LONDON & COLONIAL
INNOVATION IN PENSIONS

Press Release

The Association of British Insurer's new Code of Conduct on Retirement Choices couldn't be more timely.

This month heralds the introduction of the Association of British Insurers' (ABI) new Code of Conduct on Retirement Choices, and it couldn't be more timely.

Annuities have found themselves under the spotlight following the FSA's recent confirmation of a thematic review into whether retirees are missing out by failing to shop around.

The annuities market as a whole has come in for its fair share of bad press in more recent years due to record low rates. These low annuity rates are of course an inevitable consequence of longer life expectancy and generally lower interest rates but with the increases in the cost of living showing no sign of abating, choosing the right annuity is more important than ever. Also the widespread disillusionment with pensions in recent years should not be allowed to detract from the value and importance of flexible and secure income in retirement.

The question now is; what should the industry be doing to demonstrate this to clients?

In my opinion, the industry must do everything it can to ensure that the consumer is fully aware of all the different annuity options available. The ABI's new Code of Conduct – which requires insurers to make clear disclosure of the Open Market Option (OMO) – is a positive step in the right direction.

It is arguably the most valuable development in the annuity market since the introduction of the OMO itself back in 1978 - but even after 35 years, too many pension savers continue to lose out either as a result of poor product choice or by failing to secure the best available rates.

Which annuity?

Choosing an annuity is not a decision to be taken lightly. Any consequences arising out of the final choice – good or bad – could affect the annuitant for the rest of their life. After spending a lifetime accumulating a pension pot, one doesn't want to run the risk of choosing the wrong annuity and in doing so potentially lose tens of thousands of pounds of income over the duration of retirement.

One of the biggest hurdles is the lack of awareness among consumers of their entitlement to purchase their annuity with a provider of their choice, and not simply the one with whom they currently hold their pension.

The adviser community has a real opportunity to prove their worth by ensuring that an annuitant's choice has been carefully considered with a full understanding of all options available to them.

Many clients are aware of traditional guaranteed annuities. Much less common is their awareness of enhanced and reviewable annuities, and it could be a serious mistake for both client and adviser if these were not considered.

Enhanced annuities - payable when the client's past or present lifestyle has adverse implications for life expectancy -

are more commonly available than many people realise. Factors such as being a past or present smoker or perhaps suffering from diabetes may be overlooked. There are currently over 1,500 conditions that could see clients qualify for an enhanced annuity and it is estimated that more than half of all individuals at 65 could qualify for enhanced rates.

However, even an enhanced annuity can see a client 'locked in' to a specific rate for life, leaving them unable to benefit from any potential future uplift. Longer life expectancy means that those retiring at 65 today could live for another 3 decades and a lot could change in their circumstances during that time. Also, with annuity rates currently at an historic low, any client with a fixed rate would be left unable to benefit from any future rate increases.

To give a stark example; at the start of the nineties an annuitant with a pension pot of £100,000 would have expected to have received an income for life of around £15,640 a year. 20 years later a similar pension pot would be worth just over £5,000 a year.

It's not just annuity rates that should be considered; over the course of 30 years inflation will considerably reduce the buying power of any income in real terms as prices rise but income remains static.

Are there better options?

The benefits of reviewable annuities should not be underestimated. The income can be varied up to 120% of market rates – which could be enhanced rates – and periodic reviews will take place based upon the individual's state of health and market rates at the date of each review. Naturally the underlying investments will be chosen having regard to age and risk factors and there will not be a guarantee apart from the chosen degree of security inherent in the investment strategy. However, perhaps the most important advantage of all is that the OMO is retained and at any time a transfer can be made to a traditional guaranteed annuity. This could be particularly beneficial if for example the individual's health has deteriorated or if higher interest rates enable insurers to increase their guaranteed annuity rates.

The most important thing as always is for the adviser to match the product to the client's circumstances.

Ken Wrench, Chief Executive, London & Colonial

-ENDS-

Notes to Editors

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