

## **Annuities in the UK**

*UK has offered annuity with guarantees to the market. How is the experience and what lessons other markets can learn?*

1. Background to UK annuity market
2. UK annuity market statistics
3. UK annuity market regulations
4. Lessons for Middle East annuity market

# 1. Background to the UK annuity market

Historically companies provided **defined benefit** pensions for life to their employees

- Popular with pensioners as guaranteed income for life
- Market risk and longevity risks remained with the company
- Pensions schemes v. large e.g. BT £40bn-50bn pensioner assets vs £2-3bn annual profits.

Move to **defined contribution** combined with active annuity market (compulsory for pensioners)

- Market risk before retirement moved to employees
- Market risk and longevity risk post retirement moved to insurance companies

Pensions reform introduced in 2015 – annuities no longer compulsory

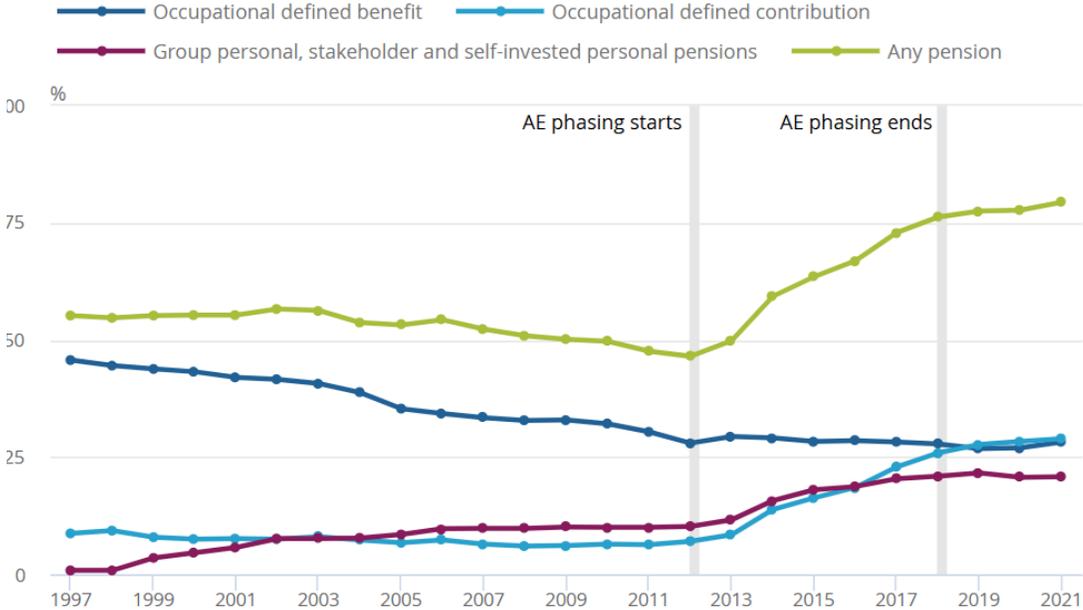
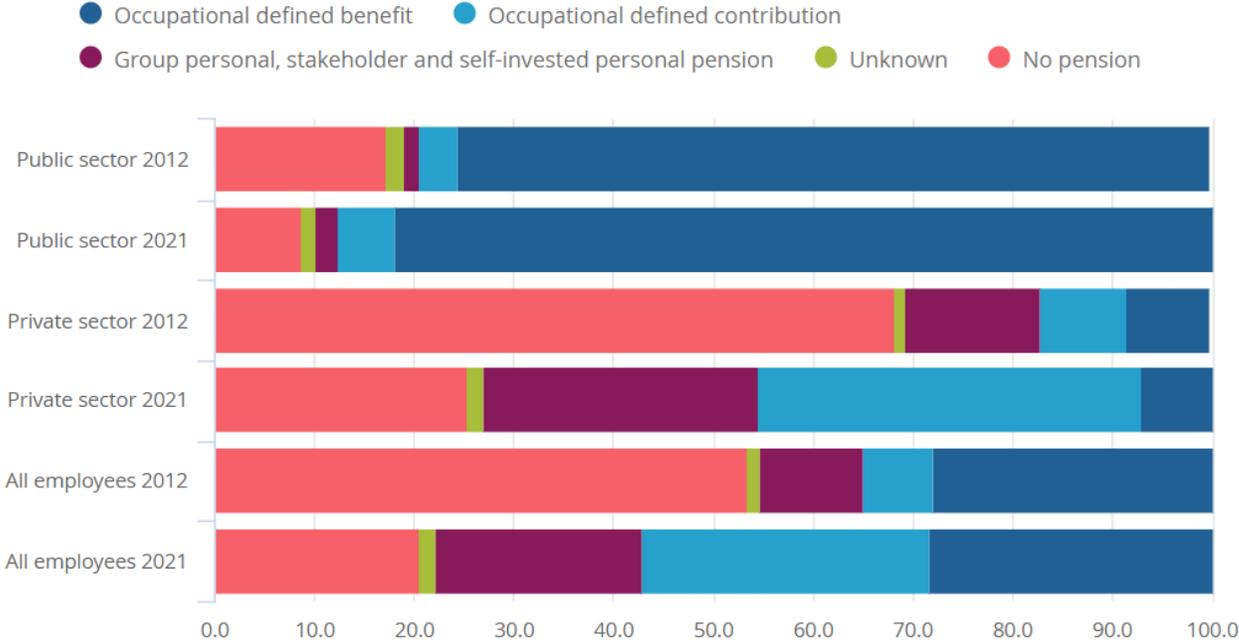
- Drawdown products more popular; low interest rates made annuities very expensive
- Without annuity market and longevity risk entirely with pensioners
- Defined benefit schemes sold to insurance companies

Current position – Interest rates have risen and annuities are better value

A mix of drawdown with later life annuity or a low-level annuity for basic needs, means market and longevity risk are managed

# 2. UK annuity market statistics

Employee workplace pensions in the UK - Office for National Statistics



Pension type	Asset value	Source
Defined benefits (private sector)	£1.2 trillion	<a href="#">ONS</a>
Defined contribution (total uk)	£1.2 trillion	<a href="#">Pension Age</a>

### 3. UK annuity market regulations

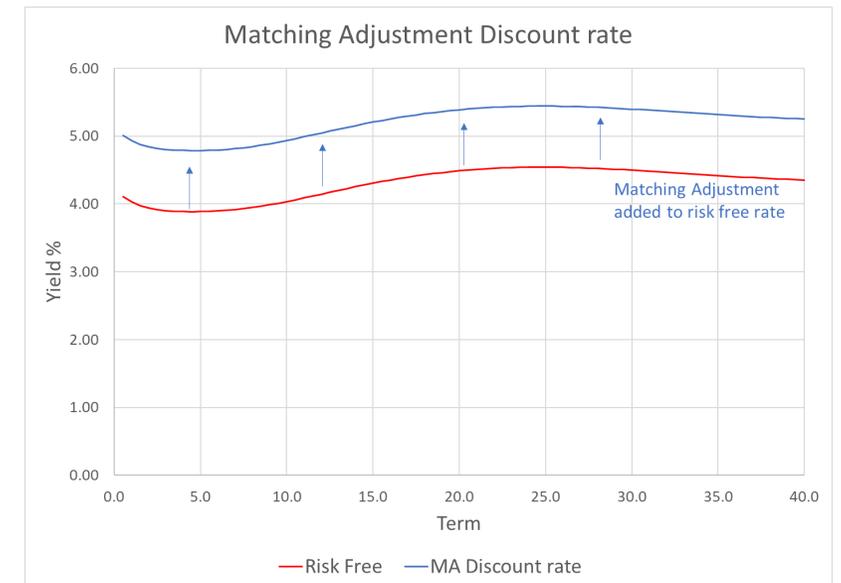
The UK uses a version of the Solvency II (2016) regulatory regime - Solvency UK (2024)

- Realistic balance sheet – introduced in 2004 following the failure of Equitable (founded 1762) in 2001
- Risk based capital – favorable treatment for credit risk relative to annuity backing assets

**The Matching Adjustment** - The key regulations for annuities are around the “matching adjustment”

- Discount rates for annuity (matching adjustment) business is 100-150bps higher than non-annuities
- Discount rates are based on the actual assets backing the annuities which means the liabilities move in sync with the asset market values creating a stable portfolio
- The Matching Adjustment involves ring fencing a portfolio of assets that would not need to be sold.
- This gives a theoretical basis for the “liquidity premium”, that we will never need to sell these assets
- The matching adjustment increases in stress reducing credit risk capital

Regulations need to be structured to provide security and confidence in insurance companies, whilst keeping costs affordable



## 4. Potential lessons for Middle East annuity market

Opportunity to take the best solutions from the UK around regulations, products and where risk should be held; whilst avoiding mistakes.

### Challenge

1. Employers want to avoid market and longevity risk whilst offering employee benefits
2. Individuals want certainty in retirement without longevity / market risk

### Potential solutions

1. **Risk pooling** - Risk sharing across many individuals' pools longevity and market risk; which was carried out via "with profits" style policies in the UK. These are Takaful consistent principles.
2. **Insurance companies** – Insurers seek longevity and market risk as their business model. It is carefully managed with appropriate investments and modelling.
3. **Drawdown** – drawdown offers ready capital, but with longevity and market risk for pensioner

Combination of drawdown, limited annuities and late-stage annuities, with long term care insurance may cover the main risks whilst offering relatively good value.