

An Interview with... Living Time



Living Time chief executive Kim Lerche-Thomsen and managing director Dave Harris discuss the firm and its ambitions with IFA and annuity expert Billy Burrows and journalist John Lappin.

Write up by John Lappin

PRIORITIES FOR 2010

Living Time has made no secret of its ambition to see the £15bn 'tower' of lifetime annuities come crashing down and into, at least in a lot of cases, fixed term annuities.

The firm says 2010 will prove pivotal as it sets out to win the hearts, minds and the recommendations of advisers. It acknowledges this is a much bigger task than simply convincing IFAs about the product's merits. Along with demonstrating the benefits for clients, it wants to show how fixed term annuities can help IFAs retain value in their businesses and reduce the compliance risk.

Harris says: "There is now a massive opportunity for people within the lifetime annuity tower to be set free. I think that tower will crumble with fixed term annuities becoming a mainstream offering. At least in four retirees should have a fixed term annuity either alone or as part of a cocktail solution."

Lerche-Thomsen says that by using fixed rate annuities, it is more likely that clients will be able to take a holistic approach to managing their assets and what they pass on to their children including of course their homes. That should place IFAs at the heart of the process.

Living Time also hopes that 2010 will bring a little help from its rivals.

Liverpool Victoria have entered the market, while Aviva is also expected to bring out a fixed term product before the end of the year. This competition is welcomed by Living Time in the belief that it can only reinforce their case.

Harris says: "As the pioneer of this category, we want to ensure that consumers get the benefit, free from what for the last hundred years or more, has been the tyranny of a lifetime annuity for healthy people and people with a mild impairment. The entrance of the other firms does legitimise fixed term annuities, and it helps them be seen as something that is set to grow. There is more than enough share for all of us."

However to help achieve this mainstream acceptance, the firm will be putting in a great deal of the groundwork with IFAs itself.

OFFER MORE OPTIONS PHASE TWO:

The Offer More Options campaign which has seen the firm lobbying extensively and signing up thousands of advisers to support more retirement choice will enter a second phase. It is planning events for a selective group of Advisory business owners, Directors and compliance officers which will look at the economic, business and regulatory case for changing current advice practices. This also builds on the

detailed research Living Time has been carrying out with the around fifty IFA businesses to date.

The Lifetime annuity 'tower' grew to reach 462,000 retirees last year, many on the back of IFAs' recommendations and the firm wants to do something to change that.

Among other things, Living Time will argue that advisers should change their stance because a lifetime annuity no longer looks like a safety first option in all cases, from neither a client nor compliance point of view. It will also be arguing that a fixed term annuity should replace at least some drawdown recommendations.

The firm also argues that advisers should modernise the decumulation part of their businesses to match changes on the accumulation side too.

Harris says: "IFAs have done a good job in the accumulation part of their business over the last few years with planning for the RDR. They understand the concept of gathering funds under management but they will happily hand over a billion pounds of lifetime annuity business every single year. The deaccumulation funds under management model is one that, with the modern options available, can be good for the consumer but also help advisers with their P&L cash flow and their long term valuation.

"I would say well done to advisers for sorting out your accumulation business but my assessment is only about 1 in 5 IFAs have made significant steps or progress in their 'at' or 'in' retirement

business. Yet the demographics show that is where their clients are."

POLITICAL AND REGULATORY ENVIRONMENT

The firm believes the environment for change is very promising. It is one of the founders of the Pension Income Choice Association but it also points to the Conservative promise to scrap the compulsory annuitisation age as evidence that innovative companies with new solutions should benefit which it believes provides a huge opportunity.

Harris wants to change the sentiment across the full retirement market but admits there are some limitations. "There is no compare the market equivalent yet," he says.

He wants to convince big providers that offer a white labelled enhanced product to offer a fixed term annuity as well. He also hopes to get the products on to the panels of the big pension consultants which work with FTSE firms.

At some stage a lifetime annuity was the right solution, and (it) probably worked 55, 50 years ago. But life has moved on and the basic product has not.

He says the annuity desks need to modernise too, perhaps to offer 'cocktails' of solutions that could include a fixed term annuity. He wants to see OMO as the default. But, as always, he urges IFAs to get there first.

USE BY HIGH NET WORTH CLIENTS IN DRAWDOWN AND OTHER SOLUTIONS

The early adopters of fixed term annuities have been IFAs advising the high net worth market or at least the affluent. The majority of recommendations – around 80 per cent when the firm initially set up and still as much as 60 per cent now – have come from advisers constructing drawdown and SIPP portfolios where the product sits alongside other investments and assets.

Harris says those IFAs are looking for a 'sleep well at night' product to fit alongside a cocktail of other investments. He says the product is being used in both the accumulation and decumulation phases.

Its strength, Harris says, is the degree of certainty, in that you can put in x, take out y as income between zero

and maximum GAD and get z back as a final sum.

Burrows' questions, challenges and observations and Living Time's answers:

LIFETIME ANNUITY VERSUS THE FIXED TERM ANNUITY AND THE ADVICE AROUND IT

Billy Burrows says that he is convinced of the appropriateness of the product as part of a 'cocktail' solution in drawdown but has one reservation about using it as a replacement for a lifetime annuity.

"It is quite clear there is an extremely strong case for Living Time in drawdown, but do you think IFAs and their customers understand the risks of going into Living Time in lieu of going into a lifetime annuity?" he asks.

Harris says: "The Achilles heel – the thing we feel is the only Achilles heel, if we are being arrogant, is the annuity

rate risk. But as long as you are aware that you are taking that risk in return for the flexibility, if your eyes are wide open to the fact that at the end of term the guaranteed payout may not get you the same income again, then I am happy that we have explained the risk."

Harris splits the potential market into Bentley, Mercedes and Mondeo clients.

Burrows asks: "Most IFAs and most customers are used to being sold products, but with annuities that requires a level of advice and discussion. Are you seeing IFAs who are advising this Mondeo class engaging in giving the right information and advice and where is the cost of that advice going to come from?"

Harris says: "We need to get IFAs to realise that what flashes past their desk as a transactional annuity sale could become a simple cocktail offered to clients. Maybe that cocktail is far simpler than a Mercedes or Bentley client would get. None-the-less it is far better than something that has one thing, a lifetime annuity, in it. If you reset your

advice process you can make more money than you think for yourself and your clients."

Burrows says: "So what is in this simple cocktail?"

Harris: "It might include a with-profit annuity, a fixed term annuity and perhaps an enhanced or impaired annuity. What you shouldn't expect to see for a healthy life is a traditional lifetime annuity," he says.

ENHANCED CONCERNS AND MORTALITY

Lerche-Thomsen says he cannot see why an unhealthy client would enter into an impaired deal rather than take a more balanced view of the income they need.

"For the sake of a few pounds extra, people are being given a lifetime solution when actually it is not what they want – they have bought the income but they've not bought a solution. Their needs are "I'm not going to live too long, I need an income." But do they want to use my funds up to the extent that I can't leave anything to my family?"

"Why do you want to lock yourself to solutions that lock you in for thirty or forty years when your life is going to change hugely? You know for certain you are going to become impaired and the ultimate impairment is death."

He says that for clients in their fifties and sixties the mortality component of the lifetime annuity is tiny.

"It is only when you get to 75 it starts to become meaningful, the so-called mortality drag. With a term assurance you pay a very small premium for a very big benefit with a lifetime annuity you pay a very big premium for a very small benefit. At some stage a lifetime annuity is the right solution and probably worked at 55, 50 years ago. But life has moved on and the basic product has not."

MANAGING EXPECTATIONS AT RETIREMENT

Burrows points out that many people do not appreciate how long they are likely to live. "It is well established that people underestimate their life expectancy and their health. They are pessimistic at the point of retirement.

They think they are going to die sooner than the average. It is quite logical that people will put a high value on the Living Time product if their circumstances change. That is the nub of it.

"On the one hand, they have the potential flexibility. The price they pay for that is they may not be able to buy a replacement. That shouldn't be a problem, if analysed correctly because there is no compulsion to buy an annuity."

Lerche-Thomsen believes a simple solution may be to buy another fixed

PROSPECTS FOR FIXED TERM ANNUITIES VERSUS VARIABLE ANNUITIES.

Living Time suggests that it can see a place for variable products although it believes fixed term annuities are best.

Burrows asks: "In five years time do you expect the market to sell more fixed term annuities or variable annuities?"

Lerche-Thomsen suggests that the boundaries may blur. At some stage Living Time may introduce products

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term product and warns that current economic conditions hardly make lifetime annuities seem value now.

He says: "When you come out of the product, if interest rates are lower just take another short term product again. If you look right now you have got quantitative easing just coming to an end, you have got low short term rates. You want to hang on in there because there is going to be some quantitative hardening, and we will see some inflation. A lifetime annuity carries immense long term inflation risk. If you bought when interest rates were low, you just need a couple of years of 25 per cent inflation and you're dead. Meanwhile if inflation goes up and you're in something short term like the lucky people who got in at the end of the 1980s they got 15 per cent but within three or four years leading on from that you didn't get anything like that."

WHAT SHOULD THE FIXED TERM ANNUITY BE COMPARED WITH WHEN USED IN DRAWDOWN?

Burrows asks: "Given the use of the product in drawdown and Sipps has Living Time changed the way it describes and compares its products say by using cash as a benchmark?"

Harris says the firm is adjusting some of its marketing to reflect this use.

"Should we compare it to a lifetime annuity? The reference point may be cash or indeed what is the fixed interest fund at M&G or what's the rate Barclays bank are offering drawdown clients," he says.

with an element of investment risk.

He is keen to emphasise that he would like IFAs to compare solutions not products – he also suggests that to produce a return equating to that provided by Living Time product most variable annuity providers would have to post returns of around eight per cent. Rolling returns on the FTSE suggest there are few periods over 7 per cent. "It is all about when you start, returns can be very good but they can be murderous," he says.

CHANGING SOCIETY

Burrows: "The pattern and behaviour of people is changing. What evidence have you for how people's circumstances at retirement are changing, taking multiple jobs, trading down their homes?"

Lerche-Thomsen says: "The evidence comes from the national statistics. There is evidence of social change and therefore needs change. The switch to people being in single housing is quite extraordinary.

"People have realised you have a very significant time in retirement. Fifty years ago, lifetime annuities were out of defined benefit schemes which they converted into an annuity. There was a bigger manufacturing base so people died earlier, sanitary conditions were worse, there was smog.

"Now the average life expectancy is 20 years in retirement. One in ten will reach 100. Even advertising has changed. You used to see people cutting roses in the garden going on the lifetime cruise before they die. There is a more active

type of advertising and the 55 to 75 is going to represent the majority."

CLOSING ARGUMENT – CONTRASTING BUSINESS MODELS.

When asked by Burrows, how Living Time may finally convince advisers, Lerche-Thomsen says the firm must contrast the nature of their business model and how it aligns with clients' needs in contrast with the traditional lifetime annuity providers.

"When we set up Living time the first thing we wrote down is "We want you to live." We are delighted if our customers get to the end of their term. We want to celebrate giving your money back to you at the end of the fixed term and if, unfortunately, you don't live we pay death benefits."