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Shopping around

The open market option is proving a great success however some people still need help

By Roy Durrant

Towers Watson's recently published analysis of the annuities market indicates that sales of enhanced annuities market indicates that sales of enhanced annuities rose by 31.9 per cent in 2008 to £1.44bn and now account for more than a quarter of annuities sold on the open market.

Clients do not need to be suffering from life-threatening diseases such as cancer or heart disease to qualify for an enhanced rate. In short, smoker rates and the consideration of other 'mild' impairments are making enhanced annuities more attractive. The selling of standard annuities should give way to a more tailored approach which recognises an individual's particular requirements.

Conventional annuities have traditionally used the early deaths of already sick people to subsidise the rest of the provider's annuity customer base. This is known as the "mortality cross subsidy" and is patently unfair.

The arrival in the market of enhanced annuity specialists like MGM Advantage and Partnership combined with IFA's growing understanding of the benefits of enhanced annuities, has made some providers realise that they may lose those conventional annuity customers who could actually qualify for an enhanced rate. This has led to some of the more conventional annuity providers like Aviva and Legal & General also starting to play in this arena.

In addition, the increasing number of people who are shopping around for annuities

using the open market option is seeing a reduction in the number of pensioners who are automatically moved into a conventional or lifetime annuity by their existing pension provider.

The Association of British Insurers figures for OMO annuity purchase was 35 per cent. This may seem a low figure but that is not the number of people who have used the open market option, it is the number of people who have used the open market option and have subsequently bought an annuity from another provider.

The FSA has twice done research that identifies a consistent three-way split. This is where you have one-third of people who will shop around and subsequently stay with their pension provider; one-third who will shop around and subsequently move; and one-third who do not appear to be making any active purchase decision. Our efforts should concentrate on making sure people in the last third have not made an active purchased decision, are fully aware of the options. But it is not just serious illnesses like cancer and heart disease that can give your clients an enhanced rate.

For example, some providers' enhanced annuity under-writing systems assess 3000 medical conditions, including smokers. If someone smokes more than 10 cigarettes a day, they will probably qualify for an enhanced rate, which could increase their annual retirement income by 19 per cent.

The common quotation form has facilitated this approach by making it possible for advisers to complete just one medical

questionnaire for their clients and send it off to all the enhanced and impaired annuity providers. The CQF addresses four main sets of health conditions in detail: diabetes, cancer, heart conditions and strokes. These conditions cover the majority of medical situations submitted to annuity providers, whose medical underwriters stipulate the need for ever more detailed information.

Providing an accurate picture of someone's medical history and current health really will help you find the best possible retirement income for your clients.

Of course, there will always be people who outlive expectations and also those who die much earlier than predicted. But, there will be far fewer "winners and losers" with an enhanced annuity compared to those forced to accept the "standard" features of a conventional annuity.

As IFAs we should be conscious of all the annuity options available to our clients and investigate thoroughly rather than relying on a comparison site and accepting the rates quoted. Calculating an impaired annuity is not an exact science and you can still negotiate once rates have been issued.

A factor to consider is the increasing popularity of the unsecured pension and fixed term annuity contracts which defer a lifetime annuity purchase. This will naturally result in clients being older when considering lifetime annuities, with the likely health issues that manifest with age. I expect this will also add to the increasing use of enhanced annuities.

As more providers offer enhanced annuities and underwriting systems become more sophisticated, personalised annuities are set to become more accessible to IFAs and their clients.

The range of impairments has increased to cover mild as well as severe conditions and more people facing retirement are becoming

aware of this and understanding the difference an enhanced annuity could make to their annual income.

Over the past couple of years the ABI's OMO campaign has aimed at driving down pension transfer times. When they carried out a survey for the industry average back in 2007, it was 31 calendar days. Now the 2009 fourth-quarter figures show it is down to 11 calendar days for OMO transfers.

Sales of impaired and enhanced annuities will continue to grow as people shop around more for the best deals. This is all good news for those facing retirement.