Retirement Partnership

THE CASE FOR CHANGE – WHY CHANGE, AND WHAT DO WE HAVE TO CHANGE?

The retirement market place, in all dimensions has changed so much in the last five years that there is no reason to be doing things the same as we were five years ago. It may seem a little dramatic, but you could say that there has been as much change in the boring old pensions industry as there has been in the music industry with the move from tape machine to digital music, and MP3.

So what has changed so much?

Life expectancy

In case you had not heard – we are all living longer. The development of science and healthier lifestyles has meant that the average male child at birth can now expect to live to age 76.9, and female until the age of 81.3. However more importantly remember the simple rule that – 'the longer you live – the longer you will live!' Life expectancy at age 65 has reached the highest level ever for both males and females. In England, a man can expect to live for 17.1 years and a woman for 19.9 years.

Can you remember what it was like in 1988? Or better still in 1978? That is how long your retirement could be

– Indeed it could be longer! The female at 60 has a 50% chance of living to 90. That is thirty years!

The Office of National Statistics publishes detailed data on life expectancy throughout the UK, and most revealing are the regional variances. So not only should the adviser be aware of the general rise in life expectancy, but also how things look in their own locality.

Healthy life expectancy

Knowing that you will have a long retirement is perhaps good news for some , however the ONS also supplies us with clear data about how long we may expect to live in good health. The data now clearly shows that 'average retirement' will be split into two, or perhaps three key periods: Good health , poor health; and dependency. The first period is more obvious in so far as we often now see the happy and active retiree featuring in adverts, TV programmes and films. The less well featured, and less glamorous are the later stages of infirmity and dependency.

Such data now allows the individual to seek enhanced annuity rates based upon their own lifestyle and health experience. Smoking and diabetes; asthma and obesity can each provide a real benefit in enhanced income levels, but 'enjoy the money while you can' should be the message, as the annuity provider obviously thinks you will not be living as long as the others.

Baby Boomer impacts

The impact of long life expectancy is all the more significant when combined with the 'baby boomer' generation now entering the retirement phase. The ratios of workers to non workers and the dependency of individuals upon the state will present huge pressures to western economies.

Inflation

Inflation is corrosive. It is also different for us all, depending upon our lifestyle and purchases. The retail price index that many pensions, including the state pension, is linked to has now reached 5%. The Alliance Trust places inflation for the 60-74 year old at 5.8% for the 12 months prior to July 2008.

OMO Offer More Options

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Many individuals take on an annuity income that will never rise. This is generally based upon the credible reason that it will take approx 10 years to catch up with the same level of income if an escalating income is chosen, and a further nine years to make up the difference.

This is fine if the retiree conveniently dies at the appropriate time, but may well lead the client into state dependency in the final years of life. No one finds the state benefit system easy to navigate in the best of health, let alone when you are in your eighties, or nineties.

The Perfect Storm

Combine these drivers and we get a perfect storm. It will never happen of course, and the state will always be there to look after us. But then may be it won't be in the same way as it is today.

The key to this sorry tale is to take action and change the way we do things. Nothing can save the retiree who simply has not saved enough money, but some will be at least better off for taking some alternative actions.

These issues combined are as big as global warming. We now know about the issues, but the real question is –what are we doing about it? A change of behaviour is essential if we are going to make a difference in our own world and that of our clients.

Education, Advice & Administration

The core principle behind any client engagement must be the provision of these three fundamentals. Educating the client about their circumstances, and options as well as the issues, and risks that they should consider has to be the adviser's fundamental role.

It is impossible to go through this process as well without conducting the sea of administration that needs to be completed, not just to provide the advice but then if required to complete the business.

The range of options

The range of options for the retiree is now wide and varied. The consideration of these options should not take hours, but must still be done.

The conventional lifetime annuity is still there, and still the most popular option for most – however is this through ignorance or choice? The case for lifetime annuity is still strong as it provides life long guaranteed income. Some may use this as the benchmark for alternative options.

Beware: Inflation is the big risk. There is also no flexibility and it's a 'one and done' decision. The death benefit structure must also be chosen on this day and cannot change if circumstances change.

The underwritten annuity which includes:

- → Lifestyle annuities e.g. smoker rates
- → The impaired life annuity e.g. asthmatic, or diabetic
- → The postcode annuity e.g. Glasgow provides a better rate than Bournemouth.
- → Severe ill health e.g. cancer

Each of these options can provide the individual with a greater annual income than the normal lifetime annuity. Key questions MUST be asked.

- → Do you Smoke?
- → Are you on medication?
- → Have you had surgery?

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The Fixed Term Annuity:
A recent addition to the annuity range made possible by legislation and product innovation. This option provides the assurance of regular fixed and guaranteed income with the knowledge that income can be reset at the end of the term.

It can also provide a guaranteed maturity value, removing the investment risk associated with USP. This provides flexibility and the opportunity to take advantage of future change to personal circumstances, and/or products in the market.

This option can also be incorporated within an unsecured pension portfolio, representing an excellent alternative to cash.

The risk is that future annuity rates move against the client, and circumstances do not actually change. A lifetime annuity variant must be purchased by age 75.

The With Profit Annuity:
An old investment style presented in the annuity format. However this is still popular with many advisers. The product allows for the annuity to grow in line with an anticipated growth rate, (ABR).

The advantage of this product is its ability to grow in line with the market and therefore provide some protection against inflation. However growth is not guaranteed and indeed income can fall. The make up of bonus structures is important as is the bonus strategy of the company concerned. This needs careful thought and consideration.

The Unit Linked Annuity:
A similar proposition to the with profit annuity without the management of returns by an actuarial team. Often providing a wide choice of investments for the client, this product style offers the client the opportunity to remain fully invested.

The advantage of fund growth is clear to see, however the client is as exposed to the down turns in the investment values and caution should always be applied.

Some Unit linked annuities also provide the advantage of mortality credit in their structure, which provides a benefit to the surviving policy holders each year from those that have died within the annuity pool. This can lead to an elimination of much of the charges in later years.

The Flexible Annuity:
Very similar to the Unit Linked Annuity, however with the addition of an increased income level equivalent to 120% of the highest annuity rates available, and also the addition of an underlying guarantee. These are key advantages over the unit linked annuity.

Unsecured Pension:
Commonly known as Income drawdown this facility has been very popular for years for clients with more substantial fund sizes. The facility offers good death benefits and a great deal of flexibility. In particular the ability to take tax free cash (pension commencement lump sum) and retain the remaining funds with no income withdrawals.

This option presents many risks and the client must be clear about what they are entering into, however with clear education of the risks involved and particularly as part of a suite of options this will remain popular.

Unsecured Pension – with Guarantee:
As above, with an underlying guarantee, these products are mistakenly called variable annuity by many. The 'risk of ruin' is mitigated by the guarantee, which is structured in slightly different ways within each product.

The guarantees launched have typically been guaranteed minimum Income benefits (GMIB). However the launch of guarantees protecting capital value, and death benefits are now arriving in the market too. These products are very well developed in the US and Japan, so the expertise and experience of developing these products already exists.

Longevity Insurance:
Not specifically a pension product, but one that should be considered at the retirement stage for clients, as they will have lump sum cash available. The issues that this product raise with the client will help explain the issue of life expectancy and the clients 'later life' financial needs.

Other Income sources

It should be clear in the provision of advice 'At Retirement' whether activities are restricted to particular pension funds, or if a wider view of retirement and later life financial planning is taking place. Establishing the client's 'Retirement Asset Pool' is important. This will identify all assets to be used for income in retirement and in turn raise the issue of the domestic residence and how that may be used in the future.

Client objectives are changing

The wants and wishes of the retiree are obviously the most important aspect of all, and need to be taken into account.

Our evidence here is merely through experience, and discussion. The retiree today is perhaps looking for the perfect answer – an income in retirement that is:

- → Sustainable – solving the longevity issues
- → Carries no undue risk – or perhaps better described as the 'can go up, but won't go down' scenario
- → Has the maximum flexibility – allows for stop / start and increases and decreases, as well as the occasional lump sum
- → Returns all their money on death – or at least that it can be seen that no one else unduly profits from the money.

In addition to the above the simple fact of life is that things do change. This applies as much to the personal circumstances of clients, as it does to the products and solutions that may become available. Using the rear view mirror again to see how much change has occurred in the last fifteen years actually presents a strong argument to provide increased flexibility to the client in their future provision.

Fulfilling all these demands, desires, or wishes may be an impossible task, however educating the client in the options and choices available to them, as well as identifying the issues and risks that different solutions present is not impossible.

The adviser should also now be conducting their business in line with the new FSA principles based regulation. Establishing a clear proposition for the client, or categories of client is in our view an essential step. Building an element of education as well as advice into even a transitional client relationship, can only be beneficial to all concerned.

The retirement market offers a huge opportunity for advisers

The Retirement market is booming and will not stop – despite down turns in the economy, indeed many may now see this as their time to step back and slow down.

The market opportunity presents the advisory firm with a great opportunity to create real value in their business through the development of a clear retirement proposition and in turn the continued management of client assets into retirement.

The reality is that no one product solves everything. The compromise solution should perhaps more often be a mix of two or even three solutions. The case for significant change in adviser practice is clear and we support this through our own activities.

If you would like support with these issues in your business please contact us below:

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