to those with vulnerable characteristics would surely be an attractive proposition. While direct-to-consumer guidance and automated advice solutions, including investment pathways, may educate people in their retirement choices and support the purchase of less complex products, for many people taking a more flexible approach to retirement income, that provides some security but can be adapted over time would be more appropriate, than a 'one and done' choice at-retirement.

"I've spoken to a number of people in the industry and there's a few supporters of sort of putting in place a default decumulation journey. But quite simply, it's such a personalised journey with so many different variables, it makes having a default, extremely challenging and potentially detrimental to individuals as well."

Renny Biggins
Head of Retirement, TISA

6

Is a hybrid 'Mix and Match' approach the answer?

As we've seen, FAD is useful for flexibility over retirement income, especially in the early stages of retirement when there is greater demand to vary income for discretionary spending on holidays, a new car and other luxuries. And at the point of retirement, people tend to like the fact they have their pension pot and are in control of their pensions rather than 'give it all away' to purchase an annuity. Yet certainty over income is also important, especially in periods of significant market volatility, to cover day-to-day essentials.

Research by the Just Group in 2015 highlighted this conflict: when it comes to their retirement income, people want to combine flexibility with certainty. It said, "The consensus of consumer research shows that people with sufficient pension savings would like the best of both worlds – a guaranteed income for life to ensure regular bills may be paid and a flexible fund that may be accessed when required for irregular expenditure and to provide a 'just in case' fund." [30]. So although this research is now 8 years old, the flexibility with certainty message is still the same and increasing more compelling. However, the industry just hasn't moved on in this time to really help retirees 'mix' their income streams to 'match' their circumstances.

A hybrid solution to pension income seems like the answer, combining the two options within a single tax-efficient wrapper. However, just as with investment choices, the best approach may not be binary. One wouldn't expect a medium risk client to invest half of their assets in low risk, and the other half in high-risk funds, just to achieve an aggregate blend that suits their requirements. And now with contemporary guaranteed retirement income solutions, there is no need to select from just a combination of FAD and traditional annuities to achieve an ideal tailored outcome. Innovation is coming to the annuity market via products where guaranteed income is paid into a pension wrapper and drawn by the consumer to meet varying needs and tax positions. Longer-term guarantees are also available offering greater flexibility over how the guaranteed income is paid.

New guaranteed income solutions can sit alongside other retirement planning products such as ISAs, investment bonds and flexi access drawdown. In this scenario, guaranteed income products start to look like a much more attractive option, and a key component to the baby boomer retirement plan.

> ***"A lot of the research shows that when you ask people if they want an annuity they say no. But then when you go through a set of questions, yes, they want guaranteed income that will never run out. The idea of annuities has fallen out of favour because post pension freedoms, why wouldn't you want flexibility? But now it's not a binary decision. Flexi-access drawdown and annuities can sit together and possibly give better outcomes."***
>
> **Cecilia Furner**
> Distribution Director,
> Retail Annuities, Legal & General

Legal & General

This combination of taking some pension funds over the requisite period post-retirement using FAD, along with the purchase at various timeline milestones of both traditional annuities and the contemporary, innovative hybrid annuity products (offering flexible terms from 5 – 30 years, options for death benefits and / or return of some capital) can now be used to provide a lifetime income journey suitable to a clients' individual circumstances and appetite for risk.

And so just as is the case with blending investments to engineer the appropriate outcome, there is now a selection of providers who offer hybrid income solutions for advisers and consumers to use to help achieve the optimum retirement solution.

Innovation in guaranteed income solutions

Hybrid solutions do exist and we look at a couple of examples below but we can expect to see more innovation from other annuity providers to create new, more flexible guaranteed income solutions to meet the needs of the majority of the population.

Canada Life™

The Retirement Account from Canada life

Provides a flexible pension plan that can be adapted as client needs change. On retirement, clients can choose between drawdown, guaranteed income, or a combination of the two. It allows clients to take their pension in one go, phase their retirement over a few years, take a tax-efficient income, access tax-free cash and provide for loved ones when they die. Clients can switch between the options as they progress through retirement and/or purchase a guaranteed income in stages to cope with changing income requirements during late life [31].

The guaranteed income element provides potential tax advantages. If income is no longer required, it can be retained within the tax wrapper with no tax payable until the income is withdrawn. In addition, on death after age 75, beneficiaries can maintain control of benefits, which allows them to manage income in the most tax-efficient way.

The Retirement Account allows you to you balance the security of a guaranteed income from an annuity with the flexibility and easy access of Pension Drawdown.

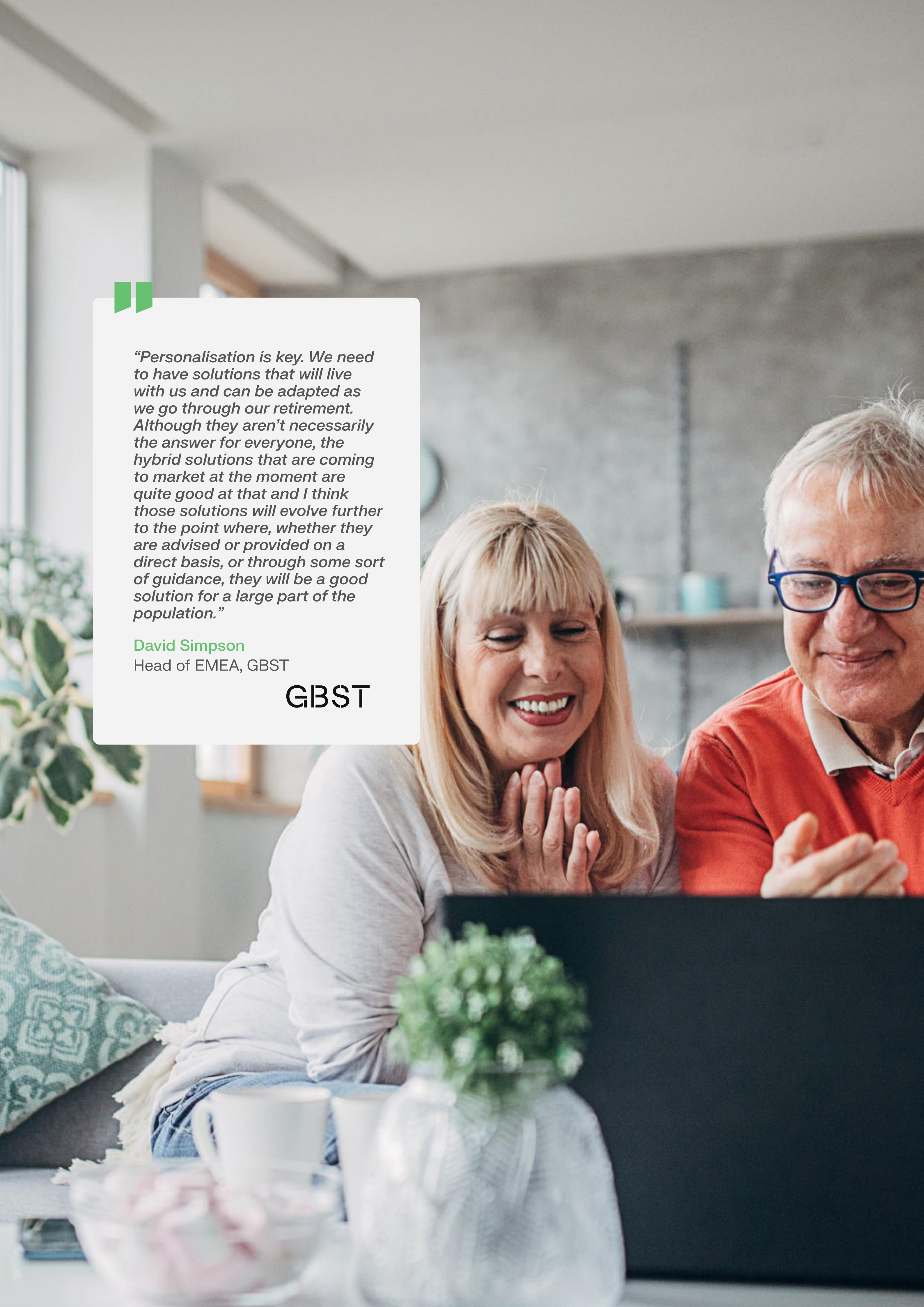
novia

Novia's Blended Retirement Income Solution

Provides clients with an element of guaranteed income alongside their retirement income portfolio. Clients with their advisers calculate the level of guaranteed income required and use a portion of their capital to secure that income, taking into account the client's individual health and lifestyle.

The guaranteed income element sits within the client's SIPP alongside their other retirement savings and investments and monthly payments can be used immediately to support their lifestyle or reinvested within their drawdown arrangement. If circumstances change, a cash-in option is available within a pre-set period after the initial decision [32].

Investments don't need to be split across multiple platforms to offer a blended investment solution and a portfolio can be built that caters for a sustainable, regular Guaranteed Income while also allowing the flexibility of investing according to the changing needs and wants of the client.



“Personalisation is key. We need to have solutions that will live with us and can be adapted as we go through our retirement. Although they aren’t necessarily the answer for everyone, the hybrid solutions that are coming to market at the moment are quite good at that and I think those solutions will evolve further to the point where, whether they are advised or provided on a direct basis, or through some sort of guidance, they will be a good solution for a large part of the population.”

David Simpson
Head of EMEA, GBST

7

Hybrid solutions in action

Let's look at an example of how flexible income solutions can meet changing income needs throughout retirement:

Joseph & Lilly are reviewing their retirement income needs to identify the options available to them.

Meet Joseph

Joseph is 55 and has reduced his working hours to enjoy a better work-life balance. He has a mortgage with a remaining term of five years, a defined contribution pension which he can access now and an occupational DB pension that will start paying at age 65 when he plans to fully retire.

Current needs and income options

Joseph wants to access his pension now to bolster his part-time earnings but expects to need less income once the mortgage is paid off in five years. When his occupational and state pensions start, his income needs will reduce further.

Joseph wants the security of having sufficient income to meet his current outgoings, with the ability to change the level of income as his circumstances change.

Joseph's needs can be met by accessing all or part of his defined contribution pension, receiving 25% as a tax-free lump sum to help him enjoy his increased free time. The remaining 75% moves to an income drawdown account.

To meet his need for a secure income for the next five years, he purchases a 5-year fixed term guaranteed income option with part of the funds in the income drawdown account, leaving the rest invested to provide a future income. The guaranteed income is paid into the income drawdown account and then paid out directly to cover his income needs.

If his income needs decrease during the term of his guarantee, he has the flexibility to leave the guaranteed income payments in his income drawdown account, invested or left as cash.

If they rise, he can sell other investments within his income drawdown account to fund additional income payments.

At the end of the five years, on receipt of a maturity value, he could take out a further fixed-term guarantee depending on his income needs, which will take him up to his full retirement age.

Income needs age 65

Joseph is fully retired and in receipt of his occupational DB pension which provides a guaranteed income that meets his day-to-day living costs.

He no longer needs additional guaranteed income and instead wishes to take ad-hoc amounts to fund his holidays. He funds these by selling investments from within his income drawdown account as required.

Income needs age 75

Joseph is concerned about the possibility of he and Lilly needing long-term care in the future, is now struggling to manage his drawdown account and wants to ensure he can fund this irrespective of how his investments perform. He also wants to pass on any remaining funds to their grandchildren when he dies.

He uses part of his remaining income drawdown fund to purchase a lifetime income guarantee within his income drawdown account to provide a guaranteed income until his death. If the income is not needed for care, it can remain in the income drawdown account alongside the remaining investments for his beneficiaries to receive on his death.

Meet Lilly

Lilly had several part-time jobs before reaching retirement age. Since the commencement of auto-enrolment, she has been a member of the workplace pension scheme offered by each employer but has no other retirement funds. As a result of her employment pattern, Lilly has several small pension pots with different providers.

Current needs and income options

Lilly is risk-averse and wants to know that her basic income needs in retirement are secure.

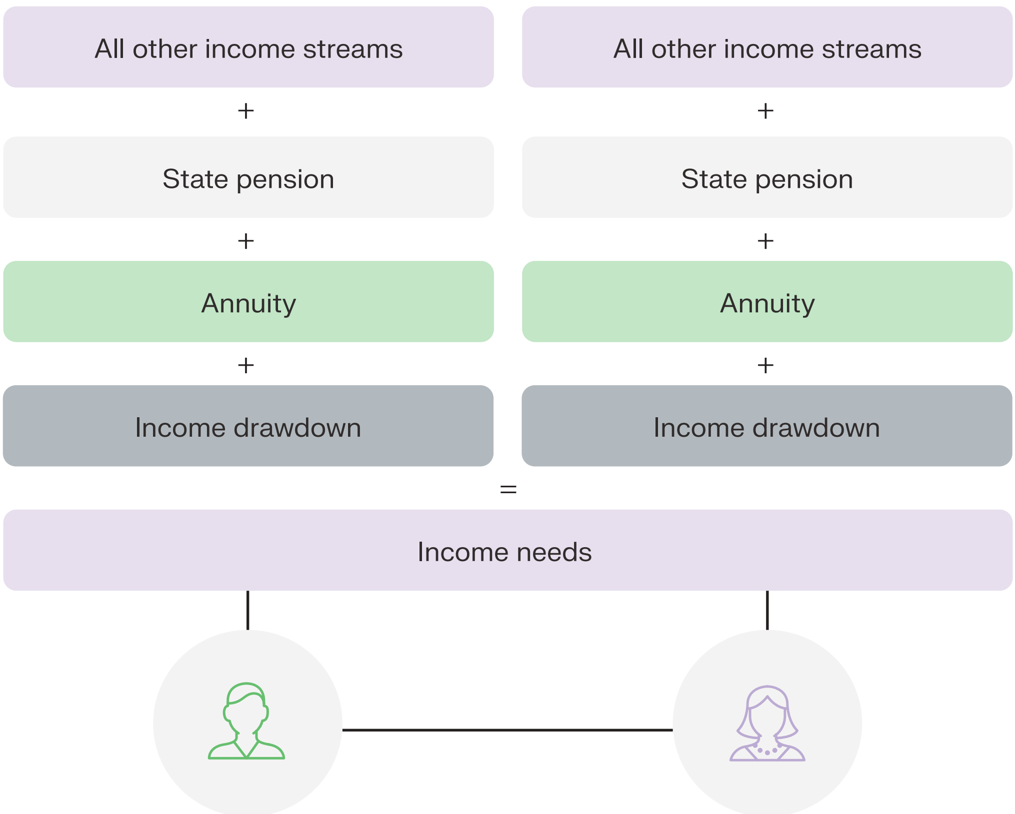
Each of Lilly's pension pots is over the allowable amount to be taken as a small lump sum, but the total value is less than £100,000. Given her income needs and attitude to risk, a guaranteed Income for Life is more suitable for her than flexi-access drawdown.

A level guaranteed income product, rather than a more expensive one that rises with inflation, fits her requirements. It provides a guaranteed income for life that meets her changing income needs throughout retirement from the first phase where spending is usually higher, to the quieter middle and late stages where spending often decreases.

Lilly chooses to pay her annuity into her SIPP wrapper, allowing her to reduce her income withdrawals when able to, whilst leaving any balance invested. In addition, this allows her to pass on any remaining balance to her beneficiaries.

One product many options

All of Joseph and Lilly's income needs can be achieved by selecting products for them both from one provider. This allows the couple to see all their retirement income in one place, but at the same time mix and match the elements used over time to meet their changing household income needs, without having to transfer money to different providers and products.



8

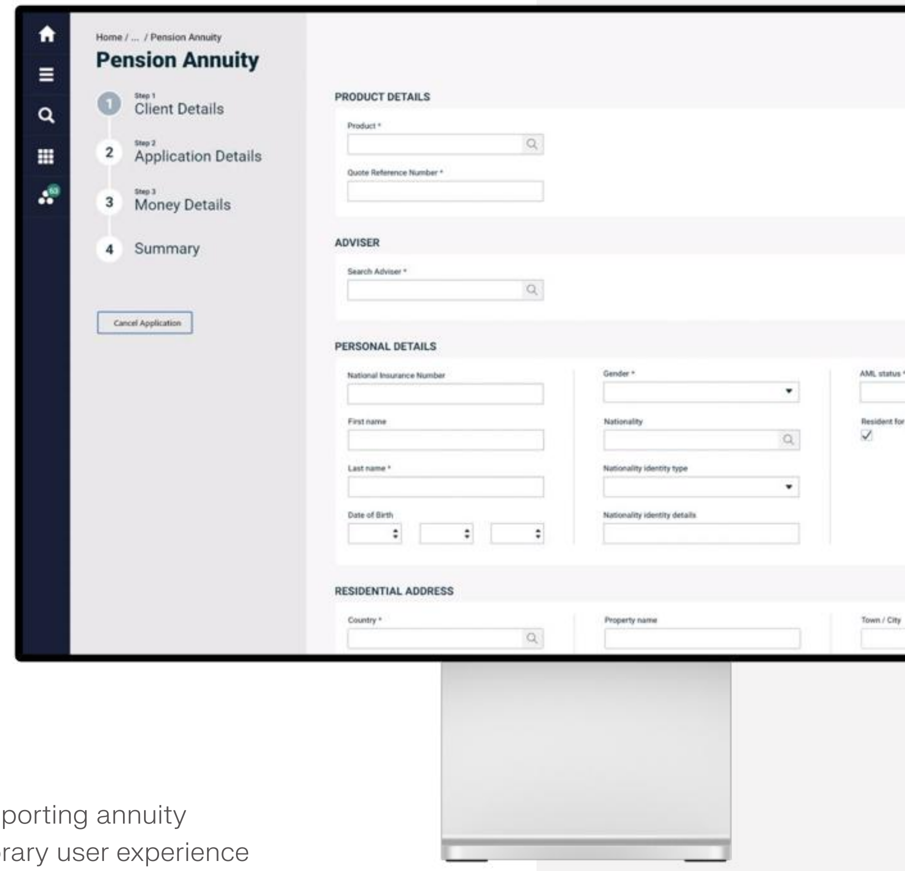
Preparing for increased demand for guaranteed income solutions

Joseph & Lilly illustrate the potential of hybrid drawdown and guaranteed income solutions within a single tax wrapper. Unfortunately, many traditional annuity providers are not currently set up to deliver a scalable new business proposition that meets the apparent demand for these solutions.

Many of the existing systems are unable to integrate with other internal and third-party systems to deliver the capability required for a hybrid solution. Frequently, providers administer older books of annuities on a legacy system and new annuity business on an alternative system, leading to broken user journeys, additional costs and risks and frustration for all parties.

Advisers and consumers now expect contemporary, joined-up, online capability to purchase products, but many systems lack efficient, intuitive user journeys for all parties. Older systems are also typically less able to deliver the digital experience commonly available for products such as ISAs, General Investment Accounts and SIPPs.

> *"Traditional annuities haven't really needed to be digitally accessible and interactive as they were a one and done solution that people bought with their whole pension pot to get an income coming into the bank account every month and that never changed. But now we're seeing annuities effectively becoming an asset class for retirement. People will have a pension pot, of which the annuity might be a small part, and also ISAs and other wrappers around it. So the annuity becomes an asset that can be managed alongside the other assets. With the changing way annuities are being used and are likely to be used, we need better technology so that they are accessible in one place with all their different wrappers and assets, for the adviser to control, and the client to see."*
>
> **Andrew Tully**
> Technical Director, Canada Life
>
> Canada Life™



Adopting modern technology capable of supporting annuity administration would facilitate this contemporary user experience for administrators, advisers and consumers. It would also provide integration capability with third-party systems where required, such as quote engines, Client ID&V and anti-money laundering tools, making the lives of all parties easier.

By migrating the older annuity books of business alongside a new business proposition on to contemporary technology, annuity providers would be able to complete all administration tasks within a single system. This carries enormous benefits in terms of removing the need for multiple, slow-running systems and manual re-keying, to enhance efficiency, reduce errors and risk and provide a better user experience.

GBST's Composer wealth administration platform is a great example of this. It supports a single customer record across a broad range of annuities types but also across other retail wealth product wrappers, including all flavours of ISA, GIA, SIPP, income drawdown, onshore and offshore bonds. These can be distributed directly, or through the advised and workplace channel. Lifetime and fixed term annuities can sit within the drawdown wrapper to retain any income so it can be paid away or reinvested based on the individuals needs.

A modern technology solution delivers high levels of automation not normally available in legacy systems, making product administration for time-consuming processes such as new business and onboarding, reporting and payments much more efficient. With the right technology, these benefits can extend across the provider's entire legacy and current product range. Providers can deliver a true 'single customer view', with common business workflows and consolidated statements across all product wrappers.

Technology to drive personalised income needs

Advances in technology and the impact this has on our lives is apparent to all of us. These advances are not stopping and will continue to accelerate, only recently we have seen the attention that AI is receiving in the media with the launch of ChatGPT, the fastest growing App on record. This capability being brought into each of our homes is very powerful with what is actually considered an early launch.

We have seen in this paper that a hybrid approach to managing income in retirement, utilising annuities for guaranteed income and flexible access drawdown to manage variable income is a sensible approach for the majority of individuals as they reach retirement. So the question is, what is the optimal approach for **ME** in retirement?

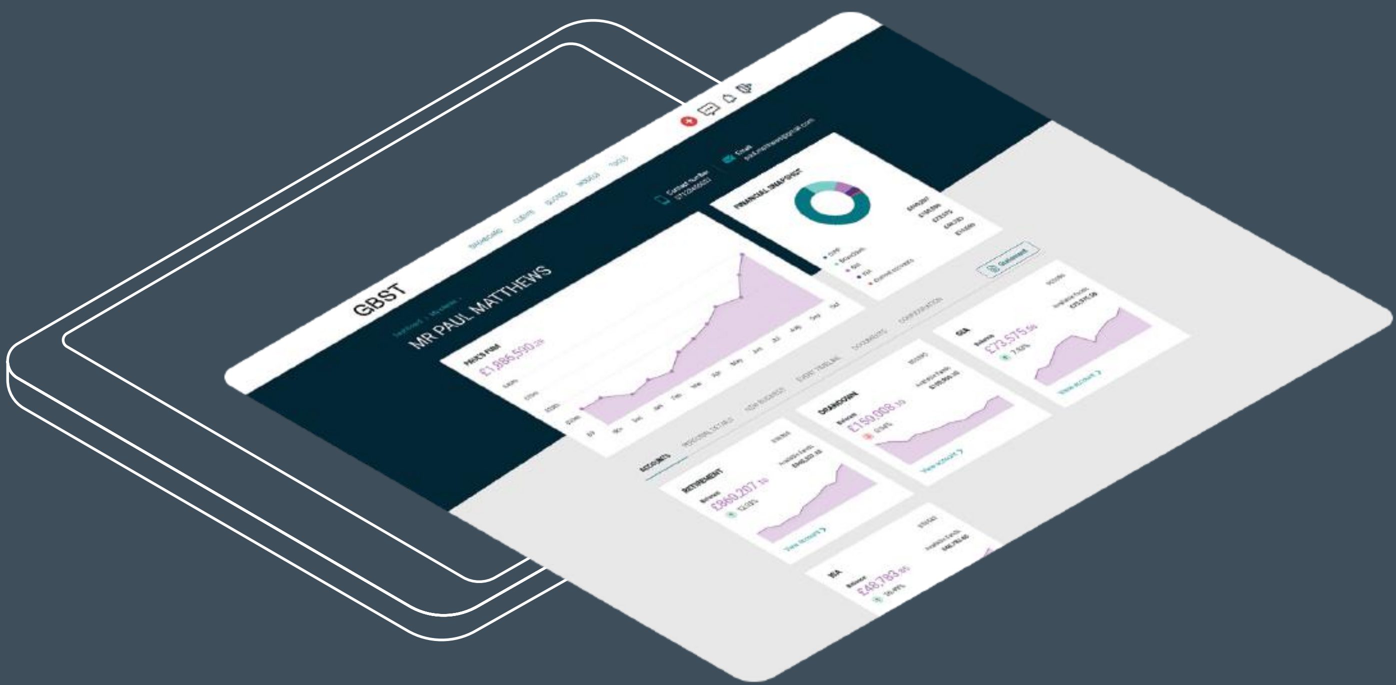
One of the primary reasons for using a financial adviser is to help with retirement income planning, whether that be in the accumulation phase, at retirement or in retirement, these are the conversations that the majority of advisers are having with client's. Financial advisers do a fantastic job at understanding the client's needs and goals, their current situation and then putting a plan in place which is personal to that one client, but that is difficult, complex, and not all advisers are equal in their ability to do this appropriately.

Technology has to play a part in this education, guidance, advice or whatever we want to call it as we progress. If we reflect back on the AI point, this ultimately comes down to relying on data driven decisions, we do this today for example with Monte Carlo simulations and stochastic models which look at historical data and predict what may happen in the future. It isn't a stretch to think that a computer model could scan vast amounts of data for similar market and customer scenarios, spot patterns and propose a retirement income plan that is personalised to each client. The model would continue to learn and improve and have greater insight and depth of understanding than any human could reasonably achieve. It could adapt the model overtime for the individual based on their changing needs and act as their financial buddy.

A newly launched service called Spero "Systematic Platform for Enhanced Retirement Outcomes" from Socius technologies goes some way towards this. Their solution provides 'dynamic retirement income solutions that are fully tailored to the individuals' unique circumstances, combining income drawdown and annuities'. Albeit not using large data sets and AI but an analytical model that is based on the concept of buying slices of annuity at different times with the objective of converting investment gains into higher levels of retirement income. It is innovative and an early example of optimising the 'mix and match' approach.

We know that financial advisers play a caring and empathetic role with clients, something that a computer is always going to struggle with but as we saw above, only 1 in 14 people get financial advice. So 93% of the population are going to be looking for a digital solution to optimise their income in retirement according to their particular lifestyle. We have seen that using one of or a combination of annuities and flexible access drawdown from their pension pot is considered sensible however there is a gap that exists in the recommendation and review phase to help direct customers to achieve an optimal income plan which aligns with their initial and ongoing needs, something that advances in AI and data driven decisions will solve.

> *"We've seen the trends in the pension landscape changing in the last few decades with DB in the private sector going and autoenrolment now firmly in place. But if you look at the ONS stats, people have got less pension wealth as they're getting older than their predecessors. We are storing up a pensions crisis for the future because the retirement pots of future generations of DC retirees aren't going to provide anything like the sort of pension income and sustainability that their parents' and grandparents' pots would have done. Technology has a big part to play in helping people manage their income effectively, which is going to become ever more important for this growing group of people who just simply aren't going to have as many assets in retirement."*
>
> Renny Biggins
> Head of Retirement, TISA



About GBST

GBST provides global technology and digital solutions for financial services organisations. Our team of experts creates vital back, middle, and front-office solutions for wealth managers, life and pension companies, stockbrokers, fund managers, investment managers and advisers, as well as delivering financial tools and digital services to banks and loan providers. Founded in 1983, GBST works with financial brands across Europe, Australia, New Zealand, the US, Canada, and the UAE. Our technology supports over 5.5 million investor accounts under administration with Direct to Consumer, Advised and Workplace channel solutions.

GBST's Composer wealth administration platform supports a single customer record across annuities but also all other retail wealth product wrappers, including all flavours of ISA, GIA, SIPP, income drawdown, onshore and offshore bonds. These can be distributed directly, or through the advised and workplace channel. Lifetime and fixed term annuities can sit within the drawdown wrapper to retain any income so it can be paid away or reinvested based on the individuals needs.

GBST Composer is a modern architected, SaaS delivered, API enabled technology platform. It streamlines operational processes, reduces operating effort and costs, drives automation, improves agility, increases security levels and reduces IT infrastructure with cloud-based solutions.

About Simplify Consulting

Simplify Consulting was set up in 2015 to bring practitioner-led consultancy services exclusively to the Wealth Management marketplace. Providing consultancy services across Strategy & Operating Model definition, Operational Excellence, Project Delivery, Analysis & Testing and Risk & Regulation for Adviser Businesses, Platforms, Asset Managers and Technology and Administration service providers.

We are known for simplicity, professionalism, and tenacious delivery. We bring domain expertise, practical hands-on experience and thought leadership to our engagements and strive to provide maximum value to our clients. Our personalised consulting approach results in tailored support designed to address the problem statement. We utilise our own SimplifyDNA Wealth capability model to support our engagements and accelerate delivery, to drive rapid benefit realisation.

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