The project on Annuity Markets is in an intermediate stage. The initial work undertaken during 2014 sought to identify the various types of annuity products that are now available in member countries and to develop a classification framework based on features and guarantees. The second stage of the effort examines several of the key regulatory and structural factors to consider their potential impact on the development of annuity markets and the availability and use of annuity products for retirement income. A special joint roundtable session with the Insurance Committee on “Annuity Risk Management and Regulation” was held on the day between the December meetings of the Working Party on Private Pensions and the full Insurance and Private Pensions Committee at which a number of presentations were made by the Insurance industry outlining the products which they currently offer and identifying major issues in the development of annuity markets. The information from both of the sessions will be used to develop a more comprehensive document on risk management practices and regulatory issues influencing annuity markets that will be presented in the June 2015 meetings for discussion and comment followed the formulation of conclusions and policy recommendations.

The note identifies and outlines three sets of issues that are perceived to affect the development of annuities markets: The overall design of the pension system, the tax treatment of annuities and issues related to insurance regulation including market conduct, prudential regulation and reserve and solvency requirements.

The paper notes that in general it has only been within pension systems that include either some requirement for full or partial annuitization or restriction on lump sum
withdrawals that widespread use of the products and related market development are observed. Examples include the UK (which rescinded its requirement in 2014), Chile, which only allows lump sum withdrawals after a minimum retirement income level is assured and Switzerland which encourages annuities in the mandatory occupational component of its pension system. The US is identified as an intermediate case where annuities have been recently incorporated in the rules on minimum withdrawals and qualified default investments.

The tax treatment of annuities is identified as an important, but not the deciding, factor in individual decisions to purchase annuities. Tax treatment is found to be largely linked to the source of income used for the purchase rather than the characteristics of the annuity product. Several cases (Denmark, Japan and Belgium) are cited as indicating how favorable tax treatment of lump sum distributions is associated with limited development of annuity markets. Differing allocations of annuity payments to non-taxed return of premium and taxable interest are also noted and differing tax treatment arising from guarantees and control of the underlying investments are also noted especially in relation to “guaranteed withdrawal benefits”.

The paper notes that the fiduciary provisions of private pension regulation that may either treat an annuity selection decision as a fiduciary act or the provision of an annuity option as implicit investment advice are associated with low rates of annuity purchases in private plans. It also suggests that limited information disclosure and consumer protection are factors constraining the development of the market.

The paper discusses in greater depth regulation on the investment, solvency and reserve requirements for annuities. In this regard it notes the potential imitations imposed by restrictions on hedging and the use of derivatives in the backing of annuities and the associated reserve and collateral requirements as potentially limiting insurer’s willingness to offer these products. Similarly it notes the potentially restrictive effects of reserve and solvency requirements that are developed in a form applied to all contracts rather than tailored to individual circumstances.

PROPOSED COMMENTS

1) The review of markets and observations presented in the note provide a useful introduction to the topic. They are however relatively limited in scope addressing only a handful of countries and attributes of annuity products. In the paper to be presented in June it would be very helpful to have a more comprehensive and in depth discussion of the products and markets that are now emerging in OECD countries. The roundtable presentations and discussion indicate a great deal of innovation in various kinds of products in regard to timing of the receipt of annuity payment, participation in the underlying investment experience and types of minimum payment or lifetime guarantees. It
would be extremely useful to have this kind of information surveying the current market developed and displayed in a more comprehensive form, both for information purposes as well as to provide a foundation for any subsequent analysis of relationships between conditions, products, regulation and utilization.

2) Most useful for private pension policy analysis purposes is the documentation and consideration of how the regulatory regimes in different countries treat the plan sponsor’s role in making an annuity product available and encouraging its use. The manner in which prudential rules are linked to tax treatment and review of innovations in this area would be particularly useful.

3) While interesting from a broader policy perspective, solvency, reserve and other investment related rules are generally of less concern to the operation of the private pension system and more appropriately a focus of insurance regulation. These issues are therefore more in the domain of the IPPC rather than the Working Party and should not be a primary focus of the work undertaken under the aegis of the Working Party on Private Pensions.