Fairer Pensions for All
UK Annuities Policy – A Framework for Change

We can help make annuities work better for everyone...

- *At no cost to the government*
- *Helping the less well off to get higher pensions*
- *Ensuring that they choose the right annuity*
- *Ensuring that they get the best rate available*
- *Enabling those who want to pass on capital from their pension pots to do so*

Annuities are a special case

- *The Government forces people to buy them.*
- *The decision, once made, is irreversible.*
- *Most people don't understand them.*
- *Most people don't get the best rate.*
- *Most people, therefore, get lower pensions than they should.*

Changes so far have really only benefited the rich

- *Current system discriminates against the poor.*
- *Proposals from existing pressure groups still only targeted at the rich.*

Policy changes that will help everyone...

- *Make sure that everyone gets at least a basic level of advice to help them choose the right kind of annuity for their circumstances.*
- *Make sure that the advice includes obtaining the best rate for the selected annuity*
- *Allow everyone the option of full capital protection for their pension savings*
- *Require standardisation of the forms for notification of pension entitlement and annuity purchase*

None of these policy changes will involve any cost to Government.

Together, they will radically improve the workings of the current system.

They will overcome the objection that the accumulated pension is lost on death.

They will ensure that the less well off get higher pensions.

In Other Words...
These Changes Will Help Give Fairer Pensions For All

Summary

Annuities are a 'special case' in the investment products arena. Firstly, the government forces people to buy them with their accumulated pension savings. Secondly, the purchase cannot be unwound – the purchaser is locked in for life and, if they choose the wrong kind of annuity, (or if new products come out which would be more suitable for them) they can never change. Given these factors, it is surely crucial to make sure that people know how to make the best choices and find the best rates before they buy.

The requirement for everyone to buy an annuity by the time they are 75 years old is fundamentally sound, as a means of providing a secure pension for life, but the way the market operates is not optimal. Annuities have been the subject of much dissatisfaction recently and several pressure groups are currently pushing for change. In fact, in recent years, the Inland Revenue has already approved a number of changes to the annuity legislation, for example, allowing phased annuitisation, investment linked annuities, income drawdown etc. However, these changes all benefit the better off and very little attention has been paid to making the annuity system work better for <u>everyone.</u> The recent initiative by the ABI to tell everyone about their Open Market Option (OMO) is a step in the right direction, but will not help most people because they do not understand the annuity choices that are available to them. Choice is, of course, a good thing but, if one does not understand what one is doing, choice without knowledge is not good. Annuities are complicated (as, of course, are pensions in general) and people need help to understand how to get the best pension from their pension savings.

This paper contains proposals to address the annuity question from a new perspective. **The proposed reforms can be implemented almost immediately and without any cost to Government. In and of themselves, they will move the process of annuitisation in a significantly positive direction in terms of fairness for all.** The proposals are backed by extensive discussions with industry participants – providers, fund managers and IFA's.

Problems of The Current System

1. ***Lack of Information/Advice*** – complex, irreversible decision, but people don't know how to choose the right annuity or get the best rate.
2. ***Unfair to the least well off***
   a. less likely to take advice.
   b. less likely to shop around for the best annuity rates available.
   c. tend to die younger and donate their mortality cross-subsidy to the rich.
   d. tend to be in worse health, but do not always know about 'impaired life' annuities.
3. ***Lack of opportunity to pass on pension to heirs if die early*** – capital protection only for up to ten years.
4. ***Lack of standardisation of forms notifying annuity information*** –people do not understand different wordings on all forms.

Policy Solutions Proposed

1. Everyone to receive at least basic advice before annuitising (choosing most suitable annuity and best rate) – funded by initial commission currently deducted for advice.
2. Annuities exchange must be used to secure best rates.
3. Capital guarantee to be permitted for life (not just 10 years).
4. Standard wording to be devised for forms relating to annuities.

Introduction

Current UK pension policy focuses on giving generous tax relief for pension savings to encourage people to accumulate funds for their retirement. In return for this tax relief, the government requires people with defined contribution arrangements to buy an annuity by age 75, to provide their pension. The rationale for this requirement is that:

- Pension savings should actually be used to provide a pension income for life.
- Some of the tax relief can be recouped by taxing the annuity income.

Annuities are an excellent product for guaranteeing lifelong income, annuitants will never run out of money, however long they live. The risk of living for 'too long' is pooled, so those who die young subsidise pensions of those living longer. About 25% of people retiring in their 60's today, will live to their 90's. They need pensions to support them.

Annuities are very much a 'special case' in the savings/investment arena. Firstly, the government forces everyone with a defined contribution pension to buy one and secondly it is the only financial decision which is completely irreversible. Once bought, you are stuck with it for life.

The demand for annuities is growing rapidly (in 2001 the market is estimated to be worth £8bn) and, as the UK's demographic profile ages, as policy moves more to encouraging individualism in the form of personal and stakeholder pensions and as occupational pension schemes move away from defined benefit towards defined contribution, the demand for annuities will grow further. Estimates suggest a growth rate of about 20% a year. It is, therefore, urgent to address some of the shortcomings of the current system.

So far, government pension policy has focused on the pre-retirement phase and not so much on the post-retirement phase. All pension savings which are not in a defined benefit scheme must be used to buy an annuity, but rather little has been done to ensure that the majority of people know what kind of annuity they need or how to obtain the best value from their annuities. In fact, any changes that have been made to the annuity rules in recent years have really only benefited the better off.

The recommendations in this note are aimed at helping the majority of pensioners (especially the poorer ones who are currently least well served). Several policy changes can be made, at no cost to the government, to help lower income pensioners obtain higher pensions. Those with large pension pots are complaining loudly about the current annuity system – and the Inland Revenue has already made changes to address their concerns – but not much has been done to help the remainder of the retiring population.

Some of the complaints about annuities arise from the sharp falls in long term interest rates and huge improvements in longevity, which have occurred in recent years. These mean that the amount of pension which can be bought with an annuity has fallen, and people perceive them now as poor value. Of course, low rates reflect lower inflation and asset prices have also risen, meaning that the accumulated pension amounts are higher. But, at the same time as interest rates have fallen, the trend to earlier retirement has increased and life expectancy has lengthened, so that people are spending far longer in retirement and annuities need to last for much longer than before. Obviously, then, the annuity payments from a particular capital sum have fallen over time. Policy cannot affect these particular issues in the short-term. However, there are many elements of the annuities market which can more easily be addressed to provide better and fairer pensions for all.

So what are some of the problems in the way annuities currently operate in the UK?

1. Complex, irreversible decision, but poorly understood

The decision to buy an annuity is not a simple one. There are many different types of annuity (single life, joint life, level, escalating, impaired life, investment linked, capital protected etc.). The rates available for annuities vary frequently, with daily changes by many providers meaning that the company which provides the best rate one day, will not be the company providing the best rate a few days later. Importantly, once the annuity is bought, it can never be changed – the person is locked in for life. It is, therefore, crucial to make the right decision.

2. Discrimination against the least well off

The present annuity system is unfair. It discriminates against the poor. Currently it is the least well off who lose out most from the annuity market. They do not get help to choose the best annuity, nor do they have access to the best rates. The table below shows figures from the ABI for Q1 2001. It is clear that only about a third of people are using the Open Market Option and it is those with larger pension pots who do so, but this represents over half of the total value of annuities purchased. It is, therefore, the ones with bigger pension pots who are more likely to get help in finding best rates, or who understand how to do so.

Annuities purchased Q1 2001

	Number	% of Total	Average Value	Total Value	% of Total
With Open Market Option	20,400	34%	£36,857	£ 661.5m	46.8%
With existing pension provider	39,200	66%	£16,875	£ 751.9m	53.2%
Total	59,600			£1,413.4m	

Source: ABI

The government is forcing people to take out an annuity but, unfortunately, it does not ensure that people know what choices they are making or how to get the best rate available in the market. In fact, most people do not get the best rate available and, therefore, have to live on a lower pension than they should, for the rest of their lives. Most estimates suggest that over 50% of those purchasing annuities do not get the best rate!

The lower income groups and those with smaller pension pots do, in fact, suffer in several ways under the current annuity system.

a. They do not tend to take any advice before they make their annuity purchase (even though over 1% of the value of their accumulated pension savings is deducted before annuitising to cover the cost of 'advice' – whether it is actually received or not!) They will, therefore, not be well-equipped to buy the best type of annuity for their circumstances, or to get the best rate for that annuity on the day of purchase. It is all very well to tell people they have an 'open market option', but they often do not understand what this means. Even the forms received which explain the value of the pension and the options available are not standardised and are extremely difficult to understand.

b. The poor tend to die younger and, therefore, their earlier death susidises the annuity payments to the longer-living better-off pensioners. In other words, the poor donate the mortality cross-subsidy to the rich.

c. The poor also tend to be in worse health and, therefore, could be eligible for 'impaired life' annuities which offer much higher pension payments. However, the lack of advice and knowledge means they are not always aware of the options available to them. Of course, once they have bought a standard annuity, they cannot change later if they find they could have done much better with an impaired life product. They really need to be helped before they buy.

d. Administration charges on smaller pension sums are often fixed monetary amounts (in the region of £50 per year ongoing charges and £100 to set up the plan), so that these charges are proportionately higher for small pension pots.

3. Capital protection only for up to 10 years

At present, it is possible to protect the capital sum built up in personal pensions so that, if a person dies shortly after taking out the annuity, the insurance company will continue to pay the annuity income to the person's heirs for up to 10 years. There is a cost involved in this protection, which means a slightly lower annuity is paid. One of the major complaints about annuities these days is often this point that people lose all their life savings if they die before receiving most of it as income. This criticism is not entirely fair, since pension savings are supposed to be for the purpose of providing a pension, not to pass capital on to one's heirs (other sources of savings should really be for this purpose). The money does not really go to the insurance company, it goes to pay the pensions of those who are fortunate enough to live longer, but the perception remains of unfairness. In fact, the government allows up to 25% of the pension fund to be withdrawn as a tax free lump sum, so this amount can also be used to satisfy the bequest motive.

The dissatisfaction with the lack of inheritability of annuities may be more a function of other general dissatisfaction, but it is nevertheless real. (Interestingly, a defined benefit occupational pension does not seem to carry perceived ownership rights in the same way as defined contribution arrangements). Before the recent falls in interest and annuity rates, the 10 year capital protection rule actually allowed more than 100% of the person's pension to be capital protected, but nowadays only 75% or so is possible. The figure of 10 years is also a rather arbitrary one. It is typically the better off, of course, who complain most about this problem and, if the capital could be protected and passed on more easily, subject obviously to the required tax being paid to the Inland Revenue, one of the big complaints about annuities today would be addressed.

The proposal would be to permit a 'money-back guarantee' to be offered as an option when buying an annuity. For a relatively small cost (at age 50 it would be less than 1%, at age 60 about 3.5%) people could guarantee to protect the balance of their pension fund that has not yet been paid out in the form of annuity income.

4. Wording on documentation to describe annuity choices not standardised and often very confusing

The wording used by all the different pension providers when informing customers of their rights and options when coming up to retirement is usually very difficult to understand. Each firm has a different form, using slightly different terms for the same things. The overall decision would be much simplified if the forms could be made more standardised. Identifying people's pension entitlements is currently very complicated. Partly this is due to a lack of a standard annuity regime (and the need for regulatory simplification is urgent, but will take time). Partly, though, there is a lack of standard forms, which makes it very difficult for anyone to understand the options available. The design of standard wording for the description of open market option and maturity letters would be very helpful.

So what can we do to address these various issues and make annuities work better – to provide fairer pensions for all?

There are several simple, no cost changes that can be made in the short term to address the problems described. This package of measures would move us a long way towards a much fairer system and would, for the first time, really meaningfully help those with lower incomes and pension savings. The policy changes so far have all helped those with larger sums and the poor are still losing out. By ensuring that they make the best annuity decision and get the best rate, the pensions of the less well off should be significantly boosted. Just obtaining the best market rate, instead of taking the one offered by the existing pension company, can ensure a pension increase of 10 – 15%, and obtaining an impaired life annuity can boost pensions even more. For example, someone with a pension pot of, say, £20,000 might receive an annuity of about £1,200 per year - £24 per week. If they shop around for the best rates, they could get an extra £2 or £3 every week for the rest of their lives and, if they were eligible for an impaired life annuity, they could even perhaps get an extra £5 or £6 per week. In the context of government pension spending, this amount of extra pension for the least well off could be particularly significant. The ABI proposals to make sure everyone hears about the 'Open Market Option' do not really go far enough. Furthermore, the ABI statement of best practice does not apply to trustees of occupational defined contribution pension schemes, so members of these do not always receive best pensions.

It seems scandalous that the government is leaving many people with several pounds a week less than they could get. Surely, the government has a duty to help people make the best decision they can – especially as the decision is irreversible. We can address this NOW.

Policy Proposals to Improve Fairness of Annuities

1. *Ensure everyone receives a <u>basic level of advice</u> before annuitising.*
2. *Ensure an annuities exchange is working to enable people to get the <u>best rate</u> available.*
3. *Permit <u>lifelong capital protection</u> if desired.*
4. *Require <u>standardisation of forms</u> to facilitate annuity process.*

All these proposals could be introduced in a relatively short time frame and would help all retirees – not just the better off. In fact, they would be of greatest help to the less well off who currently do not fully understand the process of annuitisation and do not have access to the best rates. Lifelong capital protection would be an easy answer to some of the major complaints about annuities by the better off too, because they could then pass on any unused sums to their heirs (after deduction of tax, of course!)

1. Basic annuity advice for all

The best way to ensure that people are able to make the right choice of annuity and then get the best quote for that type of annuity is to make it compulsory for them to receive advice. Having spoken to many annuity providers, it is clear that we could come up with some workable suggestions which would achieve this.

There may be a view that a 'Decision Tree Approach' would suffice, but this is just not enough. People often don't have a clue about annuities and surely need more 'hand holding' through the whole process. This advice should be tied in with ensuring the person can find the best annuity rates available at the time of their retirement which, again, a Decision Tree approach will not provide.

Given that the government mandates that an annuity must be purchased with one's pension pot and that, once it is purchased, the person is locked into that annuity for the rest of their (and perhaps their spouse's) life, shouldn't we ensure that people know how to choose the right annuity? In addition, for the better off, they will normally have access to proper financial advice, to help them choose which type of annuity to buy and obtain the best rates. However, the poor – and those with small pension pots – usually do not, cannot, or are not aware that they need to take advice. They often end up with the wrong type of annuity or, more normally, do not obtain the best rate for their annuity. The ABI proposals to make all pension providers clarify the availability of the Open Market Option are a step in the right direction, but do not go far enough. In fact, the initiative does not apply to trustees of occupational Defined Contribution Pension schemes, so these members have no guarantee of choosing the right annuity or getting the best rate. The FSA information booklets are also not sufficient.

The best results will surely be obtained with a direct, rather than an indirect approach i.e. make sure that everyone has answered the important basic questions to determine what kind of annuity is best for them and that they obtain the best rate available for their chosen annuity at the time of purchase.

Several problems arise with the suggestion of compelling people to take advice.

a. How will this advice be paid for?

b. Who will provide this advice?

c. Who will compile and police the ‘official list’ of annuity rates?

a. How will the advice be paid for?

Providers have confirmed that annuities carry an **initial commission of 1 – 1.4%** (and can be up to 2% apparently for IFA’s who bring in significant amounts of business). This charge is deducted initially, **whether or not an IFA is actually involved**. This means that, even for the average annuity purchase of, say, £20,000, assuming a 1 ¼ % advice charge, a sum of £250 is deducted by the annuity provider, even if, as we know is often the case, the person does not actually get any advice at all! Surely, then, here is the money to pay for the annuity advice at the point of retirement!

If the person is already using an IFA to advise them, the advice will be received anyway. But for those who currently don’t do this, there is a sum of money available to pay for this, within the annuity itself!

Conversations with various IFA’s, pension providers and insurance companies suggest that a sum of £200 - £250 or so could actually cover the cost of ‘basic’ advice to all prospective annuitants. They will need to answer a list of basic questions and, for those with small pension pots and few other assets, the decision-making process will not be too time-consuming. The process should take **about 2 hours of a financial adviser’s time**. If the person’s circumstances are more complicated, or if the size of the pension fund is such that more detailed advice is required, it can be up to the individual to go beyond the basic advice package. For a £250,000 pension pot, the advice commission, even at 1% will be £2,500, so this should cover a fair amount of IFA time. The issue of charges for this advice is not straightforward and consultation would certainly be useful. The charging structure could either be:

i) charge a straight 1% or so of the pension pot

ii) charge a flat fee of, say, £250.

The simplest way is the straight 1% charge out of the pension pot, but it would probably need to be capped at the upper – and maybe the lower –end, say maximum amount of £500 and minimum amount of £100, to prevent excessively high charges for a basic service and to make it worthwhile enough for the advisers to advise on small sums. The IFA’s I have spoken to believe that, even without capping, they would be willing to advise the small sums, with a view that they will be able to offset the costs of this against extra rewards from larger sums and the potential to earn fees on managing the tax free lump sums of the better off.

Once an annuity has been chosen, as long as it is a standard type (i.e. not investment linked or drawdown arrangements) the adviser should then be responsible for ensuring that the open market option is used, to check the best rate available at the time.

Thus the mandatory advice would cover two aspects: Firstly, it would ensure that the person is helped to make the right choice of annuity. Secondly, it would ensure that they obtain the best rate available at the time in the market. This would seem to solve many of the problems that currently exist with respect to annuity purchase, particularly for the less well off and would give many people a higher pension.

b. Who should provide this advice?

The large annuity specialist IFA's are not interested in advising the smaller pension pots. However, if there were a standardised format in which questions could be asked and answered and with a fee structure of 1% or maximum 2 hours for a standard fixed fee, I would expect this to be an attractive proposition for many advisers. In fact, conversations with a number of providers, IFA's (outside London!) and high street building societies and mortgage brokers all suggest that they would have an interest in providing such a basic service.

There are certainly not enough annuity specialists around to take on this work but, for small pension sums and uncomplicated cases, it would not be necessary to go to an expensive top annuity specialist adviser. These specialist firms would still probably concentrate on the high net worth end and more complicated (investment-linked) annuity or drawdown arrangements.

It would also be possible to suggest that perhaps the firm which is managing the pension pot could provide the advice, either from in-house expertise (as would be possible for many insurance companies and banks perhaps) or bought in from outside IFA firms (as, for example, with some of the pure investment management houses or even on-line brokers). The annuity provider would then pay the £200 or so to the adviser out of the initial annuity commission. In order for the existing provider to be able to carry out this advice and 'best rate' service, the FSA rules on polarisation would need to be changed. I believe this is already under discussion.

The questions that need to be considered as part of a basic advice package would include:

1. Marital Status. Do I need a joint life annuity – i.e. do I have dependants that need to be provided for if I die?

    If I need a joint life annuity, what level should I choose – half pension, two-thirds pension?

2. Do I want a level annuity or one that increases each year?

    If I want an escalating annuity, what level of increase do I want – e.g. rpi, 3%, 5%?

3. Health Status. Am I in poor health, so that I might get an impaired life annuity?
4. Do I want capital protection?

    If I want capital protection – do I want 5 years or 10 years?

5. Do I want my pension weekly, monthly, quarterly, in advance, in arrears?
6. Do I have any other assets or pensions?
7. What would I expect my expenditure to be in retirement?
8. Do I want to consider an investment linked annuity?

This 'basic advice' package could be thought of as 'Stage One' advice, for the straightforward cases. If the person's circumstances were complicated, for example if they have significant other assets or large pension savings, they may need more detailed advice and would be told to approach a more specialist IFA, for a higher level of advice. The basic questions in Stage One would be designed, in particular, to help those low income people who currently don't receive any help in making the irreversible annuity decision. It would be designed as a 'hand-holding' exercise. As it would also include shopping around for the best rate for them, the effect on their pension could be significant, improving the pension by well over 10% for the rest of their life. I think it would be sensible to introduce a requirement that people should default to the highest rate available. People should be able to choose from the top three rates in the market at the time, with a requirement to sign a form of explanation, if they do not choose one of these (for example, if they have some personal connection with another company.)

2. Annuities Exchange

There is already a service used by IFA's, which provides the best rate for annuities. It is a common trading platform which covers all providers and will produce quotes for any specified type of standard annuity (not investment linked or impaired life). This is called 'The Exchange' and could be used as a basis to provide the information needed to ensure everyone obtains the best rate for their annuity at the time of purchase. There are at least three other comparative annuity services, which claim to show the best rates, and it would probably be necessary to ensure that the providers keep their data up to date on all the services. They are not currently legally bound by the rates they post on the system, but, in practice, even if the rates are incorrect they normally hold to them. The process of ensuring that the rates available on this 'Annuities Exchange' are fixed for a certain period of time would need to be secured, so that those looking up the rates and printing them off the system would know that they can actually deal at those rates. As far as I can ascertain, this would not pose a major problem for the insurance companies and annuity providers, but more consultation is probably required.

The way the Exchange works, the IFA simply enters the relevant details (age, gender, type of annuity, payment frequency etc) and the system lists the top rates available on that day. The Exchange could hopefully be policed by the FSA, to ensure reliability and, if available to everyone with their basic advice, would enable all purchasers of annuities to get the best rate for their chosen annuity.

This requirement for basic advice and best rate should apply to all defined contribution pensions. At the moment, there is no requirement for Trustees of defined contribution occupational schemes or Group Personal Pension schemes to offer the open market option and people from these schemes currently do not always receive the best value from their pension fund. A system of advice and best rate for all would ensure that such schemes provided better value pensions for their members.

People would be required to choose one of the top 2 or 3 rates on offer and would have to sign a declaration stating reasons if they didi not choose one of these. A default option might be needed, which would probably be to go to the top rate on offer.

3. Capital protection

At the moment, annuities can only be protected for up to 10 years. Talks with the Inland Revenue suggest that they would probably not object to changing these rules to permit lifelong capital protection to be offered (providing the issue of tax on the amount passed on after death was addressed). This would mean that, in exchange for a slightly lower annuity value, any money not paid out as annuity income during their lifetime, would be paid to one's heirs on death. In other words, the capital sum accumulated in the form of pension would not be lost on death.

Providers and actuaries have produced illustrations suggesting that the cost of lifelong capital protection would not be large. People would then have the choice of whether they wanted to accept the slightly lower annuity rate and ensure that any remaining capital could be passed on to their heirs. This immediately addresses the complaints of those who object to annuities because of the capital sum lost on early death. I believe such a policy change would be a benefit to all annuitants, who would then be given a freer choice of what to do with their accumulated pension capital.

The cost of this capital protection for life has been estimated by several providers. For example, the Prudential has estimated the cost to be less than 1% of the annuity value at age 50 and still only around 10% reduction at age 70. The full table (including rates for 10 year guarantee and no guarantee) is shown below. It is clear that the price of full capital protection up to age 70 is not that high – although it does rise more significantly at older ages. However, people still would have the choice of whether to opt for the capital protection, if they so wished and could not complain about losing all their capital.

Capital protected Annuities – Hypothetical example

Age	No guarantee on annuity	10 year Guarantee Annuity	Capital protected Annuity	% reduction for capital protection
50	£ 6,472.75	£ 6,452.35	£ 6,436.05	0.3%
60	£ 7,671.77	£ 7,540.75	£ 7,469.84	1.7%
65	£ 8,717.20	£ 8,378.01	£ 8,244.69	3.9%
70	£10,247.04	£ 9,403.75	£ 9,194.92	8.2%
75	£12,460.87	£10,503.76	£10,258.79	15.7%

Source: Prudential. Annuity received for £100,000 purchase price

4. Standardised wording on forms

Retirement income is currently very difficult to process. The annuity regulations are extremely complicated, but the problems of understanding what pension one could achieve is often compounded by the lack of standardisation of forms sent out by the companies managing the pension and by the companies providing annuity quotes. Not one stage of this process is standardised. Each company can use different wording to describe the process of deciding on date of retirement, amount of annuity, amount of lump sum and so on. There is no standardisation of what type of annuity must be quoted for (single, joint, escalating etc) and often no explanation is provided with the normal letters to tell people what they can and cannot do. Every company produces its own form to notify people of their retirement options and the Maturity letters and notification of Open Market Option are all written differently. It is well nigh impossible to compare one company's letter with another and the style of English used is usually very opaque. For example 'Buying an Annuity' is sometimes called 'Settling a Pension', 'Taking Retirement Benefits', 'Projected Benefits' and so on.

It seems difficult to understand why a standard form of wording could not be used, to help everyone understand the options better. There is some work already being done on this issue and consultation with the participants in the industry would be helpful. The whole process could be substantially simplified as a result. If all the options were explained in the same language and all the forms were designed the same, with the same information in the same place on each form, the process should be intelligible.

Issues to Address in The Future

The proposals outlined in this paper would go a long way towards improving the workings of the current annuity system for, perhaps, the majority of annuitants. They are, however, only a short term solution which should not entail costs to the Exchequer, lengthy analysis or major changes in social attitudes. There are other issues associated with annuities, however, which could also usefully be addressed, if a more major overhaul of the system is undertaken. The principal ones are outlined below:

1. ***Simplification of the rules governing annuities.*** This is a HUGE issue. There are so many different and often conflicting rules governing annuitisation of different parts of one's pension, that the whole process has become fraught with complications. Each different pension regime has different annuity requirements and it would be enormously beneficial if the rules could be harmonised, to provide a single set of rules for the various elements of an annuity. This would include having the same tax-free lump sum, same escalation (if any), same spouse cover etc.

2. ***Encourage later retirement.*** Annuities were not really designed to provide an income for 30 years or so, on average. For 5 or 10 year periods of retirement, they would work much better. They are ideally suited to much shorter periods of pension support, as was the case before the trends to early retirement and increased longevity occurred in the latter part of the last century. If people could be encouraged to stay at work longer and have shorter periods in retirement, some of the problems would be reduced. In 10 years time, it is possible that there will be so much demand for annuities that even the big insurance companies will not be able to reserve enough against them. This could be a big issue and is worth planning ahead for now, while it is not actually a problem.

3. ***Require pension providers to improve their administration systems.*** Currently, the back office systems of many pension providers are not functionally well. It can take months for some companies to transfer the pension sum to a different annuity provider, and this can mean a significant change in annuity rate from the time the person first receives his quote. There should be a standard maximum time (say 2 weeks?) within which funds have to be remitted after request. At the moment, apparently, IFA's often have to beg companies to send the payment and the whole annuity process is delayed due to these administration problems. There is an initiative under way by the ABI, but it is voluntary, rather than mandatory.

4. ***Help people keep track of old pension entitlements.*** People often lose track of their old pension entitlements and it would be very helpful if some mechanism could be found to transfer a record of old pensions when moving employment. This could be as a clearing house (maybe centralised in Newcastle) like a registry of pension entitlements. Or perhaps as part of a 'Lifetime Savings Framework' in the Retirement Section. Or alternatively, perhaps with one's P45 for those who are employed and move jobs.

5. ***Educate people to understand that the act of pension accumulation should be thought of as completely separate from the drawing out of the pension***. People should realise that they do not have to take their pension from the same company with whom they built it up.

6. ***Improve pre-retirement education and start the planning process earlier.*** People currently wait until very close to retirement, before making their financial plans. This often leaves insufficient time to make the necessary arrangements to get the best pension.

7. ***The age 75 rule.*** There is significant pressure from certain lobby groups to raise the age by which a person must annuitise from 75 to 80, to take account of increased longevity and allow people to benefit from investment in assets such as equities, which should provide higher returns than bonds which are used to back annuities. It is not clear that this will change anything radically, it is merely swapping one arbitrary age for another. Certainly, some studies have shown that annuitisation after age 75 is not optimal from a financial point of view and delaying the decision to annuitise can have implications for the ability of people to make complicated decisions well into old age. I certainly would not think it advisable to delay annuitising beyond age 80, because the investment returns needed to compensate for losing the mortality cross-subsidy are of the order of 15% or so! Permitting lifelong capital protection would be an alternative way of addressing the age 75 concerns.

8. ***Income drawdown charges are very high.*** This could be the next pensions mis-selling scandal. There is also a suggestion that investment linked annuities should be transferable, which might encourage more competition on commission and charges for these products (although there may also be a risk of churning if the initial commission is high!)

9. ***Relax the work test and allow more freedom to keep working while withdrawing a partial pension from the same employer.*** Current annuity rules often force people to have to retire from their present job and go elsewhere to work part-time once they start drawing their pension.

10. ***Permit people to take the lump sum separately from the rest of the pension.*** People could partially retire and live on the capital from the tax free lump sum at first, and then annuitise the rest of the pension later, when they finish earning altogether. This is not currently possible and permitting it would increase the flexibility available to people after partial retirement.

11. ***Raise the commutation level.*** At the moment, the commutation level is very low and has not been changed for a long time. It is not economic to annuitise very small sums and there is certainly a case to consider raising the level of commutation for triviality from its current £260 per year – especially as stakeholder sums could well often be very small and give poor value pensions.

12. ***Permit people to annuitise up to a certain 'minimum income level' (indexed to inflation) and then be free to do as they wish with the rest.*** This is the main proposal of the 'Choices' Report and is a popular reform with many. It is being lobbied for by the Retirement Income Reform Campaign. The Irish system operates somewhat along these lines. Once a person has annuitised to provide sufficient lifelong income to avoid having to draw State benefits, the argument is that the government should not impose any more requirements on them. One problem with this proposal is that there are not sufficient index-linked bonds available to back index-linked annuities if they were bought on this scale.

13. ***Lack of matching assets.*** A big problem is that there are no matching assets to back the liabilities of annuities perfectly. Ideally, bonds with maturities beyond 30 years and LPI linked gilts would be needed. This exposes the insurance companies to risks of asset mis-matching, especially on rollover of long-term liabilities.

14. ***Change reserving requirements.*** Currently annuities can only be backed with fixed income instruments. Permitting a wider range of assets to back annuities would perhaps improve annuity rates for everyone.

15. ***Exempt annuity income from MIG/Pension Credit calculations.*** Currently, the proposal is that the means tests will become income based, rather than capital based. This will discriminate against annuity payments – especially level annuities. If pension income were exempt from the calculations of the Pension Credit, the disincentives to stakeholder would also be reduced for the target group.