

Annuity Industry Survey 2010

Xafinity Paymaster

May 2010

Introduction

Welcome to the first annual Annuity Industry Survey conducted by Xafinity Paymaster.

The survey targeted a mix of Product providers (Insurers), Service Providers and Annuity Influencers including product manufacturers and distributors. This is a small group and we are delighted to report a response rate of 40% which we believe indicates that participants have strong views. The results indicate that these views are often quite polarised.

As the leading independent annuity administrator in the UK, we have a role to support the development of new annuity products and services in the market and need to anticipate the future market movements. The results of this survey have given us a great insight into the market movements over the next five years. Our intention is to conduct the survey annually so that we can track trends and generate discussion and debate about annuity related topics.

I would like to thank all those who gave their time to participate and share their views and insights at this particularly interesting time in the evolution of the UK annuity market.



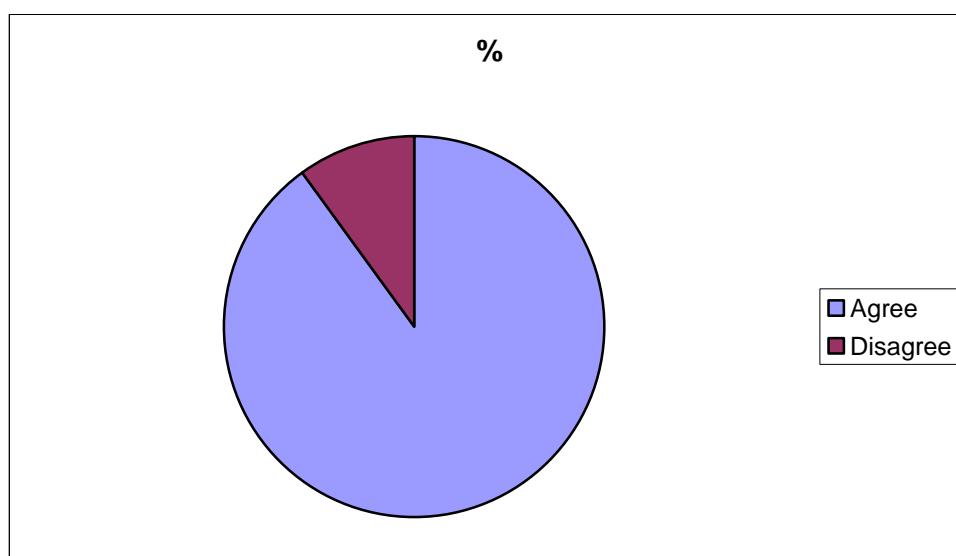
Keith Boughton
Director, Insurance and Payroll
Xafinity Paymaster

1. Despite the introduction of an increased range of annuity products lifetime annuities will remain the annuity product chosen by most retirees over the next five years.

90% believe this to be the case. Reasons given include the comment that a majority of purchasers have small amounts of money to spend and need to secure their income for the rest of their life. The more flexible products are seen to be too expensive and perhaps too sophisticated for the majority of consumers.

There was recognition that innovation was taking place in the marketplace and the expectation is that alternative products (temporary annuities and investment linked products in particular) and solutions will gain an increasing share of the market over the next 5 years as a result of Solvency II and further product innovation.

However 10% of respondents disagree and believe that the alternate products will have assumed a dominant position by the end of the next 5 years.



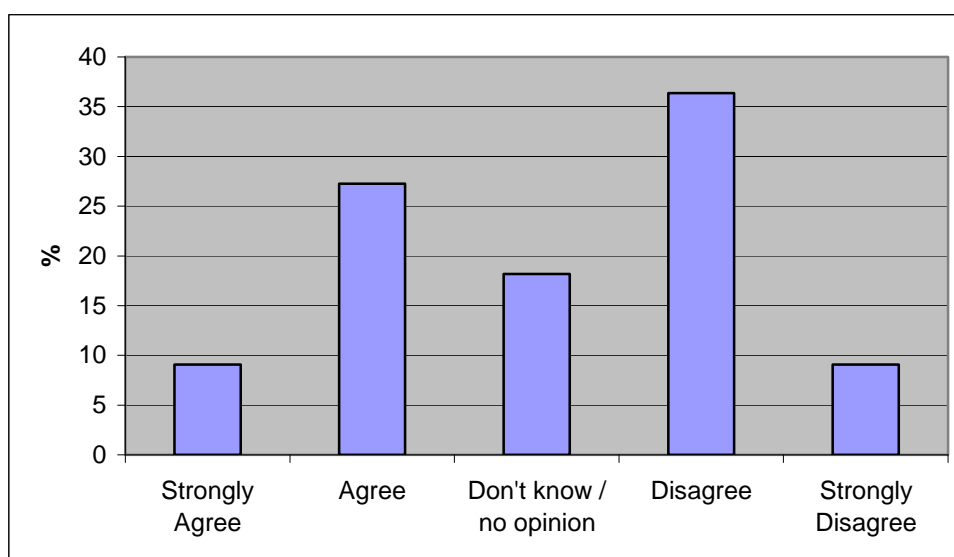
2. The introduction of Solvency II will mean that the cost of a lifetime annuity will become too expensive for most policyholders / members of defined contribution arrangements.

A complete mix and divergence of views!

37% of respondents supported this view whilst 45% disagreed.

Some respondents feel that certain insurers are already pricing for Solvency II in their rates whilst others believe that Solvency II regulations as currently drafted will be amended to improve the annuity reserving position. Perhaps those currently engrossed in addressing this internally know more and that it is seen to be 'in hand'?

It was commented that conventional lifetime annuities are poor value, especially at initial retirement age and that the additional burden of meeting Solvency II requirements resulting in a further deterioration in rates will encourage more retirees to defer buying a lifetime annuity and opt for a temporary annuity at initial retirement.

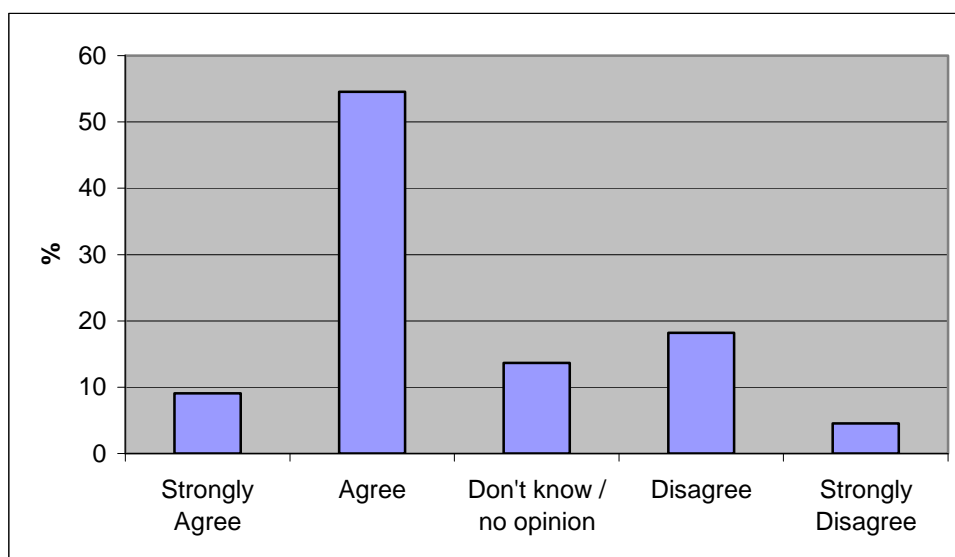


3. The existing range of annuity products (lifetime, capital protected, investment-linked, with profit, unit linked, flexible and variable annuities) along with drawdown and ASP will adequately meet the needs of the UK market for the next five years.

64% of respondents supported this view although a not insignificant 22% disagreed.

The views of respondents were however very consistent. There was a strong feeling that a blended set of retirement and annuity products is what most individuals actually require but that the size of their accumulated pension pots will prevent them going down this route. The other key comments reflected the fact that individuals will increasingly save for their retirement using alternate non-pension savings vehicles giving them greater flexibility at and during their retirement.

In a clear message to Regulators and the IFA community respondents commented that it was improved quality of advice and not more products that were needed. There was concern that an insufficient number of retirees receive the right amount of personal advice at retirement and that many buy their annuity without any appreciation of the wide and increasing range of products now available.



4. The predicted growth in the UK annuity market over the next five years (+50% increase in new contracts) will result in an increase in “consistently active” annuity providers.

and

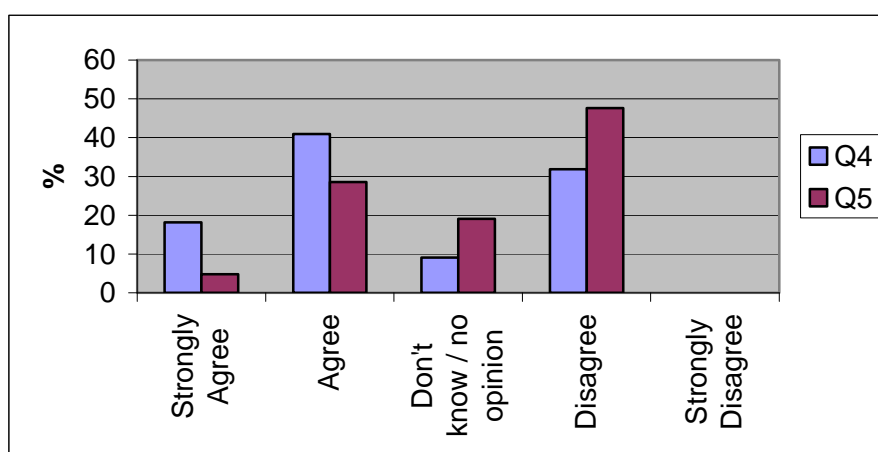
5. Despite the predicted growth in the UK annuity market over the next five years the capital requirements imposed by Solvency II will mean that there will be a reduction in “consistently active” annuity providers.

Answers to these two questions showed the current state of uncertainty and flux in the market caused by Solvency II.

Whilst 59% of respondents generally felt that there would be a modest increase in active annuity providers, 32% disagreed and feel that the number of active providers will decrease.

A significant 19% of respondents answering Question 5 said that they did not know and were awaiting clarification as to how Solvency II will be implemented. However, almost half of respondents said that Solvency II would not play a significant part in determining their product strategy.

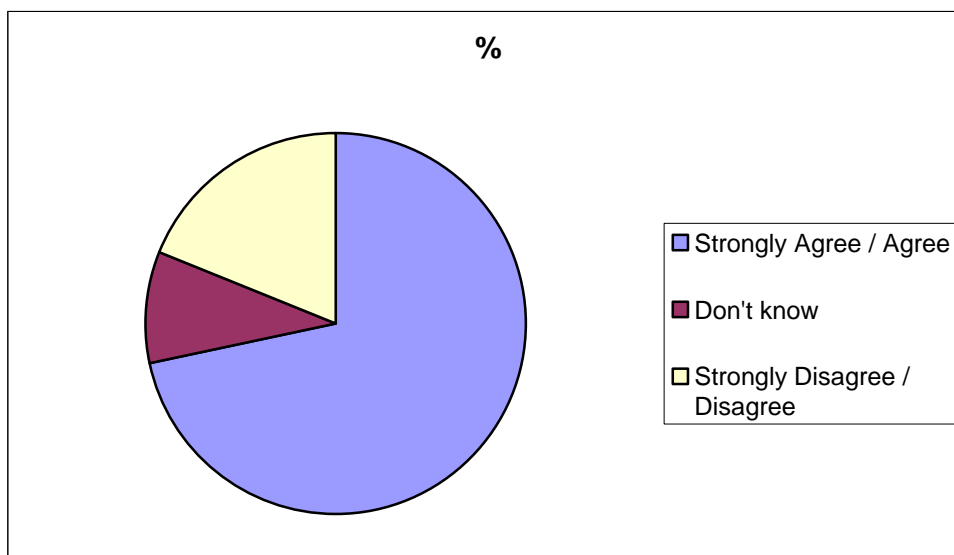
Niche enhanced annuity providers were viewed by respondents as being particularly vulnerable to the potential impact of Solvency II.



6. The implementation of RDR proposals, the low levels of annuity pots and the increased availability of internet based information will lead to a decrease in intermediary sales and an increase in execution only business.

72% of respondents agree with this statement although their comments express disappointment that this is the case.

As detailed in their response to Question 3 they stress that individuals need advice with retirement planning. However the reality is that the size of most individuals pension pots will mean that they will not seek this as they cannot afford to pay for it.



7. The distinction between impaired annuities, postcode annuities and lifestyle annuities will reduce over the next five years.

72% of respondents to Question 7 agreed with this statement and that determination of annuity rates will become more consistent and more akin to the underwriting of protection business.

and

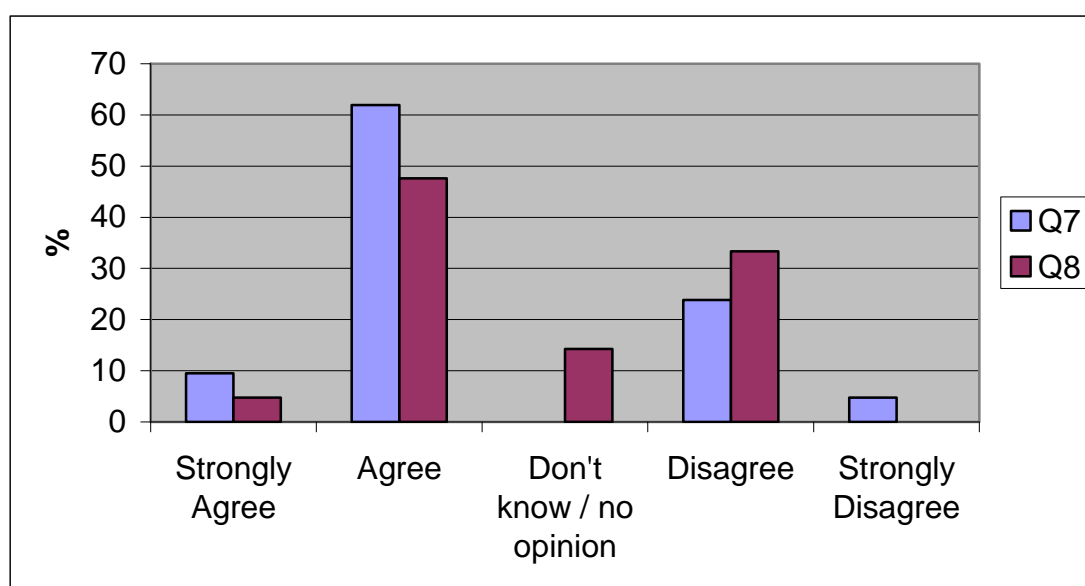
8. Full underwriting of annuities at retirement will become the normal approach within the next five years.

On reflection, we recognise that there was some ambiguity in this question and respondents have answered this question in a number of ways.

Either a greater proportion of annuity business will be underwritten. Or further lifestyle and medical questions alongside postcode information will increasingly become the norm.

53% supported full underwriting, however the cost of performing full underwriting aligned to the relatively small size of most pension pots was seen as an inhibitor.

It was also pointed out that whilst full underwriting might mean good news for some it will invariably mean bad news for others. However this is in effect no different to the current position with postcode underwriting.



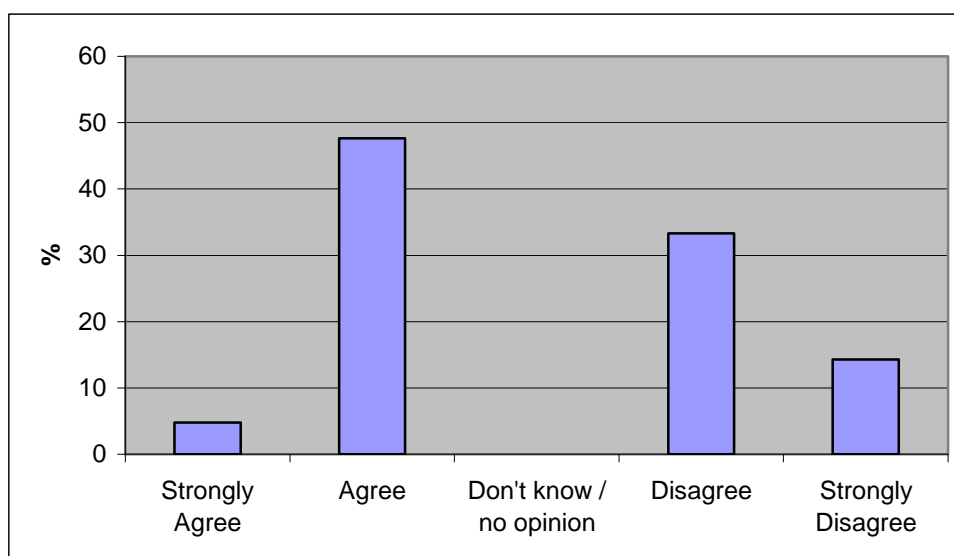
9. Any removal of the requirement to annuitise at age 75 will increase the risk of the majority of policyholders “running out of money” in retirement.

Note: Since issue of the survey the government has announced its intentions to take actions to scrap compulsory annuitisation at age 75.

This question provoked a polarised response and everyone had an opinion as indicated below.

The comments submitted in support of the response added clarification to these views and it became clear that whether this statement proves correct or incorrect will largely depend on what any new annuity regime requires. It was noted that respondents commenting before the government’s recent announcement felt that the majority of annuitants will still buy an annuity before age 75 and probably should do so.

Yet again the issue of the need for individuals to receive advice re annuity purchase arose with the specific comment made that good advice will mitigate this risk.

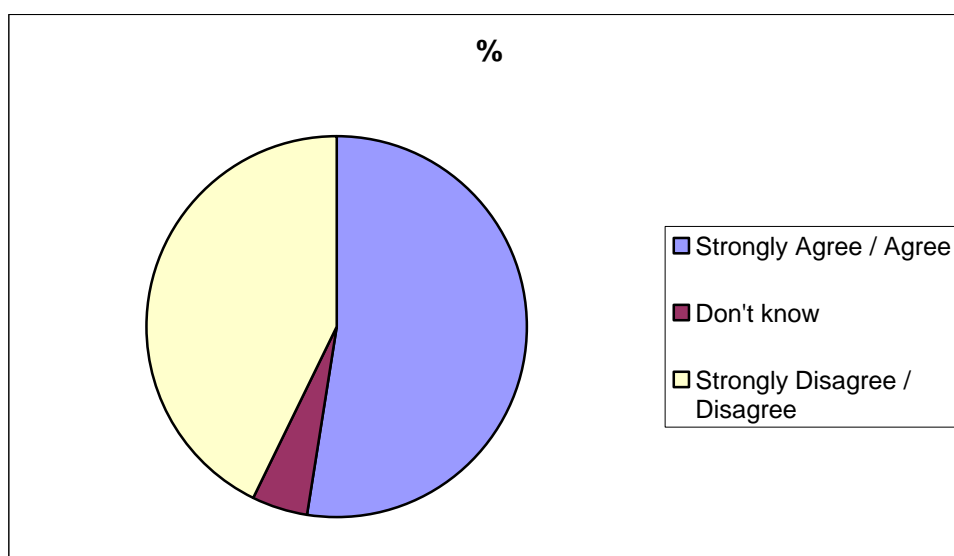


10. The Government could dramatically improve the annuity landscape and consumer perception if they allowed non utilised pension capital to be included within a deceased annuitant's estate as opposed to being retained by insurer's as "profit".

Another split vote!

More than 55% of respondents supported this view whilst 39% disagreed. The extension of value protection beyond age 75 was proposed by a number of respondents whilst others pointed out that any such government move would dramatically change the price of annuities which would be to the overall detriment of consumers.

It was clear that the real issue to be addressed is that of the consumer perception of annuity value with a challenge being made that despite appearing an attractive proposition, the reality is that consumers will not pay the price of additional guarantees.



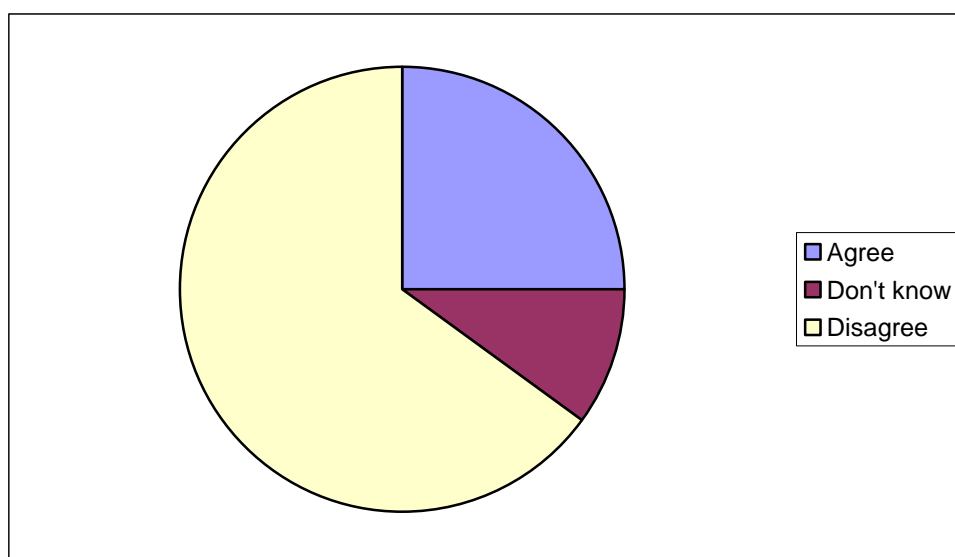
11. The small size of pension funds arising from NEST accumulations will mean that the NEST annuity panel is unlikely to include “currently active” annuity providers.

This view was rejected by more than 65% of respondents who feel that the currently active annuitant players will want to be involved in handling NEST decumulations and annuity payments going forward. This will be a relief to NEST.

The assumption is that the active annuity providers will develop an annuity product and service delivery model that overcomes their current minimum annuity purchase price approach and enables them to secure NEST business.

However some respondents suggested that the currently active annuity providers will only wish to remain on the panel for a short period whilst they “test the water”. This stance is supported by the 25% of respondents who believed that the currently active annuity providers will not wish to be involved.

This may simply be an issue of timing and long term commitment. Some feel that they would rather be involved at the outset and to try and make it work rather than to rule themselves out. Others would rather rule themselves out from the start.



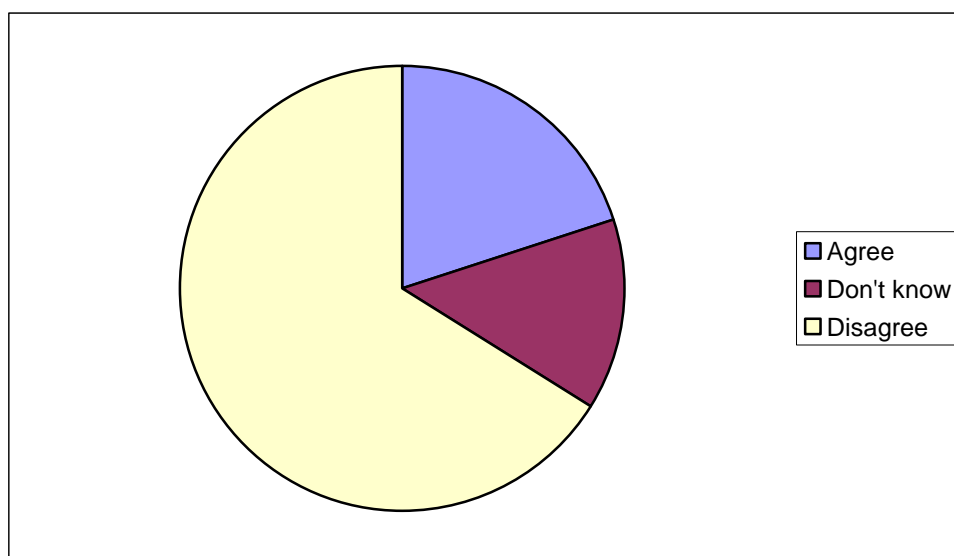
12. There will need to be a government supported annuity provider to support the administration of the smaller annuity pots that NEST will create?

This view was rejected by 67% of respondents but supported by 19%. The balance of 14% did not know.

Those who rejected this view claim that cost effective advice and administration can be achieved for pots of less than £5k and can already be handled by a panel of 4 providers.

This stance would appear to contradict the comments re the need for advice given in previous responses. However it is accepted that with small funds the scope for personalised advice is limited and a decision tree format is perhaps all that could be achieved.

Respondents who supported the statement suggested that a National Annuity might need to be the way forward as they do not believe that the current range of annuity providers can or will effectively support customers with small pension pots.



Other Comments

Respondents were invited to add any further comments that they had regarding the annuity market in the UK.

These gave respondents an opportunity to “let off steam” and some of the comments are repeated below. It is fair to say that they present a worrying picture of which the Government and Regulators should take note.

“This is a market with a lot of problems, just at a time when “boomers” come to retire. First, annuity rates are in structural decline, with “payback” on the pot invested now at 18 years for a 65 year old man. Second, the profit points and return on capital are increasingly unattractive to private capital. Third, longevity risk is a big unknown and hedging relies on counterparty risk – see Lehman Bros.”

“Annuities play an important role in ensuring stability of income in retirement for many thousands of the retired. The big challenge for annuity providers is to explain more clearly how annuities work, what risks they mitigate and what risks the consumer would be exposed to were they to adopt different approaches.”

“We need to challenge the law to remove the OMO and replace it with a Pensions Passport as an OMO only allows purchase of a lifetime annuity whereas a PP would allow purchase of all the retirement options available within the market.”

“The implications of Solvency II combined with the increasing amount of funds coming into the retirement market will mean solutions that sit somewhere between a traditional drawdown and a conventional annuity are likely to increase. Reducing annuity rates will have the effect of making other options look commensurately more attractive and we could see genuine growth in other options such as asset backed annuities and drawdown with a guarantee.”

“OMO has failed as less people are exercising choice now than before so the government/FSA should make consumers more aware, or even consider legislating, so that everyone shops around even if they eventually stay with the same provider. Most should not buy a lifetime annuity at retirement as their health and personal circumstances will change over time so they should keep their options open and buy shorter term products during their prime retirement years up to age 75 or 80.”

“Very good survey – it is helpful to segment small beer funds from middle Britain – they have different needs. The interesting thing is to look at where small beer ends and middle Britain starts e.g. £50k pot?”

More information

If you would like more information about any of the content in this survey or you would like to find out more about Xafinity Paymaster's annuity service offerings please call or email. A copy of Xafinity Paymaster's annuity brochure is available on our website - www.xafinitypaymaster.com

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About Xafinity Paymaster

Xafinity Paymaster is a leading business process outsourcer providing pension, payroll and annuity administration for a large number of insurance companies and more than 800 pension arrangements. Xafinity Paymaster delivers large scale financial administration for more than 140 major public and private sector organisations and makes payments totalling over £11 billion per annum to pensioners, dependents and annuitants in 180 countries worldwide.

About Xafinity Paymaster's Insurance and Payroll division:

- Paying 2.2 million pensioners and annuitants including 45,000 residents overseas
- Role in managing 10% of UK deaths
- Administering over 600,000 annuities on behalf of insurance companies.
- UK's leading independent provider of annuity services for insurance companies.

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