Countdown to Retirement

The outlook for Annuities in 2010

Burrows & Cummins*
8 Duncannon Street, London, WC2N 4JF
Tel: 0207 484 5366
www.burrowscummins.co.uk

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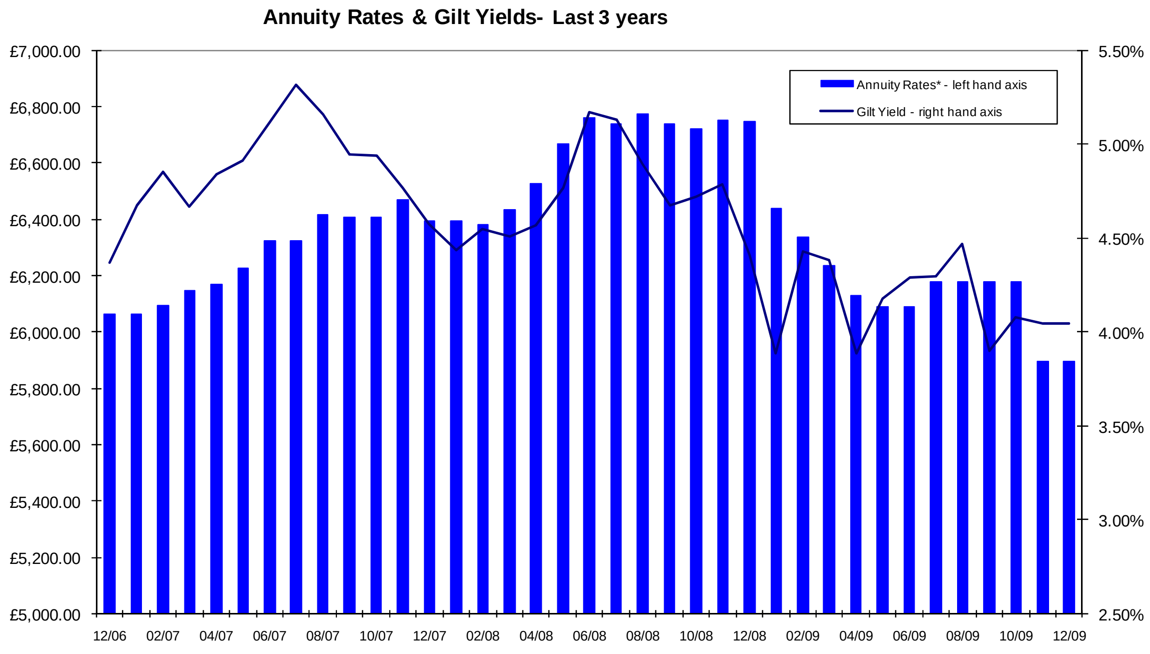
2009 will be remembered as the year of the "Annuity Crunch". The income from our benchmark annuity fell by 8% during the year. In January 2009 a £ 100,000 joint life annuity for a man aged 65 and woman aged 60 with 2/3rds spouse's pension and level payments paid £ 6,439 per annum but by December 2009 this had fallen to £ 5,897 per annum.

The main reason why annuity rates fell so much was the big fall in gilt yields caused by the Government's policy of quantitative easing, or printing money as some prefer to describe it. The Bank of England has injected money into the UK economy by buying gilts and this has pushed up prices and consequently yields fell.

The chart below shows the movements in annuity rates over the last 3 years.



* £100,000 purchase, joint life 2/3rds, man 65, women 60, level payments -

The 8% fall in annuity rates during 2009 is the largest fall since 2002 when rates fell by 12%. As the table below shows, annuity rates and bond yields have fallen consistently since 1991 when we first began collecting annuity data.

Year by year movements in annuity, gilt yields and FTSE 100 index

Year ending	Annuity	Gilt Yield	FTSE
Dec-91	-12%	-18%	22%
Dec-92	-6.87%	-12.99%	11.46%
Dec-93	-12.45%	-21.59%	11.25%
Dec-94	11.33%	34.33%	-9.86%
Dec-95	-6.10%	-9.36%	15.12%
Dec-96	-0.82%	-1.16%	9.55%
Dec-97	-5.78%	-19.28%	18.01%
Dec-98	-10.18%	-24.58%	8.37%
Dec-99	1.24%	8.86%	26.88%
Dec-00	-1.21%	-9.96%	-4.10%
Dec-01	-10.72%	5.51%	-15.38%
Dec-02	-12.45%	-7.48%	-24.07%
Dec-03	1.98%	15.37%	21.73%
Dec-04	-2.94%	-2.72%	4.28%
Dec-05	-1.00%	-8.53%	12.65%
Dec-06	1.89%	9.25%	7.65%
Dec-07	3.24%	-2.12%	3.05%
Dec-08	-0.95%	-3.58%	-33.10%
Dec-09	-8.17%	4.01%	17.05%

Source: www.burrowscummins.co.uk

When analysing annuity trends we always make the important point that annuity rates do not fall in a vacuum and it is important to consider how much pension funds have risen or fallen in value. This means that the effects of falling annuity rates may be offset by increases in fund values for those in invested in equities. This is fine for those who are some years from retirement, or who are appropriately invested in pension drawdown but as the advice to those approaching retirement is to invest in safer funds to avoid the risk of falling equity values the biggest risk they face is falling annuity rates.

Gilt yields rose during December 2009 as many investors became more concerned about the state of the nation's finances and the fear of future inflation. This rise in gilt yields has caused some commentators to suggest that annuity rates might also increase and two of the main providers, Aegon and Canada Life did change their rates but it was a case of some up, some down.

We remain less optimistic and believe that it is unlikely that annuity rates will change significantly in early 2010 unless there are more substantial increases in yields. Predicting annuity trends is more complex than in the past. Firstly, few of the main insurance companies invest the money used to buy annuities in gilts. They invest in other fixed interest investments such as corporate bonds and commercial property. The corporate bond market is haunted by the fear that some companies might go bust and consequently their corporate bonds will be worthless. To guard against this risk insurance companies, set aside some of the extra yield they make and this is known as a default margin and can typically be as much as 100 basis points (one percent).

If concerns about the risk of corporate bond defaults increases the default margin will also increase and this means that a good part of the extra yield from investing in corporate bonds is swallowed up by the default margin.

Another factor is the post coding effect. Most of the top providers are now pricing annuities based on where people live. The theory is simple; those living in Glasgow and living on a diet of fried mars bars and chips will probably not live as long as those living in Surbiton and buying their food from the local health shop.

The table shows the effects of post coding on selected areas.

Town	**Postcode**	**Gross annuity**	**Difference**
Glasgow	G22	£ 7,142.00	
Birmingham	B9	£ 7,142.00	0.00%
Bristol	BS8	£ 6,989.00	-2.14%
Gateshead	NE10	£ 6,989.00	-2.14%
Cardiff	CF	£ 6,925.00	-3.04%
Epsom	KT	£ 6,863.00	-3.91%
London	W14	£ 6,836.00	-4.28%
Source: www.burrowscummins.co.uk - 020 7484 5366			
Man 65 - £100,000 single life annuity, level payments			

Although we agree that annuity pricing should be transparent, and moves towards individual underwriting is a good thing, we are concerned that post coding will disadvantage those living in London, the home counties and other relatively affluent areas. Two people with the same financial wealth may get different annuity rates because one lives in the south, the other in the north. In this sense post coding is a blunt instrument and will have the effect of reducing the value for money from annuities for a large proportion of 'Middle Britain'.

One consequence of this is that many more investors will need to try and get better value from their annuities by considering alternative annuities such as with-profits, flexible and fixed term annuities.

In conclusion, we do not think that annuity rates will rise very quickly in 2010 but we hope that we are wrong**.** Even if annuity rates do go up for some as yields increase, others may see rates fall as post coding takes effect.

Billy Burrows

David Cummins

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