



The Actuarial Profession

making financial sense of the future

Annuities

A Briefing Document from the Actuarial Profession

March 2004

Annuities

Annuity – a stream of income payments from an insurance company in return for a single up front premium

Introduction

This document begins by explaining how annuities work. Once understood, the concept is simple, but nevertheless it is often misunderstood, which gives rise to some of the myths concerning annuities and the value they provide.

The document goes on to examine how the annuity market works, how insurers price annuities and where they invest the funds.

The paper then examines some of the current issues in the annuity market, including capital requirements, whether annuities offer fair value to consumers and the recent European Commission proposal that all annuities should be priced on a gender-neutral basis.

The paper concludes with a historical perspective, looking at how annuity rates have reduced over time and the implications for pensioners and guaranteed annuity rates.

Annuities have seen considerable recent interest shown in them by politicians, regulators, journalists and other commentators. They have a very important social function to play in the provision of retirement income. Many people have saved throughout their lifetime in a pension plan in order to provide an income after they cease employment. An annuity enables the pensioner to enjoy the fruits of their accumulated pension savings without the risk of running out of capital in old age.

How annuities work

At retirement, a pensioner may purchase an annuity from an insurance company.

In exchange for a single payment to the insurance company, the pensioner is promised a regular income for the remainder of his or her life.

The level of the pensioner's income is fixed at the commencement of the contract. This can stipulate that each year's income will be the same, or it can stipulate that each year the income will rise by a fixed amount, or it can stipulate that each year the income will rise in line with an index, such as the Retail Price Index. But the crux of the contract is that however long the pensioner lives for, the insurance company will continue to pay the pre-determined level of income.

In setting the purchase price, the insurance company takes a view on how long the pensioner is expected to live for, and how much interest the insurance company can earn during the period when it is holding the money.

Each payment of income may be viewed as combination of two elements – the interest earned on the money invested and a partial repayment of the pensioner’s capital. If the pensioner lives for their expected lifespan, the regular annuity payments will have repaid all the invested capital to the purchaser (if expenses and profits are ignored)

The pension generated by the purchase of annuity will therefore be greater than the income that would be available to the purchaser were they instead to invest their capital in a bank account and live off just the income.

Insurance companies sell annuities to a great many people, and it is this pooling of mortality experience that enables the insurer to operate the annuity. From, say 1000 annuities sold this year, the insurer will expect about 17 people to die next year, a few more the year after and so on. Each year, the insurer will have to pay a pension to a few less people than the year before. The insurer sets the annuity price accordingly.

Insurers take account of age and gender when setting the price of an annuity, but do not usually ask further questions about an individual’s health. They rely on the pooling of mortality experience to average out individual health variations.

Looking at it from the customer’s viewpoint, those who die early lose the balance of their capital that is still held by the insurance company. This capital is then used to continue pension payments to those who live longer than average, and whose own funds would have been used up.

One of the popular misapprehensions about annuities is that insurers pay out only the interest earned on the investment, and pocket all the capital on the death of the annuitant. This myth can be dispelled by the above explanation of how annuities work.

This misapprehension is particularly evident at times when interest rates are exhibiting what is called a reverse yield curve. At such times, the short term interest rates available under a bank account are higher than the long term interest rates that determine annuities (i.e. the reverse of the normal yield pattern, where long term rate are higher than short term). In these circumstances, a pensioner could generate a higher immediate income by investing in a bank account than in an annuity, but it is to be expected that the bank rate of interest will fall in due course and that the annuity will generate more income over the long term.

Case Study

Tom and Jeremy are both about to retire, aged 65, and both have savings of £10,000 that they wish to use for income throughout their retirement.

Tom goes to an insurance company, and purchases an annuity, which promises to pay him £700 pa for the rest of his life. The insurance company will invest its funds in long dated stocks giving them an interest rate of 5%.

Jeremy goes to a bank. The bank offers a guaranteed long term interest rate of 5%, which is £500 pa. Jeremy decides that he is going to take an income of £700 pa from his account (the same as Tom is getting from the insurance company), so Jeremy is using up a little of his capital each year.

Jeremy consults an actuary, who is able to tell him how much capital he will have left in his bank account to leave to his heirs when he dies.

If Jeremy dies aged 70, he will have £8,790 left. If he dies aged 80, he will have £5,278 left.

But the actuary also warns that before Jeremy reaches his 90th birthday, he will have received a letter from his bank manager telling him that his account is now empty!

Tom will have nothing to leave to his heirs, but he will receive his pension of £700 pa for as long as he lives.

The two types of annuity

There are two distinct types of annuity, called Compulsory Purchase Annuities and Purchased Life Annuities. The difference lies in their tax treatment by the Inland Revenue.

Compulsory Purchase Annuities, the more common form, are bought with the proceeds of a pension fund. The purchaser of a compulsory purchase annuity will have to pay income tax on each payment of income from the annuity. This reflects the fact that the pension fund was originally built up with pension contributions that received full relief from income tax. The Inland Revenue will usually ask the insurance company administering the annuity to deduct tax at source, in the same way as an employer deducts tax from income under the PAYE scheme.

Purchased Life Annuities, the less common form, are bought by individuals using funds from their own pocket. The Inland Revenue use a standard table to divide each annuity payment into part capital repayment and part interest. The purchaser of a Purchased Life Annuity will have to pay income tax only on that part of each payment of income that the Inland Revenue regard as interest.

How does the market operate to ensure a fair price to consumers and a fair profit to insurers?

Insurers are commercial companies that seek to make a profit from selling annuities in a competitive market.

The annuity will be priced by the insurer so that if policyholders on average live for their expected lifespan, then the sum of the initial purchase price plus the interest earned, less the insurer's expenses and less the pension payments made will be a positive sum, thus leaving a residual profit for the insurer at the end of the day.

This profit falls to the owners of the insurance company. The downside risk is that if pensioners live longer than expected, there will be a shortfall, which must be made up by the owners of the insurance company. This has been the case in recent years, which have seen actuaries revising their expectations of how long existing pensioners will live for.

In a proprietary company, the owners are shareholders, and the profits can be distributed as dividends, and losses made good either from other sources of profit or from raising fresh capital from shareholders. In the case of a mutual company, the owners are the with-profit policyholders, and profits or losses are distributed to them as policy bonuses.

There is an active market for annuities. At the time of writing, the magazine "Life & Pensions Moneyfacts" shows fifteen insurance companies actively competing for annuity business. Consumers approaching retirement are free to shop around to obtain the best price for their annuity from the competing insurers. They are encouraged to do so by the Financial Services Authority and several intermediaries who advertise in the popular press.

The annuity is a very simple and highly transparent product. The consumer makes one single payment to the insurer and in return is promised a fixed income. This means that it is easy to compare the annuities offered by rival insurers to select the one that offers the consumer the highest pension for the amount of retirement funds they have available for annuity purchase.

There is also an active intermediary market in annuities. Here, in exchange for a commission, an intermediary will use market knowledge to secure the best annuity rate for their client. These intermediaries will have access to real time information over the internet that enables them to undertake a market search more quickly and efficiently than a consumer could on their own. The intermediary will also help the consumer to choose annuity features, such as an increasing income or a spouse's pension, that meet their personal needs. Additionally, the intermediary will assist with the form filling and any technical details.

It is the operation of a market for annuities, matching consumers with suppliers, that ensures that consumers pay a fair price and that insurers earn a fair profit.

How do insurance companies estimate how long we will live for?

The Actuarial Profession has been monitoring how long people live for for over two hundred years. Some of the Profession's foremost demographers are involved on an ongoing basis in the Continuous Mortality Investigation Bureau, which publishes data on mortality rates and expected life spans.

The insurance companies that underwrite annuity business contribute data to the Continuous Mortality Investigation Bureau, which collates the data from multiple sources into a single published table.

This enables the Actuarial Profession to project the lifespan of those who purchase annuities. The Profession has found that this expected lifespan is greater than that of the general population. There is a lifestyle effect here – those who purchase an annuity will typically enjoy a better standard of living than those solely reliant on State pensions, and on average they will live for longer. This factor is taken into account by insurers in pricing annuity business.

Improvements in the health of the population over time mean that pensioners are now living longer than before. Historical data by itself is not adequate for the calculation of annuity rates, as further improvements in longevity are expected. To calculate the expected lifespan of someone retiring today, insurers must include an allowance for future mortality improvement. The pattern of mortality improvement is illustrated below:

Life expectancy for a male aged 65	
<u>Year of reaching age 65</u>	<u>Years remaining after 65</u>
1901	10.6
1928	11.5
1960	12.1
2002	16.0

Source: Government Actuary's Department and Office of National Statistics

Investment Considerations

Traditionally, insurers invested the premiums they received for annuity business in long dated British Government Stock (gilts). These assets were felt to provide the most appropriate match to the liabilities, as the interest and capital payments were guaranteed and the timing of them was known.

Actuarial techniques describe how to construct a portfolio of gilts (and gilt strips) that closely match the incidence of receipts from the investment portfolio with the need to make payments to pensioners. This temporal matching reduces or eliminates altogether the risk of having either to sell investments or to re-invest surplus funds on unknown terms in the future.

This matching is important, as the insurance company that sold the annuity has guaranteed to make future pension payments, which cannot be reduced if investments under-perform. The use of these long dated fixed interest assets makes sure that the insurance company will have funds available at the right time to pay the promised pensions.

Today, however, there are only five British Government Stocks left with maturity dates 15 or more years in the future. These stocks are also much sought after by other investors such as pension funds, so their availability is limited and their price is high. In the bulk annuity market, the purchase of sufficient stocks to match the annuities for a large pension fund wind up can visibly move the market price of gilts.

As a result of the limited availability of gilts, and to achieve higher payments to annuitants, most insurers today back their annuity liabilities with a portfolio consisting of approximately 50% gilts and 50% UK Corporate Bonds. The bonds will be high grade, typically rated AA and above.

Corporate bonds offer a higher yield than a gilt edged stock of the same duration. Typically this will be around 0.8%pa higher. The higher yield relative to gilts reflects three factors:

The company that has issued the corporate bond is more likely to default on interest or capital repayments than the British Government is

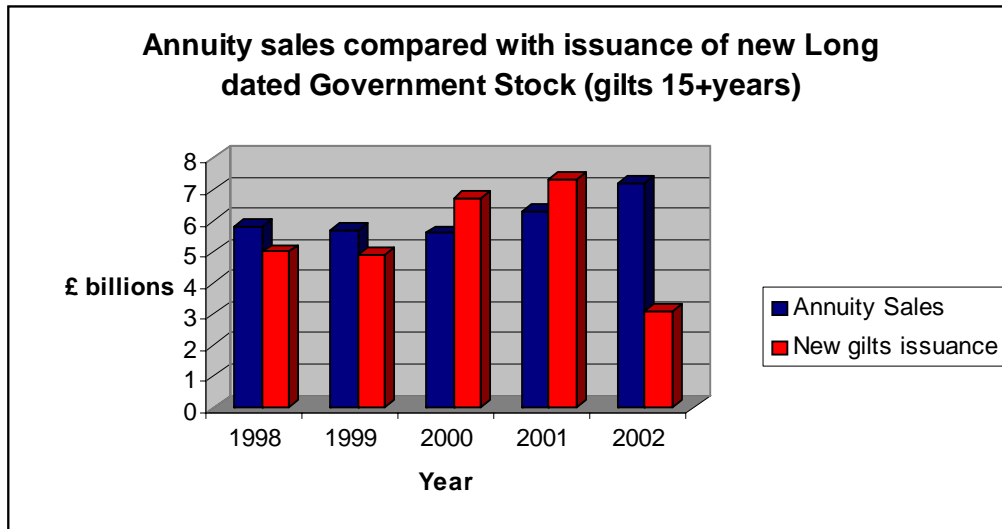
Dealing costs for corporate bonds are higher than for gilts

The illiquid nature of many of these bonds means that forced sales can result in lower prices

Whereas the second and third factors above will apply to an active investor, an insurance company using corporate bonds to back its annuity portfolio is probably buying them on a “buy them and lock them away until maturity” basis, and so the higher yield does prove particularly attractive to annuity providers. The benefits of this are passed on to consumers through improved annuity rates.

Where an insurance company does use Corporate Bond investments to back annuity liabilities, they are left at risk of default by the bond issuer, which can result in the loss of most or all of the investment. There has been a number of high profile Corporate Bond defaults in recent years. In contrast, British Government Stock is virtually risk free, as default by the British Government is almost inconceivable.

However, the demand for annuities outstrips the supply of new British Government Stock on long dated terms:



Annual Sales of Annuities and Long Dated Bond Issuance			
	Annuity Sales £bn	Gilts Issuance (15+) £bn	Corporate Bond Issuance (15+) £bn
2002	7.2	3.1	13.5
2001	6.3	7.3	16.5
2000	5.6	6.7	20.5
1999	5.7	4.9	13.4
1998	5.8	5.0	9.7

Source: ABI

The above table illustrates that even if insurance companies were the only purchasers of long dated gilts, the Government are issuing insufficient new stock to match the demand arising from annuity sales. So insurance companies have to look at alternative asset classes such as corporate bonds to make up the shortfall.

A fresh potential source of backing assets for annuities may be the long term mortgage market. The Chancellor of the Exchequer has commissioned Professor David Miles of Imperial College London to undertake a study into why UK mortgage consumers prefer variable or short term fixed rate mortgages over the long term fixed rate mortgages that are prevalent amongst our European brethren. The outcome of this study, and future developments in the mortgage market, might result in mortgages being packaged as suitable backing assets for annuity liabilities.

Capital Requirements

An annuity is a promise that the insurance company will deliver a series of pension payments. The annuitant has passed to the insurer the risks of investment performance and longevity, and the insurer must fulfil the promise no matter how adverse the experience.

As part of the prudential regulation of UK financial services, the Financial Services Authority requires insurers to set aside stringent reserves in relation to annuity business, to avoid the likelihood of insurers being unable to meet their promises to pensioners. For a portfolio of new annuities, capital requirements may well be between 7.5% and 15% of premiums received.

This capital must be set aside by the insurance company at the time of selling an annuity. If the experience of future years is adverse for the insurer, for example if pensioners live even longer than expected or if the issuer of a large corporate bond defaults, then this capital will be used to continue pension payments to the consumer. However, if the experience of future years is as predicted, then this working capital can be released back to the insurer and re-used to support fresh insurance business.

Actuaries calculate the expected financial return on the capital that is supporting annuity business, and this is a crucial pricing tool and an important measure of the profitability of the insurers that underwrite annuities.

The Association of British Insurers has undertaken a scenario analysis of the likely demand for annuities over the next decade, based on known current holdings of consumers in pre-retirement pension funds. Their findings suggest that the insurance industry will need to find at least another £1bn of additional capital every year for the next ten years to meet the expected demand for individual annuity products. On top of this, their findings suggest that if a stock market recovery were to prompt large final salary pension schemes to wind up and secure annuities, then the capital required could be tens of billions.

Capital requirements for individual annuity business appear material in the context of the current financial strength and capitalisation of the life insurance sector. Capital requirements for potential bulk annuity demand may prove very substantial.

Fresh capital can be raised, and a number of leading insurance companies of both proprietary and mutual status have done so in recent years, either through rights issues, bond issues or de-mutualisation. However, there are supply and demand implications here.

Institutional investors will provide fresh capital to insurers only if the projected return on that capital is attractive compared to alternative opportunities. More providers would enter the annuity market if the return on capital were greater. So the increased demand for annuities that is predicted by the ABI study may result in annuities becoming more expensive for consumers in the future.

Impaired Life Annuities

A rapidly growing niche market exists for impaired life annuities. Here, consumers can gain a higher level of pension if they declare that they are suffering from certain health impediments. The extra annual income reflects the fact they will probably receive it for only a shorter period than an equivalent healthy pensioner.

The ailments can be generic in nature, such as admission of being a regular smoker. Or they can be quite specific, and include detailed professional medical analysis of the patient's condition and prognosis after, say, a serious heart attack.

Currently around 10% of the individual annuity market is placed on some form of impaired life basis. This is predicted to increase in the future.

As our life expectancy continues to lengthen and as long term bond rates continue to fall towards European levels, annuities will become more expensive. This will increase the tendency for consumers to shop around and take advantage of the enhanced terms available for impaired lives. This in turn results in the average state of health of those consumers who remain purchasers of standard annuities improving, which will cause insurance companies to further increase the price of their standard annuities. The cycle described thus feeds on itself, and some industry analysts predict that sales of impaired life annuities could reach as much as 40% of the total marketplace.

Other analysts, however, believe that impaired life annuities will remain only a niche market, as the costs to the policyholder of providing clear medical evidence that he/she is suffering from a significant health impairment can easily outweigh the value of the extra income available. It is not enough just to state "I've got a dicky ticker" on the application form!

Unisex Annuities

Today, with one exception, all insurers price annuities according to the gender of the consumer. This is based on clear actuarial evidence that female annuity purchasers live, on average, for about three to five years longer than male annuity purchasers of the same age. The actuarial evidence is a study of the experience of the mortality of both sexes, which clearly differ. It does not attempt to explain the cause of the difference or to ascribe it to physiological or sociological factors.

For a given purchase price, a man will be able to buy an annuity giving about 7% to 10% extra income than for a woman of the same age.

The exception relates to members of money purchase pension plans who have contracted out of the State Earnings Related Pension or its successor, the State Second Pension. Legislation requires that these benefits be secured on annuities that do not take account of gender.

During the Autumn of 2003, the European Commission have passed a draft directive calling for all insurance products to be underwritten without regard to gender. The directive has to pass through both the Council of Ministers and the European Parliament before it can become law, and much further debate is expected.

The generations of women retiring in the future will have led a more diverse set of lifestyles, in particular taking on male patterns of work. This is bringing about some convergence of mortality rates between the sexes, but not to the point of equality. The Government Actuary's Department provide the following figures for the life expectancy of men and women achieving age 65 in the past, present and future:

Years remaining after age 65		
<u>Year of reaching age 65</u>	<u>Men</u>	<u>Women</u>
1928	11.5	13.3
1960	12.1	15.3
2002	16.0	19.9
2025	18.3	21.1
2050	19.0	21.7

Source: Government Actuary's Department (2002)

Several large insurance companies have opposed unisex annuities on the grounds that the data from the actuarial profession clearly indicates that expected longevity is related to gender, and so an insurer needs to know the gender of the applicant in order to price the annuity properly.

If an insurer does not know the annuitant's gender, or is not allowed to take account of it, then to protect themselves, insurers would have to assume that the annuitant is more likely to be female than male.

The price for a unisex annuity will fall somewhere between the prices for a male annuity and a female annuity. But not half way. Ultimately, as there is an efficient market for annuities, so the market will determine the price in a way that balances the interests of buyers and sellers.

The seller of any insurance product expects a profit as a reward for placing their capital at risk. The size of the reward expected by the seller is related to the risk, with a greater reward expected if greater risks are taken. The managers of an insurance company use the skill of underwriting to reduce the risk of uncertainty. This in turn leads to capital providers accepting lower rewards, which in turn feeds through to better prices for consumers. If the practice of underwriting is outlawed or restricted to non-gender related factors, as the proponents of unisex annuities suggest, then annuity prices generally will increase.

Unisex annuities would bring larger pensions for women and smaller pensions for men. But they would bring less benefit to women than the disadvantage they would bring to men.

Are annuity rates good value for consumers?

A study by the Leverhulme Centre for Market and Public Organisation at the University of Bristol, published in September 2002, sought to answer the question “are annuity rates unfairly low?”

They constructed a time series of annuity prices since 1972, and sought to compare the true present value of the annuity payments against the actual purchase price. They found that the present value of current annuity rates was between 90% and 100% of the purchase price, which they found surprisingly good, as insurers have costs to meet and must seek to make a profit as well. Since 1972 the value of an annuity had remained within a band of 90% to 110% of its purchase price. They concluded that annuitants have been getting a fair deal, and in some cases more.

The annuity market today is a very active one, with insurers changing rates regularly according to external factors such as investment conditions, the latest assessment of mortality trends and internal factors such as capital availability and the required rate of return on that capital compared with the alternative uses for that capital available to the insurer.

The magazine Life & Pensions Moneyfacts shows that the following annual pensions can be purchased with a lump sum of £10,000, for a male aged 65 on standard terms (the table excludes insurers that offer enhanced rates to impaired lives such as smokers, construction workers and those in ill health):

<u>Annuity Provider</u>	<u>Annual pension (£)</u>
Company A	741
Company B	738
Company C	726
Company D	709
Company E	709
Company F	707
Company G	706
Company H	701
Company I	678
Company J	642
Company K	635

The differential from top to bottom of the league table is significant. A pensioner who had thought to buy an annuity from the bottom placed insurer can secure a 16% improvement through buying from the top placed insurer.

The differential between third from the bottom and third from the top is 7%, still a worthwhile improvement in income for the remainder of the pensioner’s life.

But the differential is not so large as to suggest that insurers are taking advantage of customers. Even the gap of 16% from top to bottom is commensurate with insurers

having different expense levels, seeking different returns on capital, and having a different mortality experience from each other.

Insurance companies do price annuities according to their own mortality experience as well as having regard to the industry wide data published by the Actuarial Profession. Each insurer's experience will be driven by the nature of their own distribution channels, as these determine the sort of customer that they are likely to attract. The diversity of the UK population is quite significant, as the following two tables illustrate:

Monthly pension for a 65 year old male, increasing with RPI, for a consideration of £50,000, but substituting specific regional or socio-economic mortality experience in place of the national average:

Regional Mortality Differences			
East Anglia	All UK	Scotland	Difference
£203	£209	£223	9%
Source: Legal & General calculations based on regional mortality data from Office of Population Censuses and Surveys			

Socio-economic Mortality Differences			
Class I/II	All UK	Class IV/V	Difference
£190	£209	£240	26%
Source: Legal & General calculations based on an analysis of male mortality by socio-economic grouping published by Office of National Statistics			

The diversity of the UK population and the different distribution strategies adopted by insurers, which attract different customers, helps to place in context the range of annuity rates that are on offer in the marketplace.

Rather than insurers taking advantage of customers, there would seem to be an opportunity for customers to take advantage of insurers by shopping around in the market for the best rate.

The Financial Services Authority has recently taken a series of measures to make sure that consumers are aware that they are entitled to shop around for an annuity, and do not need to buy their annuity from the insurer that held their pre-retirement funds.

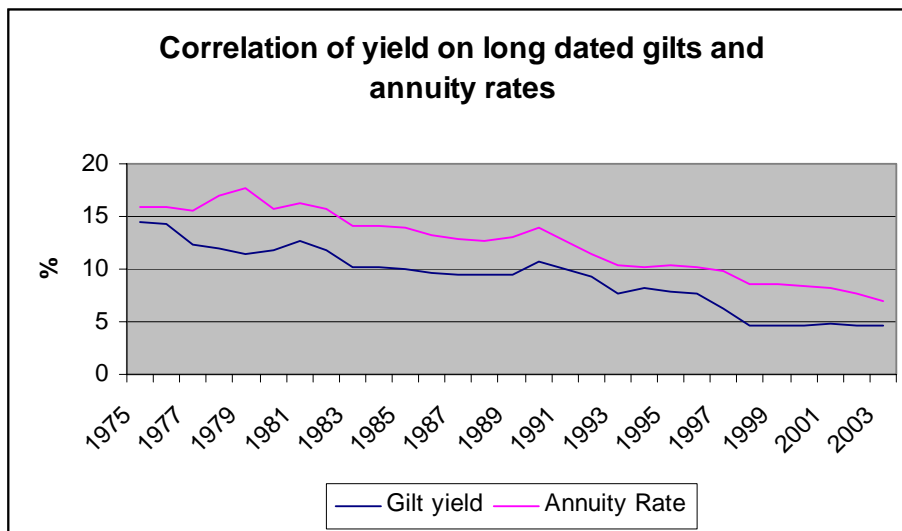
A Historical Perspective on Annuities

Britain is currently in the grip of a pensions crisis, with “three million people seriously under-providing for their retirement and a larger group of five to ten million people who may want to consider saving more or working longer”. (Source: Pensions Green Paper, Simplicity, Security and Choice, published December 2002 by Department for Work and Pensions). Everything to do with pensions seems to cost more than it used to, and annuities are no exception.

A male aged 65 retiring today with a pension fund of £10,000 can purchase an annuity giving an income of around £700pa, as we have seen earlier in this paper. Back in 1979, the same pension fund could have purchased an annual income of £1,700.

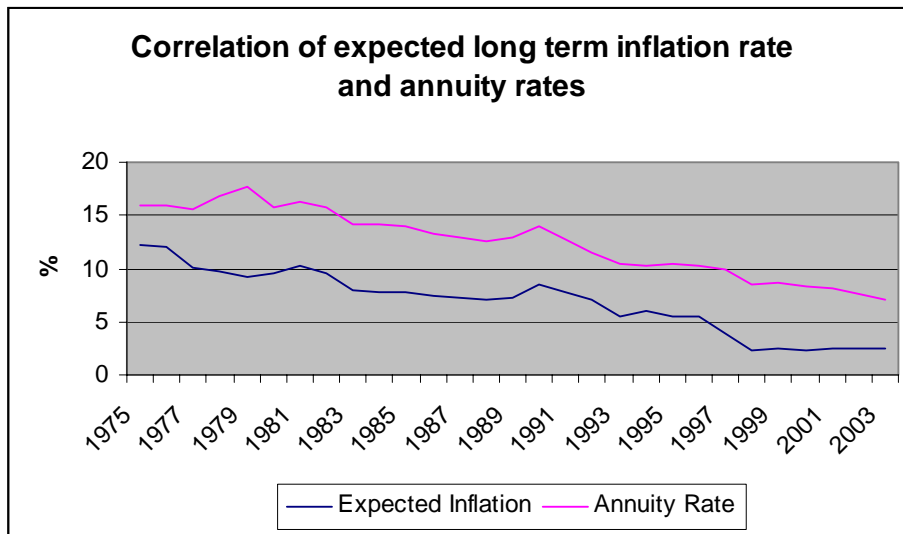
The three principle drivers of annuity prices are investment returns, mortality and expenses. We have already seen how people are living longer, which has increased the cost of an annuity. Insurance company expenses have fallen with the introduction of technology, which to a degree offsets the mortality improvement, particularly for small pensions where the administration expenses are a higher proportion. But the major factor in the change of annuity prices has been the reduction in the yield on British Government Stock (gilts), the predominant investment vehicle for annuity money.

The close correlation between gilt yields and annuity rates can be demonstrated by expressing the annuity as a yield. Thus, an annual income of £700 for a 65 year old male from an annuity purchase price of £10,000 can be expressed as 7%. The correlation since 1975 is as follows:



(Source: University of Bristol Leverhulme Centre, and updated with recent data)

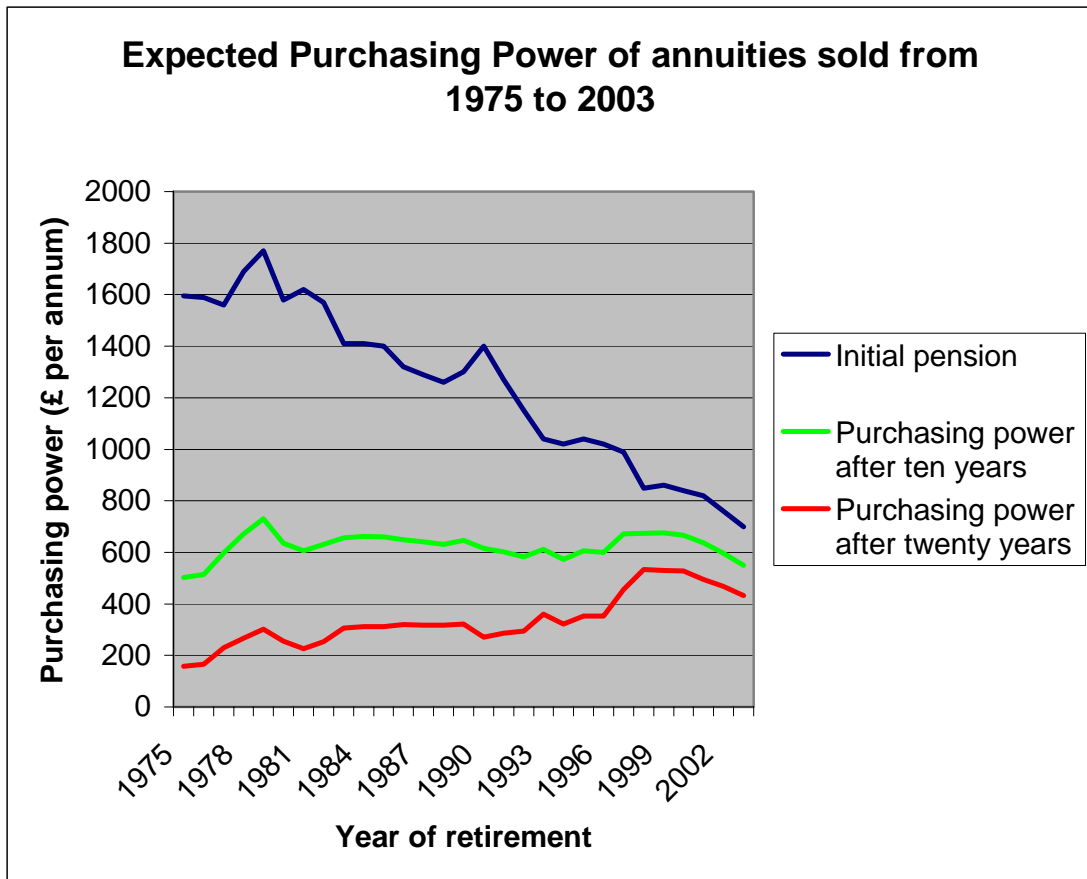
The high interest rates of the 1970's and 1980's were the result of high inflation rates. From an economic perspective, the yield on a long dated gilt can be broken down into the real interest rate on risk free securities plus the investor's long term expectation of the rate of inflation. The former real interest rate is remarkably constant at around 2% to 2.25%, so the above chart can be re-calibrated to show the correlation between investor's long term expectation of the rate of inflation and annuity rates:



It is natural that annuity rates should come down as inflation has come down. Although the starting level of income that the pensioner enjoys will be lower, the erosion of inflation on the purchasing power of the pension will be less, so later payments will be worth more.

This can be demonstrated by looking at the expected purchasing power of the pension ten years after its commencement, or about half way through a pensioner's retirement. We also show the expected purchasing power of the pension after twenty years, which is towards the end of the pensioner's life. In both cases, the analysis uses the expected long term inflation rate at the time the annuity is set up, to give what statisticians call an "ex ante" view.

The chart shows the expected purchasing power at day one and after ten and twenty years, for annuities purchased with pension savings of £10,000 by a 65 year old male:



Whilst the initial level of income available to pensioners has fallen sharply since 1975, the expected purchasing power in later retirement has improved. Pensioners who have retired recently in our current low inflation environment should be able to better maintain their standard of living than earlier generations, provided the current low inflation environment continues.

The plight of pensioners who retired in the 1980's and who have suffered serious loss of purchasing power is visible amongst claimants of State means tested benefits. Some 64% of pensioners aged over 80 are eligible for the Government's new means tested Pension Credit, whereas only 34% of pensioners aged 65 are eligible. (Source: Pensions Policy Institute – The Under Pensioned)

This historical perspective has revealed the sharp reduction in annuity rates since 1975. Many investors who began saving for retirement in the 1970's or 1980's with an insurance company will have bought pension plans that incorporated a Guaranteed Annuity Rate. At the time that the savings plan started, the Guaranteed Annuity Rates contained in the policy would have been set at a level much lower than the annuity rates then currently available to retirees.

However, changes in economic circumstances have now revealed the value of the underpin provided by these guarantees, and many investors retiring today are able to claim a guaranteed rate that is higher than the annuity rate available on the open market. These claims highlight the need for insurance companies to maintain strong capital reserves, so that unexpected payouts can be met without jeopardising the solvency of the company.

Pensions – the Age 75 Rule

Current Inland Revenue rules require the proceeds of a Personal Pension Plan to be used to purchase an annuity no later than age 75. On retirement between ages 50 and 75, the holder of a Personal Pension Plan can choose whether to purchase an annuity straightaway, or to defer annuity purchase and use an Income Drawdown Plan to generate income in the meantime.

Inland Revenue rules are expected to change in April 2005. The Government announced proposals in December 2003 that will raise the minimum retirement age from 50 to 55 by 2009, and which will enable those aged 75 to defer annuity purchase indefinitely if they wish. Under the new proposals, those aged over 75 will be able to use an Alternatively Secured Income Plan to generate a pension income as an alternative to annuity purchase.

Both Income Drawdown and Alternatively Secured Income run the risk that funds could be severely depleted or even exhausted before the pensioner's death.

Further details of Income Drawdown and Alternatively Secured Income can be found in the consultation paper "Simplifying the taxation of pensions: the Government's proposals" available from the Inland Revenue.

Summary

The key factors driving the price of a pension are longevity and interest rates. In the last two decades, trends in these factors have combined to increase dramatically that price and this paper has sought to put that rise and the continuing evolution of the pensions market in context. Annuities provide value for money in protecting pensioners against the risk of running out of capital in old age. And shopping around can ensure that consumers can get the best value available.

Contact: Iain Taylor
Actuarial Profession
020 7632 1452
07979 914217