U.K. life insurers to suffer as forced annuitization ends

By Editorial Staff *Thu, Feb 19, 2015*

The major life insurers are expected to be profitable, according to Thomson Reuters data, but profits at Aviva, Friends Life and Legal & General are expected to be flat year-over-year instead of rising.

Last spring, the British government officially ended the nation's mandatory annuity purchase policy, and the effects are expected to become evident as UK life insurers begin reporting their 2014 results in the coming weeks.

Britain's Chancellor of the Exchequer, the equivalent of our Treasury Secretary, last year surprised the life insurance industry with plans to end the policy of requiring many workers to buy a life annuity by age 75 with any remaining money in their tax-deferred defined contribution savings accounts. The new policy goes into effect this April.

Many working-class Britons simply bought a life annuity at retirement age from their DC plan provider, without even shopping for the best price on an exchange, and the annuity sales were a big source of income for insurers. (The law allowed for some flexibility. People who could demonstrate that they weren't at risk of outliving their money generally had more leeway in the disposal of their tax-deferred savings.)

The disappearance of that requirement now threatens what was a £12 billion ($18.55 billion) market. Even though the changes don't take effect for several weeks, some annuity providers told Reuters a few months ago that sales were down 50% to 60%. Analysts estimate the drop off could now be more than 80%.

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Insurers and asset managers say the proposals do create opportunity for new product sales, such as "drawdown pensions enabling pensioners to decide how much they want to withdraw each year." But those products are not as profitable as life annuities.

"An annuity is about 10 times as profitable as a pension," Gordon Aitken, analyst at RBC, told Reuters, adding that the changes could take a few years to have a deep impact on profits. The changes are likely to reduce the industry's aggregate profit potential, according to Credit Suisse analysts.

Those hardest hit are expected to be annuity specialists such as Partnership Assurance and Just Retirement. There’s been speculation that the two private equity-backed firms might be put up for sale. Partnership Assurance reports its results on March 3. Just Retirement issues half-year results on Feb 24. Aviva took action to strengthen its position with the $8.8 billion planned acquisition of Friends Life late last year. These two firms report annual results on March 5.

L&G is increasing its focus on bulk annuities, taking on the risk of defined benefit corporate pension schemes, and this month entered the market for lifetime mortgages. Standard Life, which just purchased the financial advisory firm, Pearson Jones, reports annual results this Friday. Prudential plc, owner of Jackson National Life in the U.S. (and no relation to Prudential Financial), which has a stronger focus on Asia than on Britain, is due to report on March 10.