Summary
• The take up of annuities has massively declined since the introduction of pension freedoms in 2015, calling into question their very existence.
• Rates fell to their lowest point, since the Brexit referendum, this year.
• Six providers remain, and, in July, Scottish Widows extended its services to the standard annuity market.
• Experts differ on whether a rebrand is needed, with some suggesting more needs to be done to educate people on how annuities can be used effectively.

Life in the old dog yet?

Annuity rates have taken somewhat of a battering throughout 2019, reaching their lowest point since the Brexit referendum in late August. What does this mean for the product going forward?

'Unloved', 'out of date', 'dying' – just a few of the myriad ways the annuity market has been described in recent times, as the introduction of freedom and choice has taken its toll on the market that once ruled the pensions landscape.

Figures from the Financial Conduct Authority (FCA) show that 55 per cent of all DC pension schemes are now withdrawn in full, highlighting the transformation in the way people are managing their money once they hit or get close to retirement age.

This year, annuity rates hit their lowest rates since the months following the referendum, in part driven by falling gilt yields. At its lowest point, rates were 16 per cent lower than at the start of the year for a 60 year old, 14 per cent for somebody aged 65 and 11 per cent and 9 per cent for 70 and 75 year olds, respectively.

The six main providers left in the market, Just Group, Legal & General, Canada Life, Aviva, Hodge Lifetime and Scottish Widows, accounted for four out of five annuity sales over 2018/19, but while they might have the market share, what does this mean for the annuity market as a whole?

A dog's life?

FCA figures show 11 per cent of people accessing their pension for the first time purchased an annuity over the past year, down on the 12 per cent in 2017/18 and 13 per cent over 2016/17, but there are signs the market is moving in the right direction.

In September, Scottish Widows entered into the standard annuity market, extending the current offering from five providers to six, increasing competition among providers and potentially rates.

Hargreaves Lansdown senior analyst, Nathan Long, argues that the extension of Scottish Widows from enhanced to standard annuities will benefit the market.

"Their rates are pretty competitive and as a result are forcing others in the industry to sharpen their pencils and improve their rates, which is a big positive for the market as a whole," he says.

While the overall competition of the market is changing, Pensions Institute director, David Blake, believes the way people will access annuities will change too.

"Annuities – or something very much like them – will remain an essential feature of a pension scheme at some stage. The survival credits built into annuity rates, which increase with age, means that it is not a question of if but when pensioners should annuitise," he says.

The regulator's retirement income market data showed that 55 per cent of annuities were taken out by plan holders aged 65 and over, compared to 23 per cent of other withdrawal types, meaning annuity versus drawdown is not an either or decision.

"The highest financial return may come from a mix of secure income and drawdown, including replacing bond-equity holdings with annuity-equity, and also the effects of mortality drag," says Just Group communications director, Stephen Lowe.

Despite this, Just Group made an active decision to write less business over 2019, becoming 'more selective' in the retail annuity market as it seeks to become 'capital self-sufficient' by 2023.

"We've decided not to write as much business because of that. It's not that we don't find those markets attractive, but that's our limiting factor," Lowe explains.

While freedoms have had a significant impact on the nature of the market, Long argues that the low gilt yields the annuities sector is currently operating in has meant that people just aren't getting good enough rates.

He adds that there are two significant events coming up, the election and Brexit, which could positively impact gilt yields, delivering an uptick in annuity rates.

"The point is people will buy an annuity, but not at any price," he says. "If gilts sold off and annuity rates got better, I think we'd be having a different conversation and people would be buying them."

New tricks

So if there is life in the old dog yet, what measures can be taken to teach it new tricks?

Just Group, who call the product a Guaranteed Income for Life, believes the market is calling out for 'genuine product innovation' as the market has failed to react to the introduction of freedoms.

Long agrees: "I think what we will probably see is that pensions freedoms are more aligned to modern working practices. More and more are going into semi-retirement.

"Why would you buy an inflexible income at one point in time while you still get a secure income from work. Realistically you are going to see for whatever reasons the age people are buying annuities pushed back."

However, there is some innovation happening in the market.

Earlier this year, Just Group launched a solution called Secure Lifetime Income (SLI), allowing advisers to offer their clients a guaranteed income within their self-invested pension plan (SIPP) wrapper on an investment platform.

"SLI is has been built to operate in a modern fintech world – delivering digital underwriting, online quotes and paperless applications," Lowe adds.

Recently, Legal & General introduced an annuity market comparison site, Annuity Ready, showing rates across the six annuity providers, allowing customers to straightforwardly find a better rate 'should it become available'.

While Long agrees that annuity providers must utilise fintech in order to bring costs down for both insurer and client, the real innovation needs to come from how to help clients blend annuities and drawdown.

"The most optimum price is around £40,000-£60,000, which prices many buying regular tranches of annuities out of the market. However in the future if you brought that price point down to £20,000 or £10,000, that makes it more achievable," Long explains.

"The real innovation needs to come

in how to help clients blend annuity and drawdown. How do you help them understand for themselves when they should start buying the annuities, so it's kind of on the advisers," he adds.

Blake agrees: "I think there will be a resurgence. They are most useful in the form of deferred annuities, ie, annuities that are bought when the individual retires, but do not come into effect until much later in life, say around age 75 or 80.

"It could be rebranded as 'longevity insurance', providing a guaranteed income once someone reaches a particular age. The cost will only be 10-15 per cent of the size of the pension pot at retirement, which is much easier to sell than giving away the entire pot at retirement in exchange for an immediate annuity."

While the shape of the annuity market may have changed beyond recognition since 2015, and while we may not know the extent of that change until the full extent of pension freedoms is laid bare, most still believe there is a place for a guaranteed income for life in the pensions landscape, but improvements are needed.

Written by David Andrew, a freelance journalist