UK Secondary Annuity Market
an opportunity for 2017

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Agenda

Aim – to provide an overview of how a UK secondary annuity market may develop and how it might operate

- Background – what has brought us to where we are today?
- Legislative process – what are the steps to creation of a secondary market?
- Primary UK annuity market snapshot – what is the status?
- Potential size and shape of a secondary UK annuity market
- Primary market annuity rates – how have these moved in recent times?
- Pricing mechanics – how will pricing work and what are annuitant outcomes?
- UK access to medical records – how does this operate?
- UK Medical Underwriting economics - what are the key considerations?
- Further market considerations and SL Investment predictions
- Summary

Background

1921 to 2014

- Annuity purchase for UK retirees (Defined Contribution Schemes) has effectively been compulsory for almost 100 years (**Finance Acts 1921, 1956 & 1976**)
- Primary UK annuity market (**March 2014**) - UK Chancellor announces interim tax changes immediately extending choice to those accessing pension savings

£5Bn[1] immediately wiped off the value of UK annuity providers

2015 developments (to date)

- **March** - UK Chancellor announces intention to create secondary annuity market in April 2016. 3 month consultation process launched (closed June 18th)
- **April** - full scope implementation of legislation introduced to effectively abolish compulsory primary annuity market
- **July 8th** – UK Chancellor announces secondary market postponement to 2017

"to ensure there is an indepth package to support consumers in making their decision"[2]

[1] The Guardian – 'Chancellor vows to scrap compulsory annuities in pensions overhaul' - 19/03/2014
[2] HM Treasury Budget Summary 2015 – section 1.229 p.51

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Legislative Process

The UK Treasury are now in the process of:

- Reviewing the 3 month consultation process submissions
- Meeting with potential market participants – consolidation of facts and ideas

Treasury to formally make recommendations to UK government by end of 2015

2016

- Legislation created by HM Treasury\government (date to watch, **March 2016** budget)
- FCA\PRA create regulatory framework (watch out for published Consultation Papers)

Target remains to launch market in 2017. Most likely date would be 6th April 2017

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Primary UK Annuity Market - snapshot

- 6 million annuities in force spread over an estimated 5 million policy holders[1]
- There are currently 14 major annuity providers in the UK[2] (e.g. AVIVA, Friends, Legal & General, Prudential, Standard Life)
- The mean annuity size at issue is c£35k[2]. However, the median size c£20k[2], i.e. a skew towards smaller policies
- These averages have increased recently as the rules on those with smaller pension pots have been relaxed
- Assuming an average annuity present value of £20k[3], an estimated value of the current total UK annuities in force is £120Bn[3].
- Joint life annuities represent about a third[2] of all new annuities sold.
- Enhanced annuity sales have increased from 2% to 28% over the past 10 years[2].
- UK Life Expectancy[4] at retirement is around 20 years. This could increase to 26 years by 2045.

[1] Association of British Insurers - 'UK Insurance Key Facts 2015'
[2] Association of British Insurers - 'The annuity market: Facts and Figures 2013'
[3] £20k is an SL working assumption for illustrative purposes only. £20k x 6 million policies = £120Bn
[4] ABI Retirement Conference 'A new retirement: funding life after work' 25th February 2015. Typical 65 year old male.

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Secondary UK Annuity Market - size

SL's UK endowment policy experience over past 25 years:

- 2-3% of total policy holders look to sell each year[1]
- 70-80% of the policies receive offers from the market[2]
- 15-20% of those receiving an offer choose to sell their policy[2]

…an estimated secondary market annual trades might lie between:

- 2% * 70% * 15% * £120Bn[3] = £250m
- 3% * 80% * 20% * £120Bn[3] = £580m

If the average annuity policy is £20k this could be c30,000 policies each year.

…efficient and cost effective policy origination is essential to success of market

[1] Derived from typical long term persistency rates quoted by UK insurers in their annual returns to FCA
[2] SL long term TEP market experience
[3] £120Bn est. total market from previous slide

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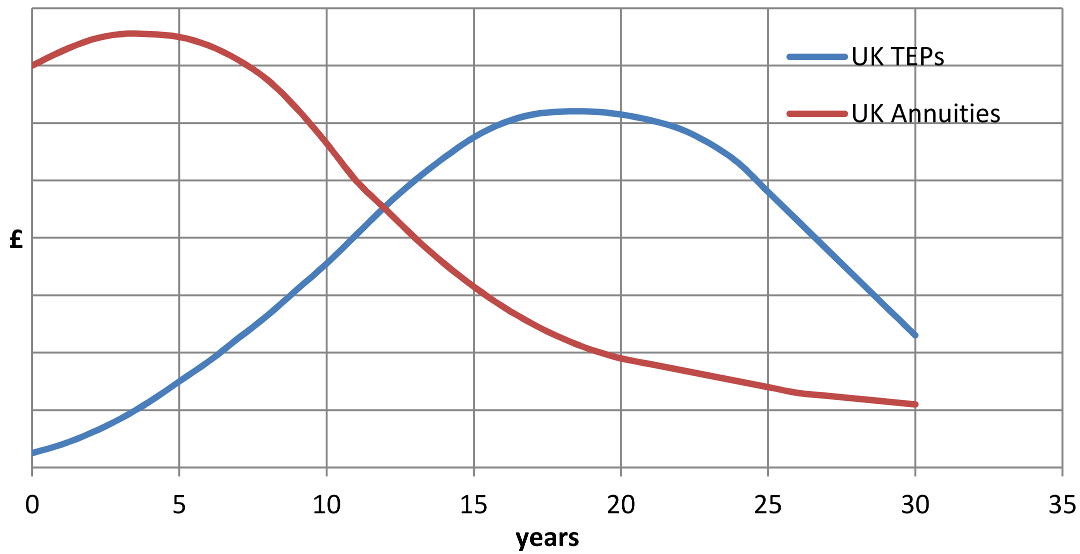
Secondary UK Annuity Market - shape

- “Disenchanted” annuity holders may be more likely to trade in earlier years
- …then a gradual tail off of annuity holders looking to trade over long term
- Lower numbers of primary market annuities created in the future
- Those annuity holders are potentially less likely to trade

<u>Secondary annuity market could be similar in scale and duration to the UK TEP market. However, volumes skewed towards the earlier years</u>

UK TEP
vs
UK Annuity[1]

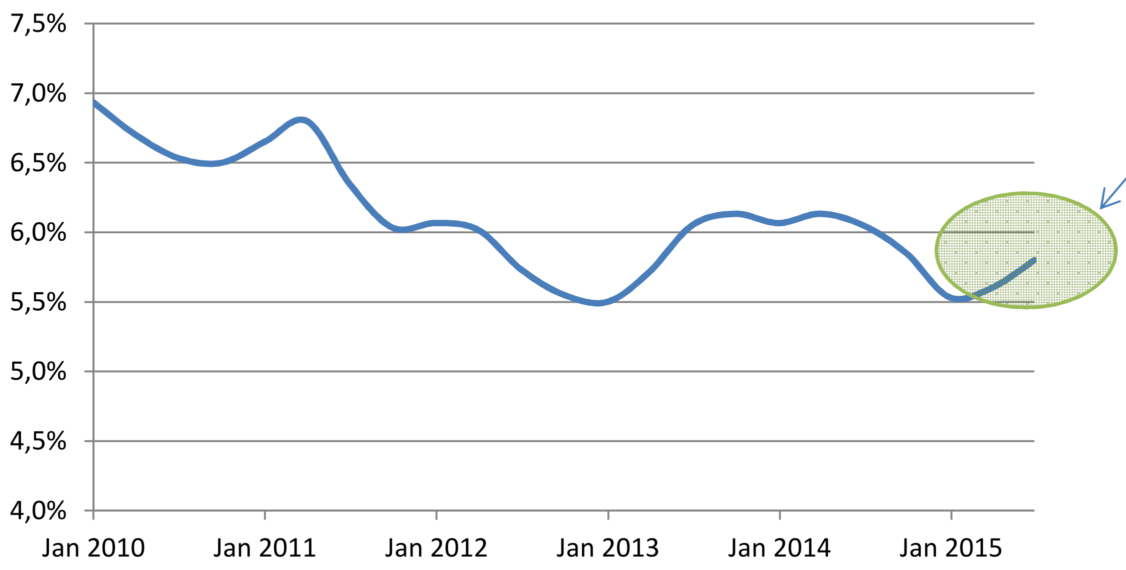


[1] Diagram is hypothetical and for illustrative purposes only

UK Annuity rates – 65 year old

- 1960s to late 1990s - UK annuity rates have remained between 10-16%[1]
- Rates have fallen considerably in the past 15 years as UK longevity has increased and background interest rates have fallen.
- EU directive prohibits gender based pricing from December 2012[2]

UK Standard level annuity rates 2010-2015[3]



A 65 year old purchasing a £100k annuity today would received around £5.8k per annum for life

Longevity	Primary IRR[4]
10 years	-9.3%
15 years	-2.1%
20 years	1.1%
25 years	2.8%
30 years	3.7%
35 years	4.3%

Average Life Expectancy of 65 year old male is currently 20 years

[1] LSE 'UK Annuity Rates and Pension Replacement Ratios 1957 – 2002' published 2003
[2] Further reading – 'Financial Services Authority Gender Directive January 2012'
[3] Based upon typical monthly open market quotes over the selected period
[4] SL derived data 2015

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Pricing mechanics

Relatively straight forward (NPV future cash streams):

- Cost – “one off” up front acquisition of asset (*):
  - Payment to policy holder
  - Life Office administration (UK TEPs up to £100 per policy[1])
  - Medical underwriting
  - Due Diligence\Legal assignment of asset
  - Marketing cost (advertising, platform, clearing house, etc)
  - Margin for sourcing agent, market maker, etc.

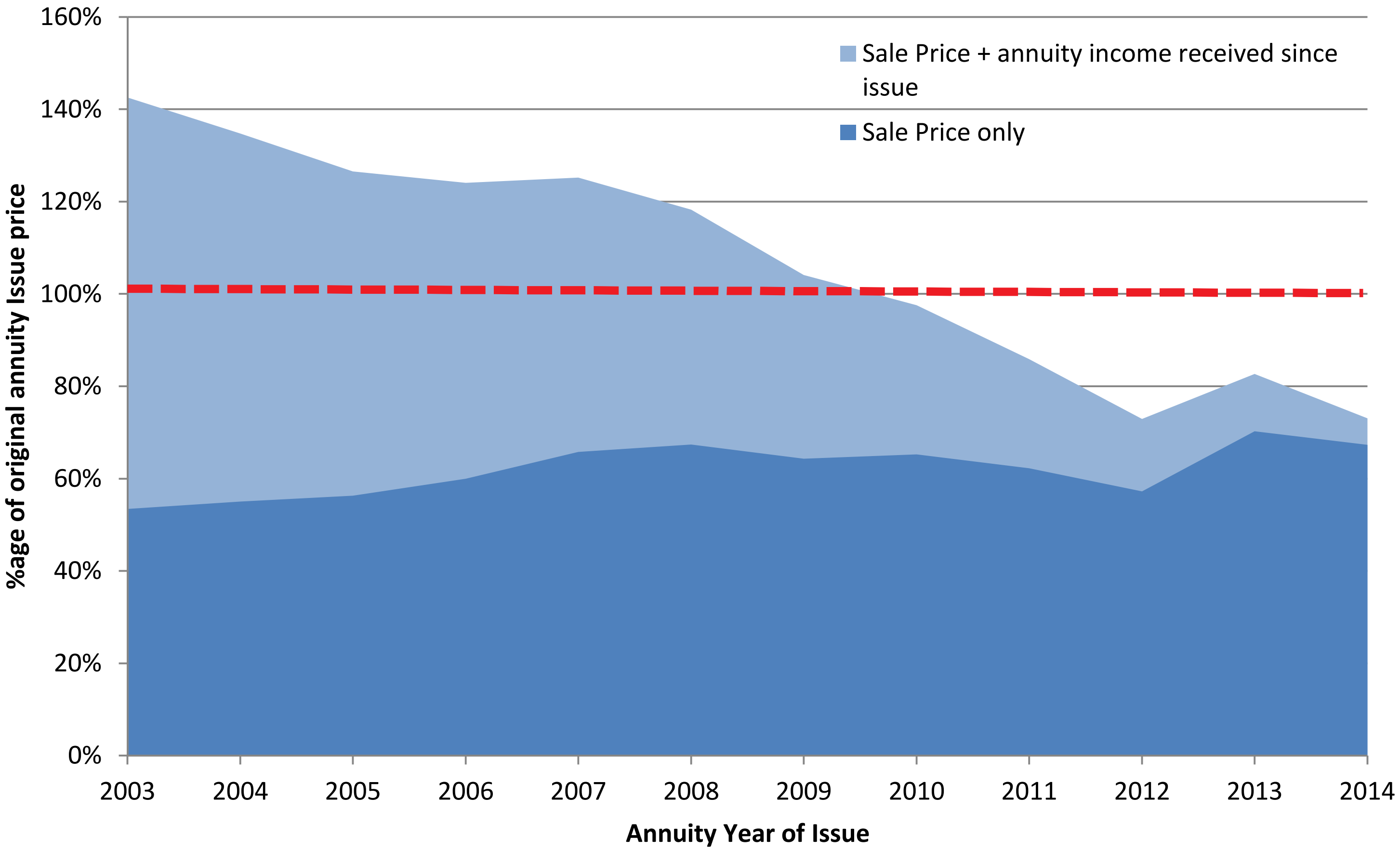
- Benefit – discounted value of expected future payments, where the expected future payments reflect the probability of survival to each of the future payment dates

…the big question of course….how long might the annuitant live?

* Policy holders may be required to seek independent financial advice prior to sale. It is assumed this is a cost borne by policy holder

[1] AVIVA Group, Scottish Provident and Royal London Group charge c£50; Friends Life & Scottish Mutual charge £100. The majority of Life Companies currently make no charge.

Potential secondary market outcomes for annuitants



source:

- SL synthesised population of UK annuities in force as of end 2014
- Secondary market prices calculated at a hypothetical 4% IRR for illustrative purposes

UK Access to medical records

Subject Access Request (SAR) under 1998 Data Protection Act[1]:

- UK public can make a request to their General Practitioner (GP)
- Authorisation can be granted for third party access.
- Guidelines 21 days. Has to be within 40 days. Charge, max £50. Typically £10

General Practitioner Report (GPR)[2]:

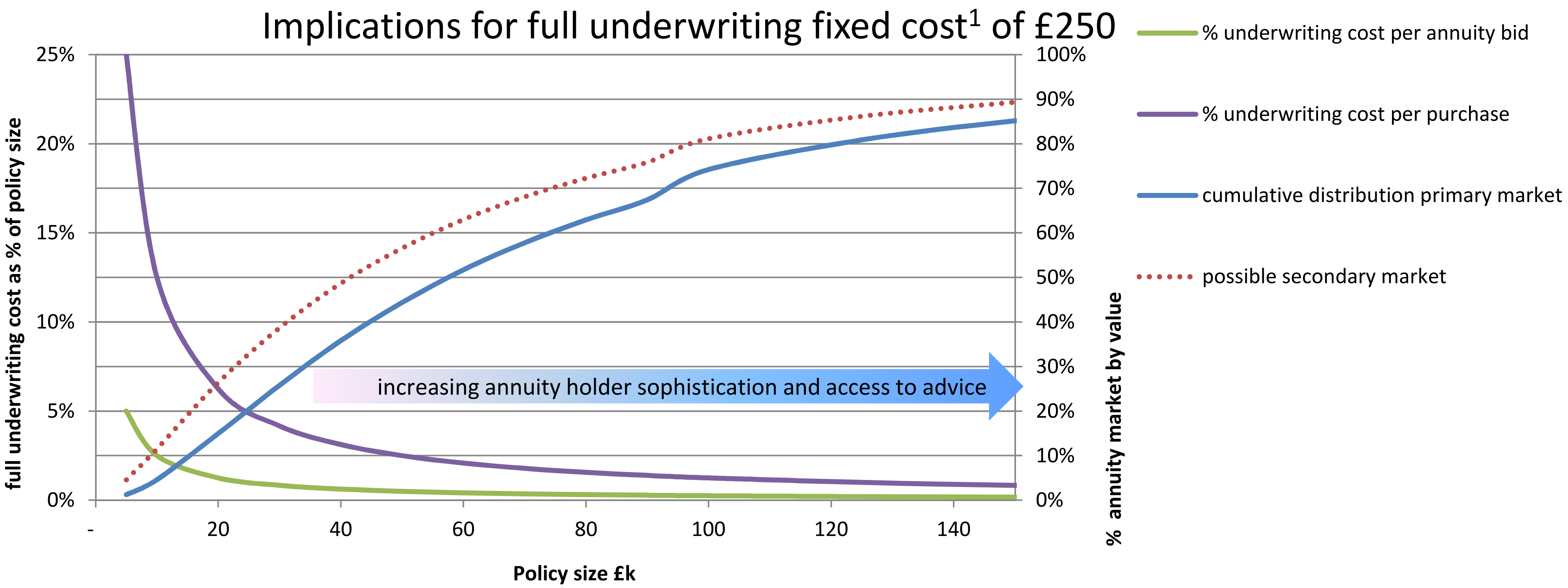
- A format agreed between British Medical Association (BMA) and Association of British Insurers (ABI). Recommended basic cost £104 (£27 per supplement).

Future:

- “Patients will be able to access and interact with their GP record online within 12 months” – Jeremy Hunt (UK Health Secretary) Sept 2015

[1] UK Information Commissioner’s Office - ‘Find out how to request your personal information’
[2] ABI\BMA joint guidelines – ‘Medical information and Insurance’ – March 2010’

UK Medical Underwriting economics



- Full underwriting perhaps cost effective above £80k. Maybe 30% of market by value
- More cost effective solutions required for smaller policies, e.g. telephone underwriting

[1] Assumes typical UK cost of £150 for full underwriting, plus £100 for access to medical records through GPR request
[2] Assumption that 20% of market bids complete to purchase – reflects SL experience in UK TEP market
[3] Secondary market prices may on average be lower than issue prices, depending upon secondary market IRRs.

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Potential issues to address

Consumer side:

- How are the interests of joint policy holders & beneficiaries preserved?
- What regulatory requirements will the FCA place on consumer advice?
- How will the UK Treasury structure the tax regulation effectively to prevent avoidance “loop holes”?
- What are the implications of annuity sale for those on means tested benefits?
- Litigation for primary market annuity mis-selling – this could be huge.

Investor side

- Tracking of life assured status – how does this work effectively as the secondary holder is not incentivised to monitor?
- What happens in cases where deaths are identified perhaps years after they occur?
- What investor IRRs will be achievable in the secondary market?
- Will secondary\tertiary investors maintain Financial Services Compensation Scheme (FSCS) protection?

SL predictions

Will annuity providers be permitted to 'buy back' their own policies?

- *"No, due to the detrimental 'captive market' effect on consumers"*

Will annuity providers be allowed to veto policy sale?

- *"No. Although they will be allowed to cover their reasonable admin costs"*

How will policy holders access the secondary market?

- *"Through an efficient referral process to online clearing houses"*

What types of investor will be permitted to buy traded annuities?

- *"Secondary investors will be limited to UK regulated entities"*
- *"However, permitted tertiary investors may include retail"*

How will secondary investors access the market?

- *"Access via online clearing houses"*

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QUESTIONS?

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