Working Party on Private Pensions

Annuity products: definition, criteria and the evolution of product design

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TABLE OF CONTENTS

ANNUITY PRODUCTS – DEFINITION, CRITERIA AND THE EVOLUTION OF PRODUCT DESIGN .......................................................................................................................... 3
Clarifying the definition of an annuity product and the scope of the project.......................................................... 3
Whether an annuity product should be fully financed by the contributions or premiums towards its purchase.......................................................... 4
Whether an annuity product pays a stream of income payments for a certain price ........................................... 4
Whether the provider of the annuity product directly guarantees the income promised to the individual or member ........................................................................................................... 5
Whether there is an insurance component involved with the promised payments .............................................. 6
Whether payments are calculated on an actuarially fair basis ............................................................................ 6
Whether there is some form of restriction for other providers to offer annuity products .................................. 6
Additional criteria that could be considered ....................................................................................................... 7
The evolution of annuity products ..................................................................................................................... 7
Observations and implications ......................................................................................................................... 13

ANNEX: PRIVATE PENSION SOURCES BASED ON ASSETS ACCUMULATED TO FINANCE RETIREMENT IN SEVERAL OECD COUNTRIES ........................................................................... 15
Austria ......................................................................................................................................................... 15
Belgium ....................................................................................................................................................... 15
Canada ....................................................................................................................................................... 16
Chile .......................................................................................................................................................... 17
Denmark .................................................................................................................................................... 18
Finland ...................................................................................................................................................... 19
France ....................................................................................................................................................... 20
Germany .................................................................................................................................................. 21
Israel ......................................................................................................................................................... 22
Japan ......................................................................................................................................................... 23
Mexico ....................................................................................................................................................... 24
South Africa ............................................................................................................................................... 24
Spain ......................................................................................................................................................... 25
Sweden ..................................................................................................................................................... 25
United Kingdom......................................................................................................................................... 27
United States ............................................................................................................................................. 28
REFERENCES ............................................................................................................................................ 30
ANNUITY PRODUCTS – DEFINITION, CRITERIA AND THE EVOLUTION OF PRODUCT DESIGN

1. This document aims to guide the discussion on the scope of annuity products that the IPPC/WPPP project on Annuity Products (DAF/AS/PEN/WD(2012)6) should examine. The project aims to identify the features of various types of annuity products available to allocate assets accumulated to finance retirement with the potential to provide a stream of payments, which are being offered on the market in different OECD countries, especially with regard to the guarantees they provide. The main goal of the project is to assess the potential impact of the regulatory and tax frameworks in different countries on the types of products and the embedded guarantees that exist.¹

2. The first step is to review the main private pension sources based on assets accumulated to finance retirement in different OECD countries. The annex provides a non-exhaustive review of the main private pension sources to accumulate assets to finance retirement in different OECD countries. Countries are encouraged to review the annex and complete or amend as required the information provided on their respective countries.

3. The second step for countries and the IPPC/WPPP is to decide which sources and products should be part of the scope of the project on annuity products. To guide this decision the Secretariat proposes in this paper six criteria for discussion. The paper presents specific examples of different sources and products to help understand the issues at stake involving each criterion presented.

4. Additionally, the report describes several different examples of some of the more innovative annuity products which can be found on the market. This discussion includes descriptions of the guarantees the products provide for customers, any challenges identified relating to the product design with respect to both the customer and the annuity provider and information on the market for these products, where available. The discussion identifies two main phenomena in product design: the increased allowance for the annuitant’s participation in market returns and the tailoring of products for specific risk profiles or needs. These both offer distinct advantages to the customer but also trade-offs in terms of what risks are insured as well as challenges for the management of the risk embedded in these products.

5. The next steps of the project on annuities are to focus on the regulatory and tax frameworks involving these types of products and the guarantees embedded. The Secretariat expects to review the regulatory and tax frameworks in OECD countries for the next IPPC and WPPP scheduled for December 2014.

Clarifying the definition of an annuity product and the scope of the project

6. Discussions around the Project on Annuity Products during the December 2013 meeting of the WPPP revealed shortcomings in the defined scope of the project and the definition of an annuity product

¹ Future work could include assessing the value that these products bring by using a cost benefit analysis and comparing them with other alternative retirement options like defined benefit arrangements.
which were put forward. The problem seems to primarily stem from the differences in the providers of annuities from one country to the next as well as the ambiguities in the naming conventions for products relating to retirement savings and income.

7. Following these discussions the Secretariat agreed to review the sources of savings and income in retirement for several countries. The annex presents the private sources for financing retirement which the Secretariat was able to identify for these countries.

➢ Delegates are invited to verify the accuracy of the information presented in the annex and to complete it, if necessary.

8. The analysis of those sources to finance retirement in order to understand the issues at stake to decide which of those income sources should be classified as an annuity product in the scope of the WPPP/IPPC Project on Annuity Products has led to several criteria for discussion:

1. Whether an annuity product should be fully financed by the contributions or premiums towards its purchase

2. Whether an annuity product promises to pay a stream of income payments for a certain price

3. Whether the provider of the annuity product directly guarantees the income promised to the individual or member

4. Whether there is an insurance component in the promised payments

5. Whether payments are calculated on an actuarially fair basis

6. Whether there is some form of restriction for other providers to offer the annuity products

**Whether an annuity product should be fully financed by the contributions or premiums towards its purchase**

9. To be considered as fully financed by contributions would generally require that premiums or contributions are put aside to fund the reserves which back the expected future annuity payments. PAYG pension schemes where contributions are not going directly to fund the future payments being promised are therefore suggested to be out of the scope of the project.

**Whether an annuity product pays a stream of income payments for a certain price**

10. The purpose of an annuity is to provide a stream of payments. However the definition of an annuity becomes less clear when discussing deferred annuities, where payments can begin at some future point in time, and in some cases may never begin at all if accumulated funds are allowed to be taken as a lump-sum payment. There are products in which individuals accumulate assets to finance retirement. In these products, when reaching retirement individuals can choose whether to convert them into an annuity or cash them out as a lump-sum.
11. The distinction lies in whether the price of a certain level of future income is known at the time of purchase or when contributions begin. These products, where the individual can choose at retirement whether to take a lump-sum or convert them into an annuity, can have the conversion rate specified before the choice is made or at the time they decide to take an annuity or not. The question then is whether products that are clearly for retirement but can be taken as a lump-sum or an annuity should be in the scope of the project on annuity products.

12. Take, for example, the deferred Variable Annuity products offered in the United States, this is a retirement savings product with investment guarantees during the accumulation phase, and at pay-out accumulated funds may be taken as a lump sum rather than annuitized. Individuals purchasing these products more often prefer to take lump-sums over annuity payments. However, these products also typically provide a guaranteed annuity conversion rate at the time of purchase, so the individual knows the minimum level of future income he could expect to receive given the level of contributions being accumulated.

13. Another example is the group insurance pensions which are commonly provided by employers in Belgium. These behave similarly to the variable annuity described above, albeit in a group setting, in that assets are accumulated with a guaranteed minimum rate of return, and may be paid out as either a lump-sum or an annuity, with the lump-sum payment chosen by the vast majority of individuals. However, in this case, the annuity conversion rate is not guaranteed in advance and is determined at the time the individual chooses to annuitize his assets. This type of plan could therefore be viewed as a retirement savings plan only, with an immediate annuity being purchased at retirement if the annuity option is chosen.

14. A final example is the pension schemes in the UK in which individuals may accumulate assets, 75% of which were effectively required to be annuitized upon retirement. Annuity quotes are given based on the amount of accumulated assets at retirement, and individuals may remain with the provider involved in the asset accumulation or choose a different annuity provider who may be offering a better price. As with the Belgian plans described above, these types of plans also behave as retirement savings plans with immediate annuities being purchased at retirement. However, occasionally the pension provider guarantees the annuity conversion rate at the outset of the contract.

Whether the provider of the annuity product directly guarantees the income promised to the individual or member

15. The promised benefit payments made to the individual may be guaranteed directly by the entity promising the payments (pension fund or insurance company), or they may be reinsured by a third party. One example of an annuity-type product functioning as reinsurance is a reinsurance company providing reinsurance coverage for an insurer’s annuity portfolio. Buy-in deals common in the UK where a pension plan purchases a bulk annuity from insurer or reinsurer to partially or totally insure its pension obligations is another example.

2 This requirement was relaxed in March 2014.
16. Products like group annuities purchased by employers (e.g. Denmark) in which the promised payment is made directly by the pension fund or the insurance company are different from those examples in which the promises are re-insured by a third party.

**Whether there is an insurance component involved with the promised payments**

17. The provider of a life annuity insures longevity risk. The provider of an annuity certain insures investment risk over the guaranteed time period. Both of these types of products therefore have an insurance component.

18. There is no insurance component in the case of programmed withdrawals, as even though regular payments are provided the individual runs the risk of depleting his fund before anticipated. Insurance wrappers for programmed withdrawals, however, could provide that insurance component. This includes the Guaranteed Minimum Withdrawal Benefit offered with Variable Annuities in the US, with pension plans in the UK and segregated funds in Canada. Participating or variable annuity payments which guarantee a minimum income level plus a bonus linked to profits or underlying investment performance would also be considered to have an insurance component.

**Whether payments are calculated on an actuarially fair basis**

19. Calculating payments on an actuarially fair basis means that the promised payments are computed based on a discount rate and mortality assumptions which reasonably reflect conditions at the time the annuity is purchased. This implies a direct link between contributions/premiums paid towards the annuity and the actual level of income received.

20. Defined benefit schemes linked to final salary would not meet this criterion as there is not a direct link between contributions made and the promised payment.

21. Mandatory occupational schemes in Switzerland would not meet this criterion either as the annuity conversion rate is set by regulation and not necessarily reflective of the current market environment, as evidenced by the difference compared to the market quotes provided by insurers for non-mandatory annuities. Annuities bought with accumulated assets from the super-mandatory portion funded by contributions beyond the regulatory requirement would, however, technically meet this as annuity providers are allowed to calculate the income level based on their own assumptions. Nevertheless in practice it could be difficult to separate these two components.

**Whether there is some form of restriction for other providers to offer annuity products**

An example of restrictions imposed on providers would be any employer-provided pensions which are kept on a book reserve basis as they are the sole provider. The ATP in Denmark and the Premium Pensions in Sweden provide additional examples, as they are the sole annuity providers for the mandatory defined contribution plans and no other option is provided.

- Do delegates have examples which may not fit any of these criteria or invalidate them?
- Could delegates let the Secretariat know whether there are any remaining ambiguities that the report fails to address?
Additional criteria that could be considered

Open market access to purchase the annuity product

22. Several comments received during discussions around the scope of the project suggested considering whether the annuity product was available for purchase on the open market as a criterion to be in scope. Many times this is not the case, for example where pensions are arranged by collective agreements for certain industries or access to a pension is only available via an employer.

23. However the criterion requiring pricing on an actuarially fair basis is seems to address this issue as it directly implies fair market pricing. This criterion does not necessarily imply access for all persons, and does allow for market segregation. For example plans limited to certain industries may take into account the differences in mortality for these specific populations compared to the total population based on the type of work or income level involved. This would represent a fair market price, even though this price would not apply to all. To take another perspective, enhanced annuities, which offer a more attractive rate for people who smoke or are in poor health, are not available to healthy non-smokers.

- Do delegates have any additional criterion that should be considered?
- Delegates are encouraged to provide through the written procedure their opinion on which sources of income to finance retirement should be included in the scope of the project.

The evolution of annuity products

24. Annuity providers around the world have come up with numerous variations on the traditional annuity product in an attempt to meet the needs of consumers and address some of the obstacles relating to the lack of demand for annuity products. The traditional product pays a pre-defined level of payments for a given level of premium(s) over a specified number of years or for life. The traditional annuity product is typically a difficult sale due in part to the lack of access to capital and the locking-in of an investment return which could potentially increase in the future. Providers have sought to respond to these concerns through features which allow participation in market returns or company profits as well as offering more flexibility around the design of the payout phase as well as partial protection from inflation risk. At the same time, products are being designed which limit the risk to providers via risk-sharing features in order to better ensure the sustainability of providing annuity payments to individuals. Others target specific segments of the market to better tailor price or payouts to different profiles or needs. Some of these annuity product variations are described and discussed below.

Variable Payout Annuities

25. Variable payout annuities, also known as variable immediate annuities and unit-linked annuities, are annuities for which the annuity payment varies along with asset returns. At purchase, the initial payment is calculated using a reference rate of return defined in the contract. Subsequent payments are adjusted by the ratio of the actual return on assets over the reference return, so if the market returns are higher (lower) than the reference return annuity payments will increase (decrease).

26. While this structure limits the investment risk for the insurer, the individual purchasing this type of annuity will be exposed to potentially high volatility of the annuity payments. However, this product does
provide longevity insurance to the individual while offering the potential for benefit from high investment returns and indirect inflation protection, as well as control over the investment of the assets. Despite this, variable immediate annuities are less popular than their fixed counterparts.

*With Profit Annuities*

27. With profit annuities, as they are known in the UK, are very similar to variable immediate annuities, as the actual annuity payment will vary depending on the performance of the underlying investment fund compared to a reference rate chosen by the policyholder. The main differences with these products is that the funds are invested in the insurer’s with-profit fund, so the policyholder is not in control of the investment decisions, and the insurer offers a guaranteed minimum level of income which typically assumes 0% return on investment. Furthermore, some of the gains in good years are retained by the insurer to be paid out in years of poorer performance, smoothing the annuitants’ income from extreme volatility.

28. These annuities proved quite popular leading up to the crisis, and generally outperformed traditional annuity offerings. However falling returns have reduced their popularity in more recent years as annuitants have seen their payments significantly reduced, and some providers have pulled out of the market in the UK.

*Smoothed Income Annuities*

29. Smoothed Income Annuities have been more recently launched in Denmark, and represent a kind of hybrid product between variable payout and with profit annuities. These products aim to offer participation in market returns during both the accumulation and payout phase, while smoothing income using a clearly defined formula, thereby offering more transparency in the calculation of additional payments than a with profits annuity does. This is accomplished by managing an individual buffer fund for each policy to absorb the impact of market volatility, and ultimately allows for a higher proportion of assets to be invested in equities, resulting in higher expected returns in the long run. At a minimum, the insurance company guarantees and annuity certain up to 25 years, but the insurance company may also offer additional return guarantees and/or longevity insurance with the product. Payments may also gradually be adjusted for future changes in mortality assumptions.

30. This product represented 25% of pension sales for SEB Pension, which is currently the only company offering the product and has a market share in Denmark of around 10% (Pechter, 2013).

*Participating Payout Life Annuities*

31. Participating payout life annuities (PLAs) in Germany offer a guaranteed minimum payment for life with the possibility of this amount increasing based on the insurer’s realized profits. The minimum payment is calculated based on conservative assumptions which contain significant margins, so the existence of a surplus should be regularly expected. Surpluses are calculated based only on the PLA product group and are therefore not subsidized by any other product line. Additionally, policyholders have the right to share the surplus from all sources of gain, and the insurer cannot cross-subsidize these sources. For example, the

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3 [http://www.sharingpensions.co.uk/annuity_with_profits.htm](http://www.sharingpensions.co.uk/annuity_with_profits.htm)
surplus coming from higher mortality experience than assumed cannot offset a loss on investment. Individuals have the option of one of two formulas for participation. The first is to annuitize the surplus, in other words to increase the amount of the annuity and therefore also minimum guaranteed payment. The second option is to receive the total surplus as a lump-sum payment, effectively topping up the guaranteed payment without impacting the future guarantee. Part of the surplus allocated to be paid back to policyholders is retained by the insurer in a reserve fund which is used to smooth the surplus payments over time, resulting in less volatile payments for the annuitants.

32. Two-thirds of regular premium annuity contracts sold in Germany are participating. The majority of single premium annuities are also of this type.

33. Variations on annuities which offer similar profit-sharing features can be found in several countries in Europe (e.g. Czech Republic, Denmark, Estonia, Italy, Sweden) and is at times imposed by regulation (e.g. Finland).

Variable Annuities

34. Variable annuities (US, Japan, Europe) and segregated funds (Canada) are deferred annuity savings products for which the underlying assets are managed in individual accounts, usually with variety of investment options, allowing for the realization of market returns rather than locking in a fixed rate. A minimum rate at which the accumulated funds can be converted into an annuity is guaranteed at issue, though annuitization is not mandatory and the policy may be surrendered instead. Optional guarantees are provided by the insurers which offer additional levels of protection from investment, mortality and/or longevity risk. These guarantees have become the distinguishing feature of variable annuity products, and the various types offered are described below.

- **Guaranteed Minimum Income Benefit (GMIB)** – Guarantees a minimum rate of return on investment during the accumulation/deferral phase for the calculation of the conversion of the accumulated funds into an annuity, effectively guaranteeing a minimum level of income from the future annuity payments.

- **Guaranteed Minimum Withdrawal Benefit (GMWB)** - Guarantees a minimum level of programmed withdrawals without the need to annuitize, allowing continued participation in market returns during the drawdown phase. This can guarantee withdrawals over a specified number of years, or for life (Guaranteed Lifetime Withdrawal Benefit, GLWB), which provides longevity protection as a life annuity would, albeit with a lower guaranteed income level.

- **Guaranteed Minimum Accumulation Benefit (GMAB)** – Guarantees a minimum return on assets for the purpose of taking a lump sum withdrawal from the product.

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4. “Role of annuities in payout phase under increasing life expectancy”, presentation by Brigitte Miksa of Allianz, Seoul, Korea, November 2013
Guaranteed Minimum Death Benefit (GMDB) – Guarantees a minimum sum to be paid to beneficiaries upon death; usually the account value with any guaranteed minimum returns.

Guarantees on investment returns typically take one or more of the following forms:

- **Roll-ups** – A guaranteed annual return of a specified rate, e.g. 4%

- **Ratchets** – Guarantees that accumulated assets will never decrease from the value assessed at predefined intervals, e.g. annually

- ** Resets** – Equivalent to ratchets except the time at which the value is assessed is determined by the policyholder (within limits)

The insurers typically hedge the investment risk of providing investment guarantees using financial derivatives to limit potential losses and the volatility of mark-to-market accounting and solvency measures. Following significant losses during the financial crisis, several providers exited the market. Those that have remained have attempted to reduce the riskiness of the products by modifying their design, for example by limiting the number of investment options available, reducing the level of the guaranteed returns, and placing further restrictions on the amount and timing of withdrawals from the account.

The United States represents the largest market for Variable Annuities, and while sales decreased significantly during the crisis they have since rebounded to pre-crisis levels, reaching over $150 billion in 2011 (Geneva Association, 2013). GLWBs have been the most popular type of guarantee elected, attracting two-thirds of total guarantee sales in 2011 (Society of Actuaries, LIMRA, 2013).

Sales of segregated funds in Canada follow a sales pattern similar to that of the US, though at a lower magnitude, with 2011 sales at around $11 billion (Geneva Association, 2013). The GLWB was introduced for segregated funds in Canada in 2007 and, as in the US, has proven to be extremely popular as an alternative to traditional annuitization.

Similar types of the guarantees listed above have also been offered separately in the UK by insurance companies to provide investment and longevity protection for DC pension savings plans.

Variable annuities rapidly expanded in Japan in the early 2000’s, with sales exceeding four trillion JPY in 2005. However following the financial crisis several high-profile insurers exited the market and sales have since declined dramatically, falling to less than 500 billion by 2011. Sales have more recently recovered somewhat with the higher interest rates.

Variable annuities and their guarantees were introduced in Europe as well, but have not proven to be very popular and the growth of the market has been slow. Total technical provisions backing variable annuities amounted to less than €200 billion in early 2010.

**Fixed Indexed Annuities**

As insurers have sought to limit the risk of variable annuities but maintain the clear value proposition they offered to customers, fixed indexed annuities have gradually been growing in the market.
These products offer returns which are indexed to the market along with downside protection through the same types of optional investment guarantees offered with variable annuities. The upside return is usually capped at around 4-5% for the customer.

43. For insurers these products offer lower risk than variable annuities as the investment fund selection is limited and the volatility is lower, resulting in more effective hedging of the downside investment risk.

44. Sales reached nearly $34 billion in the United States in 2012, representing nearly half of all fixed annuity sales. When offered with these products, the GLWB has proven continued popularity as an alternative to traditional annuitization, being bought by 67% of customers purchasing fixed indexed annuities in 2011 where the option was available (Raham et al, 2012).

Enhanced Annuities

45. Enhanced annuities pay out a higher income level to individuals deemed to have a shorter life expectancy. Qualification for such an annuity can be based on the existence of a health impairment, such as high blood pressure or diabetes, or based on lifestyle factors such as tobacco use or socio-professional category.

46. These products seek to increase the market for annuities by offering more attractive rates to individuals who would otherwise be likely to lose out from purchasing a regular immediate life annuity because their life expectancy is lower than the average of the population. However, the insurer also takes a larger risk in terms of accurately pricing the annuity, as this is subject to an accurate assessment of the reduction in life expectancy for an individual given the specific qualifying condition. Furthermore, the existence of a market for enhanced annuities could shift the business mix from regular annuity books, affecting the life expectancy and therefore the annuity cost for this pool of individuals going forward.

47. The largest market for enhanced annuities is in the UK, where they represent around 20% of total annuity contracts sold and sales have grown exponentially, surpassing 4 billion GBP in 2012 (Towers Watson 2012). The increasing popularity has likely been due to the effective requirement to annuitize pension assets, as enhanced annuities would provide a solution for individuals for whom the requirement to purchase a regular annuity would be unfair given their mortality outlook.

48. The US market, where these types of annuities are known as substandard annuities, is much smaller. Less than 10% of annuity providers offer them, and as of 2005 they represented only 4% of the total immediate annuity contracts in force (LIMRA 2006). Furthermore, a large portion of these premiums seem to be used to provide premium financing arrangements rather than retirement income. These financing arrangements are essentially a way to arbitrage insurance premiums, which is clearly not the intended purpose of these products and could potentially increase the anti-selection and concentration risk for the insurer. As a result some providers have pulled out of the US market.

http://online.wsj.com/news/articles/SB10001424127887323455104579014792319250018

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Advanced Life Deferred Annuities

49. Advanced life deferred annuities (ALDA), also known as longevity insurance, are deferred annuities with a long deferral period of typically over 20 years with payments that are expected to begin at a more advanced age, usually when an individual is in their 70s or 80s. This product behaves as a traditional annuity in that the premium is non-refundable and payments are only made if the person survives to the age to which payments were deferred. The advantage of these products for the customer is that they provide longevity insurance for a relative bargain, and is significantly cheaper than purchasing an immediate annuity providing the same level of income.

50. A modified version of these products is the Deferred Income Annuity (DIA), which allows for shorter deferral periods, is not necessarily funded with a single premium, and offers additional options regarding death benefits and liquidity. The age at which annuity payments begin is typically defined at purchase.

51. DIAs represent a very small portion of the annuity market in the US, with annual sales making up less than 1% of total annuity sales, though sales have been increasing rapidly since the product was introduced to the market (IRI 2013). Proposed regulation would exclude the funds used to purchase a DIA for the minimum withdrawal calculation in IRAs, allowing for a lower annual withdrawal from the fund. This change may encourage the growth of this market in the US.

52. A similar product to the ALDA is offered as a payment option under Chile’s individual retirement account system. This is meant to be combined with programmed withdrawals up to the age at which the annuity payments begin, usually no earlier than age 75. While not as popular as immediate annuities, around a third of annuity premiums, or over 600 billion CLP, were paid go towards the purchase of these types of products in 2012.

53. These types of annuities are not available in the UK, which some argue is a result of high risk-based solvency requirements and the lack of a financial instrument which can be used to hedge long-duration longevity risk (Blake & Turner, 2013). However, these arguments would also hold true for deferred annuities issued at younger ages.

Life Care and Immediate Needs Annuities

54. Hybrid long-term care insurance and annuity products have also recently emerged in the market. In the US, this type of product is usually structured to increase annuity payments in the event that long-term care is needed. This structure can address the risk to individuals that retirement income from annuity payments will not be sufficient to meet liquidity needs in the event that long-term care is required, which could be a potential barrier to the purchase of a regular life annuity which locks in an inflexible income level.

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6. The OECD Roadmap for the Good Design of DC Pension Plans recommends combining programmed withdrawals with deferred life annuities as a solution for the payout phase.

7. Superintendencia de Valores y Seguros (SVS).
55. In the UK, the immediate needs annuity can be purchased to pay directly for long-term care costs for someone already in need of such care. The purpose of this annuity is therefore to cover the cost of care for the lifetime of the individual rather than provide income in retirement, though the risk insured is that of longevity.

56. In the UK in 2011, around 5000 immediate needs annuity policies were in force, representing approximately 4% of individuals paying for their own long-term care (Lloyd, 2011). The purchase of these types of annuities seems to face similar psychological barriers to the purchase of regular life annuities, and the products remain overall unpopular and the number of providers limited.

- Could delegates provide additional details of other annuity products in their jurisdictions?

Observations and implications

57. Annuity providers are making an effort to design products which respond to the concerns of potential annuitants and make their products more attractive, with implications for the risk assumed by the customer and insurer alike.

58. There is a clear movement towards the offer of annuity products which provide annuitants more opportunity to participate in the market returns of the underlying investment. Nevertheless, in opting for an annuity product offering this flexibility, the annuity buyer will have to accept a trade-off. On the positive side, the market or profit participation feature can potentially increase the annuity payments which the individual will receive and indirectly protect payments from being devalued due to inflation. However, on the negative side, any guaranteed minimum income from these types of products will be lower than the level guaranteed by a traditional fixed annuity, and payments will be subject to some level of volatility if market or profit participation is offered during the payout phase. This could pose a challenge to individuals who require a stable income in retirement to meet fixed budget constraints.

59. A second direction in product innovation seems to be the development of annuities targeted at individuals with more specific risk profiles or needs. Enhanced annuities and immediate needs annuities insure the longevity risk for impaired lives (or those individuals with a higher risk of mortality) at a more reasonable price than what they could expect to pay otherwise. Similarly, advanced life deferred annuities provide insurance specifically for old-age longevity risk, taking advantage of the not insignificant probability that an individual will die before reaching the age at which payments begin in order to be able to offer much more affordable premiums for a given level of income compared to an immediate annuity bought at retirement. These developments have the potential to expand the annuity market and offer longevity insurance to individuals for whom the purchase of an annuity would otherwise be prohibitively expensive.

60. Annuity providers have also attempted to better manage the risks to which they are exposed from offering more innovative annuity products, particularly following the effects of the financial crisis and the trend of increasing solvency capital requirements. This is especially pertinent to the case of variable annuities, which suffered significant losses in the midst of falling returns and increased volatility in the market. To better limit the risk of losses, the new generations of these products have offered fewer investment options in order to increase the hedging efficiency for the embedded investment guarantees, and the level of investment guarantees has been reduced. Additionally, annuity providers have realized that uncertainty
around the behaviour of policyholders can become quite costly, and have placed additional limits on the ability for them to withdraw funds as well as on the timing for annuity payments to begin.

61. Product design innovations have furthermore aimed in many cases to increase the risk sharing between the annuity providers and consumers to limit the risk retained by the insurer. This has been done with investment risk, for example, by limiting the upside return passed on to annuitants in fixed indexed annuities, or by sharing some of downside risk, as is done with smoothed income annuities. The sharing of longevity risk has also emerged, with annuitants benefiting directly from higher mortality experience in Germany’s participating pay-out annuities, and the possibility for annuity payments to be revised according to emerging longevity experience in Denmark’s smoothed income annuities.

- Are there any specific issues which delegates would like to address further regarding product design or innovations?

62. While it would be virtually impossible to identify and describe all the variations of annuity products found in the market around the world, the products discussed above should provide an overview of the types of features which are available and the various ways in which products can be structured. Beyond this, endless variations from these core designs are possible, and ultimately what succeeds will be a question of striking a balance between what protections can be provided at a reasonable price for consumers and what product design results in a manageable risk for the annuity providers.
ANNEX: PRIVATE PENSION SOURCES BASED ON ASSETS ACCUMULATED TO FINANCE RETIREMENT IN SEVERAL OECD COUNTRIES

63. This annex presents the private sources for financing retirement which the Secretariat was able to identify for several OECD countries. Countries are encouraged to assess which of these sources should be in the scope of the IPPC/WPPP project on annuity products. The criteria presented in the main text could serve as guidance.

Austria

Severance Funds

64. Employers are obliged to contribute to a defined contribution severance fund on behalf of their employees equal to 1.53% of the employee’s salary.

65. If employees have worked for at least three years, they have the option of taking the accumulated severance funds as a lump sum upon the termination of employment. At normal retirement age, employees can receive the accumulated funds as a lump sum or as an annuity. Lump-sum payments made up 96% of payouts in 2007.8

Employer arranged retirement savings

66. Employers have the option of establishing a pension plan for their employees. This can be done via one of various ways: in-house via book reserves, through a Pensionskassen, through a collective insurance agreement or through a group insurance contract with an insurer.

67. Accumulated funds in an employer sponsored defined contribution account with a Pensionskassen can be paid as a lump sum or a life annuity.

Individual retirement savings

68. The government subsidizes a voluntary individual retirement savings plan. Contributions must be made for at least 10 years and are subject to a limit. Accumulated funds may be paid out as a lump sum or an annuity from age 40.

Belgium

Employer arranged savings

69. Employers often provide employees with a pension savings plan via a group insurance policy administered by an insurance company, via a pension fund or with a collective pension savings account administered by a collective investment institution. Personal savings plans can also be organized by the

employer. For DC plans, employers are required to guarantee a minimum rate of return over the individual’s lifetime. Funds accumulated in employer plans may be paid out as a lump sum or a life annuity from a minimum age of 60.

70. Group insurance is the most common form of employer sponsored pensions. Accumulated savings is most often taken as a lump sum.

*Individual retirement savings*

71. Individuals have the option of investing in a personal pension savings account. Pension insurance contracts provided by insurance companies are required to guarantee a minimum rate of return, while pension savings provided by banks are not obliged to provide any guarantees. Lump sum payments are most often taken from personal pension savings contracts. Guaranteed annuity conversion rates or a guaranteed level of income are not offered under these pension savings contracts, so any ‘deferred annuity’ taken is effectively converting the accumulated assets into an immediate annuity.

72. Payments may be indexed to inflation or linked to market returns.

*Canada*

*Employer Registered Retirement Savings Plans (RRSP)*

73. Employers have the option to establish a pension plan for their employees in which participation may be mandatory or optional for employees. For defined contribution plans, accumulated funds will be paid out as lifetime income, which may or may not be indexed to inflation. If the employee changes employers, there is also the option to transfer accumulated pension assets to a “locked-in retirement account”. At retirement accumulated assets must be used to purchase a Life Income Fund or an annuity from an insurer.

74. Life Income Funds may be established using funds from a locked-in retirement account. Annual withdrawals are subject to a minimum and maximum limit. Some provinces require that funds remaining at age 80 or 90 must be used to purchase an annuity. Locked in retirement income funds are also available in some provinces, and have no requirement for the purchase of an annuity.

*Deferred Profit Sharing Plan*

75. Employers may also set up a Deferred Profit Sharing Plan and make contributions for employees based on profits. At retirement the funds may be paid out as a lump sum, transferred to a RRSP or a Registered Retirement Income Fund, or used to purchase and annuity from an insurance company.

*Individual RRSP*

76. Individuals can accumulate retirement savings on their own by investing in a Registered Retirement Savings Plans (RRSP). Withdrawals from the fund can be made at any point in time. Contributions can be made up until the age of 71, at which point the funds must be transferred into a Registered Retirement Income Fund, buy an annuity from an insurer, or paid as a lump-sum.
A Registered Retirement Income Fund may be established with any licensed financial intermediary (e.g. bank, insurance company) using funds from a RRSP. The pensioner must take minimum annual withdrawals from the fund. Minimum amounts are established by the government, and are set as percentages which increase with age. There is no maximum limit on withdrawals, and the fund may be transferred to a spouse upon death.

**Individual Annuity Products**

Deferred annuities and segregated funds, which are only offered by insurance companies, may be purchased within an RRSP or with non-registered assets. In 2012, 40% of annuity premiums came from RRSP assets (Canadian Life and Health Insurance Association).

Assets backing segregated funds are nearly double those backing traditional deferred annuities, and in 2012 significantly more money was invested in these types of savings vehicles than in purchasing conventional deferred annuities. Guaranteed withdrawal benefits for life (GWBL) for segregated funds are becoming popular (Milevsky & Shao, 2010).

The majority of immediate annuities purchased have fixed payment patterns. While increasing or inflation linked annuities exist, they are not very popular.

The group annuity market is significant and tends to cover employers’ Defined Benefit plans.

**Chile**

*Mandatory Individual Savings Accounts*

Workers are required to contribute at least 10% of their salary into an account managed by a pension fund administrator (Administradora de Fondo de Pensión, AFP). These assets are accumulated in a limited number of investment fund options for which the AFPs are required to guarantee a minimum relative rate of return.

If accumulated assets meet a certain minimum threshold, pensioners have the option to take a partial lump sum from their fund at retirement. With the remaining assets, they have the option of taking a programmed withdrawal, purchasing a life annuity, or purchasing a deferred annuity and taking programmed withdrawals temporarily until the annuity payments begin. Combining programmed withdrawal with the purchase of an annuity is also possible, as is purchasing an immediate annuity at a later point in time with remaining assets if programmed withdrawals were taken initially. If accumulated assets do not meet a certain minimum requirement, pensioners must draw down the assets using a programmed withdrawal at the level of the minimum pension guarantee (MPG), with the government providing the remaining pension payments once assets are exhausted.

With programmed withdrawals, assets remain in the AFP and the maximum withdrawal amounts are calculated based on life expectancy. The minimum withdrawal permitted is the level of the MPG.

Life annuities are purchased from insurance companies, and are required to be indexed to inflation. Married individuals are required to purchase a joint-life annuity.
Immediate life annuities represent 60% of the market, with the remaining portion being deferred annuities in the form of advance life deferred annuities which begin payments at an older age. Around 65% of new retirees purchase an annuity.

Deferred annuities remain less popular than other retirement income options due to the perceived complexity of the products as well as the uncertainty stemming from their long-term nature.

Voluntary individual savings

Individuals may also contribute to voluntary savings accounts offered by financial intermediaries (AFPs, banks, insurance companies). Voluntary savings can also be transferred to the mandatory accounts to increase retirement income.

Denmark

ATP

All employees are required to contribute around 1% of their income to the Arbejdsmarkedets Tillaegspenson (ATP), a public pension fund, with employer contributions matching employees’ at 200%. The ATP is required to guarantee a minimum level of return, which is reset occasionally to reflect the prevailing yields in the bond and swap market. Annual bonus payments are made to the accumulating funds based on the overall investment and longevity performance. The minimum deferred annuity conversion factor is also guaranteed by the ATP, and varies by the age at which the annuity income begins.

All funds accumulated in the ATP are paid out as a life annuity unless the accumulated funds are below a certain limit, in which case they are paid out as a lump sum. ATP benefits must be claimed by the age of 75.

Voluntary supplementary pension plans

Other voluntary supplementary pension plans are available which are similar to the ATP but are either closing down or targeting specific subsets of the population, such as those on disability pensions or particular groups of civil servants.

Employer arranged savings

Employer arranged occupational pensions are not mandatory, but are common and if an employer has established a pension plan, participation by the employee is mandatory. Most are defined contribution in structure, and contributions are tax deductible, though interest earned is taxed annually. Life insurance companies and multi-employer pension plans manage the vast majority of these pension arrangements, with terms being negotiated with the companies, though banks also take about 15% of the market. Plans managed directly by single employers are becoming rare. Insurance companies and pension plans directly compete in the market, as both are subject to the same regulation. Group annuities are frequently used, and minimum return guarantees (subject to a regulatory maximum) and profit-sharing bonuses are common. Minimum annuity conversion rates are also often guaranteed, and pricing is on a unisex basis. Banks, however, do not offer any such guarantees and are not allowed to offer annuities.
93. Individuals often have the choice of the structure of payout with these plans, and can choose among life annuities, term annuities, programmed withdrawals, annuities deferred to older ages and lump sums. Assets backing programmed withdrawals and lump sums may be converted to an annuity at a later date. Some plans, however, limit the choice by directing most of the contributions to the purchase of a group annuity, locking in the annuity payout for its employees.

94. In 2008 42% of contributions in these plans were directed towards the purchase of an annuity and 47% were used for programmed withdrawals. Lump-sum payments made up the balance. The preference for taking an annuity has declined over time, with programmed withdrawals increasing in popularity. Lump-sum payments have become less popular with the change in tax-laws making them less attractive. Recently investment-linked annuities have become more popular (Rocha et al., 2011).

**Individual retirement savings**

95. Individuals also have the opportunity to invest in personal pension plans. These can be offered by any financial intermediary, with banks dominating 65% of the market.

96. Options for the payout of personal pension plans are similar to those offered under the occupational plans, though annuities purchased through a personal pension plan are priced by gender and subject to additional underwriting.

97. Only 15% of contributions to these plans were used to purchase a life annuity in 2008, with the most popular payout option being programmed withdrawals.

98. Banks are not allowed to offer annuities.

**Annuity Products**

99. Annuity payments with profit-sharing bonuses linked to contributions are common, and some annuities are variable and linked directly to the underlying investment performance, often with a minimum guaranteed return and/or payment.

100. Recent trends appear to be moving towards products with fewer guarantees and less profit sharing, such as innovative hybrid products which fall between more traditional and market linked annuities. This trend seems to cater towards the desire of the customer for transparent products for which they have more control (Rocha et al, 2011). A more recent innovation has been the smoothed income annuity, which aims for higher participation in market returns and potential upside while providing stable annuity payments by implementing a buffer fund to absorb market shocks.

**Finland**

**Voluntary retirement savings**

101. Outside of the partially-funded mandatory earnings related pension scheme, voluntary arrangements make up a small source of retirement income. Voluntary pension made up only 14% of pension wealth in 2010, with voluntary contributions to earnings related pensions and individual pensions making up
4.4% and 2.7% of total contributions, respectively (Barr 2013). Around 13% of the working age population contribute to voluntary pensions (Harju 2009).

102. Funding methods for voluntary occupational pensions are similar to those for the mandatory occupational scheme, and can be managed through pension funds, pension foundations or insurance companies. The two former schemes only account for 15% of voluntary contributions, with the remaining going to insurance companies. A common form of voluntary savings is to simply make additional contributions to the mandatory scheme.

103. Individuals may also directly apply for insurance or have a personal pension through their employer, typically provided by insurance companies. Voluntary pensions of this type are typically offered to top management.

*France*

**PERCO**

104. Plans d’épargne retraite (PERCO) are collectively arranged by employers for employees. Employees may make contributions of up to 25% of their salary, which the employer may match up to a certain limit. At least three different investment options must be provided. Funds may not be withdrawn before the age of 60, excluding certain life events. Payout may take the form of a lump sum or a life annuity.

*Other employer arranged retirement savings*

105. Employers may also arrange retirement savings for employees themselves via a book reserve system or alternatively with an insurance company, mutual fund or pension fund.

**PERP**

106. The plan d’épargne retraite populaire is a voluntary individual retirement savings vehicle offered by banks and insurance companies. A minimum guaranteed return must be provided and a life cycle investment strategy is typically implemented. Accumulated funds may not be taken before the age of 60 and are paid out as life annuities unless used to purchase a primary residence in which case a lump sum may be taken.

**Assurance vie**

107. Life insurance contracts are individual retirement savings contracts offered by banks and insurance companies. Withdrawals may be made within four years subject to a capital gains tax, between four and eight years at a lower tax rate and after 8 years withdrawals may be made up to certain limits free of capital gains tax.
Germany

Employer arranged retirement savings

108. Employees have the legal right to contribute up to 4% of their salary to an employer-organized deferred compensation savings plan. Pure defined contribution schemes are not allowed, and the expected benefit must be defined in some way, for example based on salary or via a guaranteed rate of return. Employers have five options to finance these occupational schemes.

109. The first option is a book reserve system, for which the employer takes direct responsibility for making pensions payments. Employers using this approach may insure some or all of their promises externally.

110. Employers may also outsource the responsibility to a Pensionskassen, which essentially provide insurance contracts directly to employees for their pensions.

111. Supportfunds are funded by the contributions from the employer, and the employer may never reduce its annual contributions for a given employee.

112. Employers can also purchase direct insurance to provide coverage for the employee.

113. Pensionsfonds were established as an alternative to insurance and Pensionskassen and allow for a wider range of investment options.

114. Occupational pension schemes may pay pension promises as lump sums or life annuities.

Ruerup pensions

115. The Ruerup-pension is an individual pension contract established with certain licensed providers. Accumulated funds from Ruerup-pensions must be taken in the form of a life annuity from a minimum age of 60.

Riester pensions

116. Individuals may invest in a Reister product to which they may make contributions to purchase qualified products from financial institutions offering minimum benefit guarantees. State subsidies are provided. The individual has the option to transfer accumulated funds and change providers during the accumulation phase.

117. Funds accumulated in Reister products may not be withdrawn before the age of 60. A maximum of 30% of the capital available to be taken as a lump-sum and the remainder can be paid out as a life annuity or a programmed withdrawal combined with a life annuity beginning payments no later than age 85. Individual annuity products

118. Any annuities offered by insurance companies are subject to a legislative requirement of a guaranteed minimum return to annuitants. On top of this guarantee, insurers are obliged to distribute a large portion of their surplus back to annuitants as a profit-sharing bonus. The profit sharing can be structured so
that annual payments may never be reduced, in other words the gain received from the insurer’s surplus cannot go down in subsequent years, or alternatively so that bonus payments will vary each year in line with the insurer’s actual profits. Common features also include guaranteed periods and the return of capital.

**Israel**

119. New regulation requires all long term savers in Israel to acquire a minimum level of annuity for retirement.

*Employer arranged pension pans*

120. Employers are required to provide pension plans for employees. Pension plans are managed by external pension managing entities whose sole activity is the management of pension and provident funds. Employers and employees are subject to minimum and maximum allowable contributions. Survivorship and disability benefits must be included. The government requires that a life cycle investment strategy be implemented.

121. Defined contribution plans within pension plans are to be paid out as a life annuity no earlier than the age of 60, unless the accumulated assets do not exceed a minimum level at normal retirement age (67/62 for men/women), in which case funds will be paid as a lump-sum. A 60 month guarantee period is imposed, which is reset in the case of survival to 60 months, 120 months and 180 months.

*Keren Hishtalmut*

122. The Keren Hishtalmut⁹ is an optional savings plan which can be offered to employees or opened by self-employed individuals. Funds accumulated in the Keren Hishtalmut can be withdrawn after 6 years.

*Provident Funds*

123. Individuals have the option to make contributions to a personal savings plan within a provident fund. Since 2008 funds accumulated in provident funds are not allowed to be taken as a lump sum in totality and must be taken as a life annuity. If accumulated funds exceed a certain level, the excess may be taken as a lump sum.

*Individual Life Insurance Policies*

124. Life insurance policies are paid out the same way as provident funds.

125. Guaranteed annuity options are common in life insurance products, though due to the risk involved the government has imposed age restrictions on the offering of such guarantees.

126. Inflation linked annuities are common.

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Japan

Employer arranged plans

127. Occupational pension plans are prevalent in Japan. Employees are only allowed to contribute to certain plans. Plans may be managed by the employer or contracted out to a pension management organization.

128. Most occupational benefits are paid out as a lump sum, though some schemes must offer an annuity as a payout option, though these are often term annuities. Lump-sums are largely preferred by participants. Annuity payments are administered by the employer or contracted out to a pension management organization, though for defined contribution plans a life annuity is only an option when the investment options include life insurer’s guaranteed investment contracts (GICs). In general benefits cannot be received before age 60.

Employees’ Asset Building Promotion Scheme

129. The employer may give employees access to an Employees’ Asset Building Promotion Scheme, which are individual pension savings plans provided by a financial institution. No choice of investment in generally allowed, though minimum return guarantees may be provided.

130. Benefit payments from the Employees’ Asset Building Promotion Scheme take the form of annuities. Only life insurers are allowed to offer life annuities; term annuities can be offered by other financial institutions.

Individual retirement savings

131. Two plans are also available for self-employed individuals: National Pension Funds (NPF) or a self-directed individual defined contribution plan. The NPF guarantee a certain level of income from a term or life annuity at the age of 65. Benefits from the NPF are paid out as annuities for the selected duration. Individual defined contributions plans may pay out as a lump-sum, term annuity, life annuity or a combination of these options from the age of 60.

132. Only insurance companies are allowed to offer life annuities.

133. Individual annuities, both fixed and variable, can be purchased from an insurance company.

134. Lump sums are largely favoured over annuity income.

Individual annuity products

135. Only 20-30% of individuals are estimated to purchase annuities. Among fixed annuity payment options, life annuities represent only a small portion of payments, with the majority of individuals opting for term annuities. Those with life annuities often elect to have a guaranteed period of 10 years.
136. Sales of variable annuities, rich with investment and annuity conversion guarantees, have
decreased significantly over the last few years as the guarantees have become quite costly given the
depressed market conditions and several suppliers have pulled out of the market.

137. The majority of individuals rely on bank deposits for their income in retirement (Urata 2009).

138. Group annuities seem to only be used to insure DB plans.

**Mexico**

*Employer arranged plans*

139. Employers may offer occupational plans to their employees which are either managed by the
employer via a book reserve or managed through trusts administered by financial institutions. Most of these
plans are defined benefit, although 30% are defined contribution or hybrid. These plans are not widespread,
with only 3% of the labour force being covered.

140. Any form of payout from these plans may be taken, with the vast majority choosing annuities.

*Mandatory individual retirement savings*

141. Individuals are required to have individual retirement accounts which are managed by AFOREs.
Minimum required contributions are made by individuals and employers with a small subsidy from the
government. Additional voluntary contributions may also be made, though these contributions are managed
in separate sub-accounts.

142. Payouts from the individual accounts are allowed from the age of 65 unless accumulated funds
exceed a certain threshold, then the individual may take an early retirement. If an individual has not
contributed for a long enough period or accumulated funds do not exceed a minimum threshold, individuals
are allowed to take a lump sum payout. A lump sum may also be taken if accumulated funds exceed the
amount required to obtain the minimum annuity (130% of the minimum pension guarantee). With the
remaining balance the individual must choose between programmed withdrawals or an inflation linked life
annuity. Programmed withdrawals are managed by the AFORES, and annuities are provided by insurance
companies.

143. AFOREs along with financial institutions and insurance companies offer voluntary pension
products.

**South Africa**

*Employer arranged retirement savings*

144. Employers may arrange for a pension plan for employees, in which participation may be voluntary
or mandatory. If established as a pension fund, one third of accumulated funds may be taken as a lump sum
at retirement, with the remainder required to be converted to a life annuity paid by a life insurance company.
If established as a provident fund, benefits are paid as a lump sum.
An individual leaving their employer may put accumulated funds into a preservation fund until another savings vehicle is found. A withdrawal from the fund is allowed once before retirement.

**Individual retirement savings plans**

Deferred ‘retirement annuities’ are offered by insurance companies, for which regular or single premiums may be paid. Accumulated funds may not be accessed before the age of 55, and accumulation is generally indexed to the performance of the underlying fund. At retirement, up to 30% of accumulated assets may be taken as a lump sum, and the remainder must be used to purchase a life annuity. Annuity payments are often fixed but may also be indexed to inflation or profits. ‘Living annuities’ do not provide any investment or longevity insurance and funds may be depleted before death. These types of products are becoming much more popular than the traditional annuities with the insurance components.10

**Spain**

**Employer arranged retirement savings**

Individuals may contribute to individual or employer-arranged pension plans. These may be established through pension funds or insurance companies, or rarely with the company itself via a book reserve system. These plans are typically defined contribution plans.

Employees may typically choose among a lump sum, an annuity, or a combination of both for the payout of the pension plan.

22% of benefits from pension plans in 2006 were paid as annuities.

**Individual annuity products**

Individual annuities may also be purchased, either with single premiums or regular premiums.

**Sweden**

**Premium Pension Authority (PPM)**

A portion of the public pension system is implemented as a financial defined contribution scheme which is managed by the government’s Premium Pension Authority (PPM). These mandatory self-directed personal accounts are funded with 2.5% of annual earnings can be invested with a number of registered fund managers, including insurers, or in a publically managed default investment fund. In 2007 the major insurers held over 40% of the total assets, with the default fund holding nearly 30%. Individuals may switch the funds in which they invest at any point in time.


11 Note that figures provided in questionnaire probably include pension plans
The PPM pays a life annuity to pensioners based on the level of funds accumulated in the mandatory personal account, with the level of income being based on the age at which payments begin. Payments may not begin before the age of 61, and may have with-profit bonuses or be unit linked to the underlying investment, the latter providing no real insurance for the individual against longevity or investment risk as funds could be depleted to a very low level towards the end of life.

**Occupational pensions**

Occupational pension plans funded by employers are negotiated with collective bargaining, and different plans cover different industries. Most plans have been converted to financial defined contribution plans. These plans can be managed through the employer itself on a book reserve system, by a pension fund or by an insurance company. Companies on a book reserve system often reinsure their plans with the insurer FPG.

Benefits from occupational plans must be taken over at least five years, so are taken as either phased withdrawals or life annuities.

**Personal voluntary savings**

Individuals may also save for retirement with insurance products bought from insurance companies. Deferred annuities often provide death benefits before the age of 55 and offer a guaranteed minimum return and annuity conversion rate. A profit sharing bonus is also often paid. Unit-linked products give the individual control over the investment of their funds, but no guaranteed return is normally offered. Banks and investment funds offer retirement savings accounts.

Payments from insurance products and retirement savings accounts cannot begin before the age of 55 and must be spread over at least five years in order to take advantage of the preferential tax treatment. Payouts may be lump-sum, phased withdrawals or life annuities. Only insurance companies may provide life annuities, and income payments are often accompanied by a profit sharing bonus.

40% of individuals in 2004 were paying premiums for private insurance products. Investment linked contracts have been becoming more popular.

Programmed withdrawals are more popular than life annuities for the payout of private savings.

**Mandatory employer arranged plans**

Employers are obliged to organize a pension plan for employees, and employee participation is mandatory for those whose earnings exceed a certain threshold. Most are defined contribution in structure. The pension plans are typically organized via external pension funds or insurance companies. Legislation defines minimum contributions levels for both employer and employee, though additional voluntary contributions over a certain threshold may be made towards a ‘super-mandatory’ pension. Minimum return guarantees are also defined by legislation, and capital is required to be fully portable when employment changes. Death and disability insurance is mandatory during the accumulation phase.
161. Payout at retirement can only take the form of a lump-sum or life annuity (or a combination). Funds are required to allow at least 25% of accumulated assets to be taken as a lump sum with no legal maximum, though an advance notice of up to three years for the election of this option can be required to mitigate adverse selection. The conversion factor to be used to convert accumulated funds into an annuity for the mandatory portion of the pension is imposed by legislation, and the factor does not vary by individual. Joint survival annuities are paid to married individuals. Market rates are allowed to be used for the super-mandatory portion, and when used these have tended to be much lower than the legal conversion rate. Payments are usually flat and not indexed.

162. Annuity rates tend to be rather high.

Voluntary individual retirement savings

163. Individuals also have the option to contribute to individual voluntary savings plans, however only a small portion of these types of savings are annuitized; most are taken as lump-sums. Most of these products are provided by insurance companies.

United Kingdom

Pension Plans

164. Individuals have the opportunity to invest funds in pension schemes to save for retirement, either through their employer or individually. These schemes are managed either by an internal or external pension scheme or an insurer. The government backed National Employment Savings Trust (NEST) scheme, a low cost scheme run on a not-for-profit basis, was launched to facilitate the requirement for employers to automatically enrol employees in pension plans from 2013. 2,405 billion GBP in assets were held in pension funds in 2012, 44% of these held by insurers (ABI, November 2013).

165. It is possible to purchase insurance wrappers for pension funds which offer specific return or income guarantees during the accumulation phase.

166. Up until March 2014, 25% of assets accumulated in pension funds are permitted to be taken as a tax-free lump sum at retirement, while the remainder of the assets are effectively required to be converted into an individual or joint life annuity by the age of 75. As an alternative, phased withdrawals were allowed if the pensioner is able to prove an income of 20,000 GBP annually from another source. Average annual income from private pension savings in 2010/11 was 11,900 for couples, 8,500 for single males and 5,900 for single females (ABI, 2012).

167. Pensioners are allowed to use their assets to purchase an annuity from a provider other than the one involved in the accumulation of assets. This is called the Open Market Option (OMO). In 2012, 48% of pensioners changed providers, an increase from around a third over the last decade (ABI, 2013). Individuals who switch providers tend to have a higher level of accumulated assets, so the difference in price was likely more material thus providing more incentive to shop around. Additionally, not all insurers provide annuities externally (i.e. to individuals for whom they were not providing pension plans), and those who do often have minimum premium requirements. Guaranteed conversion rates may also limit the number of individuals who exercise the OMO if they are guaranteed better rates than what the market is currently offering. Individuals
looking for a better price via an enhanced annuity were significantly more likely to have shopped around. However since March 2014, the effective requirement to annuitize has been significantly relaxed and annuitization rates are expected to decline.

168. The vast majority of individuals buying annuities with their pension assets in 2010 elected a fixed payment pattern (85%), followed by with-profit annuities having a guaranteed minimum payment with an additional bonus linked to smoothed investment performance of the company’s with profit fund (6%), fixed escalating payments (2%) and inflation linked payments (1%). 13% of annuities purchased were enhanced annuities, up from 5% in 2006. 6% of individuals took the guaranteed annuity rate offered by their pension provider. (Crouch et al, 2010) In 2006 around 70% of individuals elected a guaranteed period (Gunawardena et al, 2008).

169. Group annuities are primarily used by pension plans to insure payments to pensioners (i.e. buy-ins).

Individual Annuity Products

170. Individuals may also purchase annuity products from an insurance company from assets accumulated outside of a pension fund.

United States

Employer provided pension

171. Employers have the option of providing pension plans for employees which are treated as deferred compensation. These plans usually take the form of a DB or Hybrid plan. Accumulated benefits may typically be taken as a lump-sum upon leaving the employer, subject to a minimum vesting period and tax-disincentives before the age of 59.5. The option to take accumulated benefits as a life annuity is also usually an option.

Individual Retirement Savings Plans

172. Individuals have the opportunity to contribute on a voluntary basis to retirement funds either through their employer or individually. 401(k) plans are an example of an employer sponsored plans, to which employees may contribute up to a certain percentage of their salary each year. Employers often match employee contributions up to a certain point. Individual retirement arrangements (IRAs) or Roth IRAs may also be established, to which individuals having earned income may contribute up to a total of $5,500 annually. Funds from employer sponsored plans may also be rolled over into IRAs to consolidate retirement savings for individuals.

173. Individuals are free to withdraw funds from their retirement fund at any point, subject to tax disincentives before the age of 59.5. There is no requirement to annuitize the funds at retirement and individuals may take the accumulated assets as a lump sum. If funds are left in the plan, minimum withdrawals based on the applicable distribution period or life expectancy are required from the age 70.5. Accumulated funds may also be used to purchase an annuity product with an insurance company.
Individual Annuity Products

174. Individuals may purchase individual retirement annuities from life insurance companies with funds within the retirement savings plans. In order to qualify to be purchased within the savings plans, these annuities are deferred and typically funded by periodic premiums which must be flexible and the funds non-transferrable. Income from the annuity must begin before the age of 70.5.

175. Non-qualified annuities may be purchased outside of qualified retirement accounts from life insurance companies. The vast majority of individual annuities in the United States are deferred annuities. Almost three-quarters of the market is made up of investment linked products, followed by around 20% of annuities having fixed payments and the remaining linked to an index, with annuities linked to inflation available since around 2000 though still not common. Inflation linked annuities represented less than 3% of immediate annuities sold in 2006 (Webb 2010). Among immediate annuities sold, life annuities are the most popular.

177. The majority of payout elections from investment linked deferred annuities (VAs) seem to be as lump-sums rather than converting the funds into a fixed annuity.

178. Deferred Income Annuities, which are conventional annuities which typically begin payments at older ages (70s and 80s) doubled in popularity in 2013. Fixed payment annuities also increased sales, while investment linked annuity sales have fallen slightly (IRI, December 2013).

179. Group annuities tend to only be linked to defined benefit pension plans to insure employees’ pensions.
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