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How a Developing Actuary Defines Today's U.K. Annuity Market

By Caroline Liu

The evolution of the annuity market in the United Kingdom is strikingly similar to one's progression through the actuarial examination system, as I have learned over my first 18 months working in the United Kingdom.

Let's begin the development of my realization of this parallelism.

It all began with the 1956 Finance Act, which opened the doors to the compulsory annuity (also known as Compulsory Purchase Annuity, or CPA) market in the United Kingdom. It was this act that allowed the Defined Contribution plan to become a truly viable option for retirement income by granting tax relief to such schemes while requiring the funds to be annuitized at retirement. Similar to actuarial students taking their first exam, companies became aware of the potential monetary benefits that awaited them in the seemingly distant future. At that moment, each was an actuarial infant, if you will, of the game. One is both doubtful and afraid of being the first of his or her peers to enter the market, and similarly, register for the exam. It's hard to know what to expect and exactly how much time and effort is enough to succeed. And often in the initial phase, it's difficult for some not to compensate for their fears by overanalyzing the situation or over-studying. Hopefully, for the few that do end up initiating themselves, the final resolve comes that one really just needs to have faith in oneself to attempt that first hurdle.

There are simplified rules and definitions, of course, that aid today's annuity provider and actuarial student. An explanation of the path to becoming an actuary, for example, is the requirement of the successful completion of a series of examinations and a minimum number of professional development hours. Likewise, an annuity is basically a series of payments, usually guaranteed for life but sometimes for a fixed term. The payments may be level, increasing, decreasing (depending on the spousal percentage options), or linked to an investment fund. Also, the current U.K. rules for CPAs obligate the purchase of an annuity between ages 55 and 75.

Those are just the basics. Once you enter the market, it doesn't stop there. You soon realize you are competing with the best of the best risk managers, statisticians, and economists, all vying for the same limited number of "pass marks" in a multi-billion pound market. There are admittedly more overachieving types who have the ability to repeatedly pass several exams simultaneously than firms, or even pricing actuaries, who continuously maintain the best annuity rates in the market, but the latter do exist. Eventually, an unsustainable investment outlook, the risk of severe operational inefficiencies, and a combination of internal and external pressures will bring a long-time leading company back in line with its competitors. From many come few. Those less diligent are driven out, leaving an increasingly elite group. Annuity rates are viciously competitive in the United Kingdom, to the extent that a 2 percent difference in the periodic annuity payment can take a company from first to fifth place overnight. Last year alone, the top five annuity providers adjusted their conventional annuity rates almost 70 times! That averages to over 13 times a year per provider.

A couple of years' experience in the system and now you've got some momentum. Your confidence increases as you realize you can keep up with the big boys by continuing to pass exams

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and being acknowledged as a solid competitor in the market. You start to recognize the same faces in the exam room, at professional development events, in sales and marketing conferences, and on board committees. You grow more comfortable and stable.

Undoubtedly, the steady passing of exams doesn't come without its challenges. Just as the annuity industry must evolve to meet the demands of its clients, competitors, and regulators, so too must the actuarial candidate adapt to changes to the examination process. Is more experience going to be required in the future? How do the new rules affect my organization and me? How can I best approach and possibly capitalize on my new situation? Rapid memorization and only a basic understanding are no longer enough to get by, let alone sustain one's foothold. Coincidentally, in the same year as the CA3, or Communications exam, is offered for the last time as a three-hour written exam and is replaced by a two-day course, so too do the Institute of Actuaries and the Faculty of Actuaries propose an increase in the Professional Development requirements for actuaries practicing in the United Kingdom. Further, in the same month the exam is last offered, the minimum annuitant age of 50 is raised to age 55, so that the market is flooded with annuitants hurrying to retire early and likely a record number of students registering for the CA3 exam for the April 2010 sitting.

A more serious issue affecting the annuities industry today is the implementation of the new Solvency II (SII) regulation by the European Commission. SII is an update to the former set of capital requirements and attempts to unify insurance services in the EU by setting a consistent economic basis for the valuation of assets and liabilities using a risk-based approach. It also enforces higher levels of consumer protection and capital adequacy in an effort to promote the overall financial stability of the industry. Although SII does not formally come into effect until late 2012, its ramifications compel insurers to prepare for it well in advance. This regulation cannot be outlined here in the details with which it deserves; suffice it to say, it will have significant effects on the entire European annuity industry and has been affectionately termed the "Basel for Insurers."

Developing actuarial students are often employed, so they must learn to optimize their time to succeed in the exam room, at the office, and at home. The ability to nourish both one's professional and personal lives is a real skill, as many of us will remember. Passing one exam is only one small step in becoming an actuary, just as learning how to price one type of annuity will only get a company so far. In the United Kingdom, for example, it became apparent that pricing by age, gender, and fund size was no longer enough to capture the mortality risk accurately. Improving longevity and fierce competition forced the introduction of new rating factors, so providers sought to improve their pricing sophistication. Notably, in 1995, Stalwart launched the first smoker annuity, while Partnership Assurance (formerly the Pension Assured Friendly Society) offered the first enhanced annuity, or one based on medical factors. Milestones in annuity pricing continued with the aggressive launch of postcode pricing by Legal & General and, not unlike study groups that are formed to encourage fellow students in

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their exam endeavours, annuity providers co-operated with each other to design the Industry Common Medical Form. This questionnaire for enhanced annuities has enabled the retrieval of better quality health information.

Certainly, in the last five years, the U.K. annuity market has undergone a massive phase of evolution, especially with the expansion of the enhanced annuity market. A myriad of rating factors varying from postcode, marital status, and occupation, to lifestyle factors (e.g., smoking, body mass index, hypertension, diabetes, and high cholesterol) to even more serious medical conditions is now becoming the norm.

Ask any actuarial student who has ever failed an exam and he or she will describe a feeling not too different than that experienced by providers who have invested heavily in the marketing and development of the U.S.–styled variable annuities. While conventional, postcode, and enhanced annuities constitute the bulk of the market, this product has struggled in an area already rich in diversity, and may ultimately end up being stripped down and simplified by providers in the United Kingdom, possibly then becoming a realistic export!

Like the future of a newly qualified actuary, the outlook of the U.K. annuity market looks promising at the least, with over £10.8 billion in premiums last year, according to the Association of British Insurers (ABI), and a forecast of £18 billion by 2012. The innovations continue with more sophisticated online quoting tools and are expected to tighten the market even more as companies scramble to find the next best thing.

So, what is the moral of this story? That one's goals should be clear in order to achieve success. That innovation and perseverance can help both the actuarial student and insurance company to excel. And that it takes hard work and serious dedication, not to mention courage, to become an actuary, particularly one who has decided to focus her attention on the rapidly evolving annuity market in the United Kingdom. Hats off to all the actuarial students and annuity providers for their relentless efforts. And three final words for this small fish who has recently crossed the pond: Wish me luck! □

Frequency of Conventional and Postcode Annuity Rate Changes in 2009

Company	Number of Changes
Aviva	16
Prudential	14
Legal & General	13
Canada Life	13
AEGON Scottish Equitable	11
TOTAL	67

Source: Legal & General

ABI 2009 New Premium for Top 5 Annuity Providers

Company	New Premium (£million)	% of Total ABI
Prudential	2,189	20.2
Aviva	1,688	15.6
AEGON Scottish Equitable	1,185	10.9
Legal & General	1,033	9.5
Canada Life	760	7.0
TOTAL ABI Companies	10,835	63.3

Source: Association of British Insurers