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Insurance in focus: From Decline to Demand – The Evolving UK Annuities Market

Nick Pacheco	Welcome to the latest episode of the Slaughter and May Insurance Podcast. In this edition, we'll be discussing the state of the market for sales of annuity policies, as well as the broader market, including the bulk annuity market and related regulatory issues. I'm Nick Pacheco, a Partner in our Insurance Practice, and I'm joined today by our Head of Insurance, Jonathan Marks
Jonathan Marks	Hello Nick.
Nick Pacheco	And Sarah Osprey, a Partner in our Tax Department.
Sarah Osprey	Hello.
Nick Pacheco	There has been a significant amount of recent press coverage about a resurgence of interest in annuities with sales at a 10 year high, and insurers, such as Standard Life, re-entering the individual annuity market. We'll come back to what's underpinning these improved figures, but first of all Sarah, would you mind giving us a bit of background on why annuities have been out of favour over the last decade.
Sarah Osprey	Thanks Nick. Yes, this goes back to a major reform of the Pensions Tax Rules in April 2015, known as the Pension Freedoms. Prior to these reforms, members of defined contribution schemes were effectively forced to use their pension pot to purchase individual annuities by the age of 75. If they didn't, they could face tax charges of up to 55% when accessing their pension savings, other than in some limited circumstances. The Pension Freedoms in April 2015, gave individuals much greater flexibility to choose what they wanted to do with their pension pots without the same adverse tax consequences – so you won't push down the annuity route in quite the same way. The data shows a big shift in the purchase of annuities following the Pension Freedoms. The Treasury estimated that prior to April 2015, 75% of people who reached retirement with defined contribution pension savings used those savings to purchase an individual annuity. After the reforms, FCA data showed that the purchase of annuities had significantly reduced. Jonathan, I know that the Pension Freedom Reforms were introduced at a time of very low interest rates, presumably that would have been a key reason for individuals to move away from annuities.

Jonathan Marks	Yes, rates in 2015 were below 1%, and only really started to increase in mid-2022. Life annuity rates are directly linked to interest rates, so at the time when people were given more freedom to choose how to use their pension savings, annuities were not a very attractive option. This was also the time of strong equity returns, for example the FTSE100 returned 7% in 2014.
Nick Pacheco	So looking at the market now, the ABI and others have reported that individual annuity sales have risen over the past few years, both in terms of the number of annuities sold and the total value of those annuities, nearly 90,000 annuities were sold last year, compared with just over 72,000 in 2023, and doing the maths very quickly in my head, I think that's an increase of about 25%, and £7 billion in individual annuities were sold, which slightly exceeds the £6.9 billion of value of annuities that were sold back in 2014, the year the Pension Freedoms were announced. So, Jonathan, what do you think is behind this trend.
Jonathan Marks	There are a few things, but we shouldn't get too carried away. Although the total value of pension annuity sales has risen in recent years, on an inflation adjusted basis, this is still less than 2014 sales, let-alone the amount of annuities sold in the years before the Pension Freedoms were announced. For example, pension annuity sales were around £14 billion in 2012, so if you inflation adjusting for that you'll get to the best part of £20 billion. There are a few things that are likely to have influenced sales over the last few years. One is rising interest rates, which have significantly increased annuity rates and therefore made products more attractive, another is the more general economic volatility, which has prevailed since Brexit, and even more so since the invasion of Ukraine. This may be encouraging people to lock in certainty into their retirement income, rather than choosing a less predictable investment plan. Of course that still leaves you exposed to inflation, but it's interesting there that sales of inflation linked to annuities have ticked up in the last couple of years, suggesting that some people at least are keen to future proof even at the expense of short-term levels of income. Obviously, you have to pay extra to get that inflation linking and therefore the amount you actually receive per year is less.
Nick Pacheco	Thanks Jonathan. Sarah, are there any tax related drivers that could be behind the increasing popularity of annuities.
Sarah Osprey	Yes indeed there are. Another potential influence going forward is an upcoming change to the inheritance tax rules. Currently, most unused pension pots and discretionary death benefits are not included in the value of an individual's estate when completing any liability to inheritance tax. The Government has considered that that has led to pension pots being used, not as a vehicle for providing a reliable income on retirement, but rather as a vehicle for inter-generational wealth transfer and tax planning. It has therefore been announced that from 6 April 2027, most unused pension funds and death benefits will now be included within the value of a person's estate. This means that the inheritance tax incentive to leave a pension pot untouched, will disappear and accordingly alternative strategies,

	such as purchasing an individual annuity may become more popular, and we are seeing in the market that the dots are being joined between the inheritance tax changes and the relative attractiveness of individual annuities.
Nick Pacheco	So, in summary, there's a number of different drivers here that could potentially be pushing people to select annuities when they're looking to figure out what to do with their pension pot. But if we now turn to the current state of the market, the majority of the new individual annuities that are being sold are actually being sold by a relatively small number of life insurers. Who are the major players in the market at the moment Jonathan?
Jonathan Marks	Well Nick, the main players are household names, such as Aviva, Legal & General, Canada Life, Standard Life, Just, not so surprising that well known names are selected by individual customers. Most of the main providers are also highly active in the pensions derisking market, which provides, as you know, annuity insurance policies to defined benefit scheme trustees. This is a natural crossover, because when pension schemes move from buy-in to buy-out, the insurer will issue individual annuity contracts to the Scheme Members. Now as more pension schemes move to buy-out stage, something we're increasingly seeing, you'll also get greater numbers of annuities being issued as a result of that process, as well as the pick-up in individual sales.
Nick Pacheco	Thanks, and of course there have been historical regulatory issues with the sales of annuities, and Jonathan you probably haven't forgotten, that about a decade ago you and I spent a couple of years helping a client through with these issues. Can you talk us through some of the key regulatory issues that tend to arise when people are selling annuities.
Jonathan Marks	Nick, you're right. Historically, some firms have inadequate processes, governance and monitoring arrangements for this. Particularly when dealing with customers who might be eligible for enhanced annuities because of health issues i.e. they would get a higher pay out per year because they were seen as likely to have relatively short lives. Those regulatory issues led to some sizeable fines being handed down by the FCA following a 2016 review of past sales practices. Now looking forward, insurers selling annuities have now an obligation, when dealing with existing pension customers, to explain to them during the sales process that they might get a better annuity rate by shopping around on the open market, and the rules around this are set out in the FCA Handbook in Cobs 19.
Nick Pacheco	It's obviously great news that more people are shopping around when they're deciding whether or not to buy an annuity, because choosing what you're going to do with your pension savings is obviously a major investment decision for most people, do we think that people are being supported adequately in making this important decision?
Jonathan Marks	There is evidence that there is more shopping around. The ABI figures suggest that in 2024, about 69% of customers switched from their existing pension provider when purchasing an annuity, and there's been scope for at least one

	insurer to re-enter the market after a period of absence, Standard Life has taken an approximately 12% share having come back into the market a couple of years ago. On the other hand, there is still the more general issue in the market, both the pensions market and the market for investment products more generally around customers taking advice. The FCA's retirement income market data for 23/24 showed that a significant number of people accessing their pension plans for the first time were completely unadvised. Only around 1/3 of pension plans were accessed by people who had taken regulated advice, some more though did at least go to the Government's Pension Wise Service, which provides information and guidance, but not full advice. Customers making investment decisions without taking advice has been an ongoing issue since the retail distribution review reforms led to customers being required to pay for financial advice themselves upfront as an alternative to commission being paid to the adviser. The Government and the FCA have been working on how to address this issue for some time under the advice guidance boundary review. As you know Nick, the latest publication from the FCA is a consultation paper issued in June on the provision of targeted support by firms to customers in respect to pensions and investment products. This will involve the creation of a new regulated activity, under which firms can provide ready-made suggestions to predefined consumer segments sharing common characteristics. The FCA hopes this will provide more support to customers without the need for them to pay for regulated advice. There are still question marks over where the lines will be drawn between targeted support and advice. I suggest firms may want to address this point as part of the consultation process. The position with annuities being issued to defined benefit scheme members on a buy-out is different of course. The underlying derisking arrangement is between the insurer and the scheme trustee. So annuities will be issued to members automatically. Of course, once they're issued, they need to be administered properly and I know of at least one insurer who administers all of their individual annuity business together, regardless of the source of the business.
Sarah Osprey	Going back briefly to the position of individual annuities before we move on, the themes you mentioned, Jonathan, are also apparent in the tax space. It seems that the general population at large is not nearly as obsessed with tax as I am, which is probably a good thing, but it can also swing too far the other way. For example, the FCA financial live survey in 2024 found that 56% of consumers taking money out of their defined contribution pots in the 4 years to May 2024, either did not consider the tax implications of doing so or can't remember whether they thought about tax or not. Whilst the Pension Freedoms we discussed earlier, did create more flexibility to access pension savings tax free, that freedom is of course not limitless, and the rules remain complex, there may well therefore be plenty of individuals out there who find themselves with unexpected tax bills.
Nick Pacheco	So looking beyond the sales of annuities, are there any broader regulatory issues in the retirement income market that are worth touching on Jonathan.

Jonathan Marks	Yes, shifting focus a little bit, we should note that the recently published Pension Schemes Bill introduced new duties for trustees of occupational defined contribution schemes, they have to provide default pension benefit solutions for members at the point at which they can access their pension savings, which again is aimed at making sure savers get the right support at this important stage, and members of defined benefit schemes remain relevant to the broader picture as well. Both because they receive individual annuities at the point of buy-out as we discussed, and also because members have the right to transfer out of their workplace pension schemes into another pension vehicle until a year before retirement.
Nick Pacheco	Jonathan, earlier on you touched on the overlap between providers of individual annuities and insurers who are active in the pensions derisking market, can you say a couple of words about any current hot topics in the latter bit of the market?
Jonathan Marks	Yes, we discussed this also as part of the Horizon scanning podcast a few weeks back. On the bulk annuity side, business has been booming the last few years and the PRA remains concerned about the potential for a build-up of risk in the insurance sector as a result, particularly given the concern of an expansion of insurer's risk appetite. It's clearly easier to sell a bulk annuity where thousands of members end up insured, than a lot of individual annuities, but the risk is that you price it wrong. A connected area of regulatory concern has been the associated use of offshore funded reinsurance transactions to provide capacity for deals. In principle, the same issue applies if insurers are looking to hedge large books of individual annuities, although this hasn't so far been the focus of the PRA's work, perhaps because of the lower business sales that we talked about earlier. More recently, the PRA has also highlighted the potential risk to insurers from the use of termination rights links to breach of solvency thresholds in buy-in policies. Of course, you don't get those sorts of provisions in individual annuity contracts. Thinking about investments, liabilities under both annuities and pension buy-in arrangements would generally qualify for matching adjustment treatment. So, in principle, providers would have benefitted from recent reforms to the matching adjustment regime. There are more reforms coming down the track in the form of the PRA's proposed matching adjustment investment accelerator. This in turn links to the potential contribution of long-term insurers to the Government's growth agenda. A number of annuity insurers pledged in 2024 to invest £100 billion over 10 years into UK productive assets following reforms to the Solvency 2 regime. A report published by the ABI in February, showed that in 2023 £178 billion of assets held by participating firms were invested in the UK, much of that was channelled into UK housing and infrastructure, including regeneration products, renewable energy and social housing.
Nick Pacheco	And so to wrap up, Jonathan, Sarah, are there any final reflections that you care to share.

Jonathan Marks	Well, the data shows that there are more annuity sales now than there have been in recent years. But it's unlikely that we're ever going to get back to a time when nearly everyone with a private pension has an annuity, and there's also a question mark over whether stronger annuity sales will continue if interest rates decline significantly. It's also probably worth noting that as numbers of annuities in payment grow, including as a result of buy-ins turning to buy-out, insurers need to make sure that they're able to provide adequate administration of policies for the growing numbers of individual annuitants.
Sarah Osprey	And to Jonathan's point, it will be interesting to see whether the impact of declining interest rates on the attractiveness of individual annuities might be offset by future changes in the tax rules, including the upcoming changes to inheritance tax that I mentioned earlier.
Nick Pacheco	I would say that my key takeaway point from today, is that more possibly needs to be done in the area of advice and to make sure that people are making what can be really important decision. But thank you both for joining us today and thanks to everyone listening. That concludes our podcast. If you'd like to discuss any of the points raised in more detail, then please do get in touch with any of us, or your usual contact at Slaughter and May. If you'd like to receive future insurance podcasts, and other podcasts from Slaughter and May, please subscribe to the Slaughter and May Horizon Scanning Podcast show, wherever you get your podcasts.