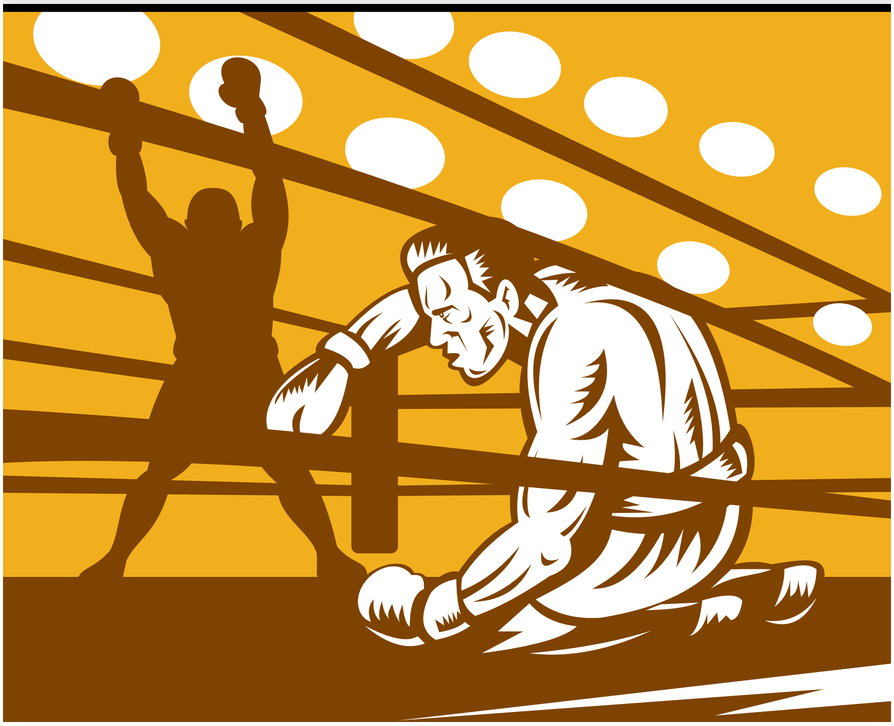
Summary
- Since the government's freedom and choice announcement removing the effective requirement for pension savers to purchase an annuity, the annuity market has suffered a series of difficulties. These include providers leaving the market, annuity rates declining and the number of annuities taken dropping from 400,000 to 80,000.
- Blended products, which incorporate the security of an annuity with the flexibility of income drawdown, are starting to enter the market. Hybrid annuities and fixed-term annuities are two products being offered.
- The decline in annuity providers and buyers has led to concerns over a lack of competition regarding annuity pricing, along with insufficient emphasis on the need for individuals to shop around.



Down but not out

Annuities may have taken a kicking following freedom and choice, but there's still a place for retirement savers to have a product that provides a regular, guaranteed income. Lauren Weymouth explores how the annuities market is evolving to meet the changing marketplace

On 19 March 2014, a statement was delivered that was set to change the pensions landscape as we knew it. Or so we thought. When former-Chancellor George Osborne said the words "let me be clear: no one will have to buy an annuity", the whole pensions industry sat in awe, and waited for the system to come crashing down.

At the time, the move wiped almost £5 billion off the value of shares in the firms providing annuities and the buy-to-let market almost immediately boomed as pensioners sought another form of regular income. If the annuity market wasn't unloved before, then it was certainly going to be now.

It wasn't just going to be savers turning their backs on annuities, either. Within the space of two years since the announcement was first made, six annuity providers have dropped out of the open market. Reliance Mutual dropped out in 2014, followed by Friends Life in April 2015 (through a merger with Aviva) and Partnership Assurance (which merged with Just Retirement), Prudential, Aegon and Standard Life in 2016.

Obstacles

Meanwhile, as a result of a cut to interest rates, annuity purchases dropped from 400,000 a year down to 80,000 in mid-2016 and four of the UK's largest insurers – Aviva, Legal & General, LV= and Just Retirement – all slashed pension payouts and axed top deals.

If that wasn't enough, the effect of Brexit began to kick in, which also sent annuity rates "falling like stone". In the two weeks following the EU referendum results alone, rates had fallen some 2-3 per cent. "In real money," Retirement Intelligence director Billy Burrows notes, "what that means is if you have £100,000 in your pension, you'll be able to get £500 a year less compared to a year ago and £100 to £150 less than you could have got last week."

So it's safe to say, things haven't been looking good. Annuities have been running hurdles for two years, persevering in a market that is dwindling by the day.

New faces

But while market turbulence has dominated the headlines, potential alternatives to the traditional annuity seem to have been like a fox in the night time; quietly doing their business with no one around to see.

Punter Southall Aspire to Retire principal Stephen Greenstreet highlights how post-April 2015 – when the new changes came into effect – has required greater innovation from providers to offer products that offer guaranteed income and sustainable income.

Greenstreet highlights how this is "beginning to emerge now that we are beginning to understand behavioural trends". He explains that whilst we now understand the impact of low interest and gilt yields, "it is clear that annuities remain important to a lot of individuals, especially in terms of the guarantees they offer, the improved flexibility surrounding death benefits and how they can be used within a blended solution approach to retirement planning".

But how many providers have been offering alternative products? Capita head of retirement Rob Tinsley notes how just "one or two" providers have introduced a contract that can incorporate drawdown and annuity. But, he says: "These are gaining some traction as they provide a vehicle to achieve a blended approach which, for many, combines the benefits of a guarantee and flexibility."

Hybrid annuities have become increasingly popular among savers as they combine both drawdown and annuity elements, providing people with a steady income stream, but with the additional benefit of being able to drawdown along the way.

But Tinsley adds there has also been an increase in the use of some fixed-term annuities, for the extraction of cash from small pots. "This provides a tax-efficient method to extract cash over a period of years and includes some guarantees not available under FAD," he notes.

Fixed-term annuities and hybrid annuities with guarantee periods have picked up momentum as they address retirees' concerns that an early death no longer has to mean total loss of their retirement pot for dependants, Altus senior consultant Jon Dean adds.

But while some of these products have been quietly picked up, savers are still continuing to opt for traditional annuities, as for many, a constant income stream provides a safer and more reliable retirement.

Greenstreet notes how the demand for traditional annuities particularly lies in the "mid mass market" where individuals are "not looking to take cash beyond their pension commencement lump sum".

"Annuities are an important part of retirement planning and this can extend to ensuring there is at least a guaranteed level of income to meet essential expenditure needs, maybe as part of a blended solutions approach combined with other products as well as the intergenerational tax planning opportunities that are now available," he continues.

Market competition

While the market remains volatile and there is still a demand for annuities, it has become more important than ever that shopping around is a possibility for savers. But with a mass exodus of providers from the open market, there is a serious lack of competition to keep rates low.

Hargreaves Lansdown head of retirement policy Tom McPhail notes how the Association of British Insurers introduced annuity rate tracking because of these kind of concerns about market competition, but it was then "quietly dropped" after the freedoms, arguing most investors weren't buying an annuity any more.

"However 80,000 people a year are still buying an annuity," he argues. "Fewer companies are competing on the open market and fewer investors are shopping around. Unless decisive action is taken quickly, in a few years' time insurance companies are going to be looking back at another miss-selling scandal, wondering how it all went wrong yet again."

Research conducted by the Financial Conduct Authority found 80 per cent of annuity purchasers could get a better deal by shopping around, with the average increase in income available standing at 6.8 per cent. Furthermore, ABI data shows the difference between the best and worst annuity rates is typically around 20 per cent.

But why do such gaps exist? Moneyfacts head of pensions Richard Eagling explains the rates are so varied because a significant number of retirees are remaining with their existing pension provider, which is in turn, reducing the motivation for providers to compete on price.

Eagling adds this is also the reason some annuity providers, such as the big six that have already left, are pulling out of the annuity market so rapidly, as they have been evaluating whether it is viable or attractive to play an active role in the market, or whether they should concentrate on areas such as drawdown instead.

A place in the future

However, despite such negative market volatility, it is somewhat reassuring to see the annuity market has not given up. Providers are gradually coming up with new retirement solutions and savers are still opting for a constant and reliable income stream, even if it is blended with a little freedom.

But as Altus senior consultant Jon Dean notes, with low interest rates it is "still too soon to say whether sales have bottomed out to the 'new normal'.

"Initially after the 2014 Budget, all annuity sales suffered a massive drop (although they were on the decline since 2012). Since then we've seen fluctuations and mini-recoveries, but are these statistically significant or just seasonal?" he asks. Only time will tell.

Written by Lauren Weymouth, a freelance journalist