

Investment News

Monthly Bulletin from the Insurance & Investment Team

October 2018

Last Month in Brief

The Italian government announced plans to maintain a budget deficit of 2.4% of GDP for the next three years, causing Italian bond yields to increase significantly and a fall in the Euro of 2%.

Following Theresa May's Brexit statement on 21 September the value of the pound against the dollar fell, driven by market fears of a no deal Brexit. After briefly rallying, the pound continued to fall, and has fallen to \$1.28 since the end of September.

Oil prices hit four-year highs, driven by fears of reduced supply following sanctions the US intend to implement on Iran in November. This has been exacerbated by oil suppliers stating they do not intend to increase production, despite protests from President Trump.

The Office for National Statistics published its quarterly GDP estimate for the UK. Growth in quarter 2 was estimated as 0.4%, while growth in quarter 1 was revised down from 0.2% to 0.1%. This growth was driven by increases in household spending of 0.4%, however business investment decreased 0.7%. The underlying trend was described as a "slowing of real GDP growth".

Chart 1: Equity Indices

All markets fell during September, before regaining their value.

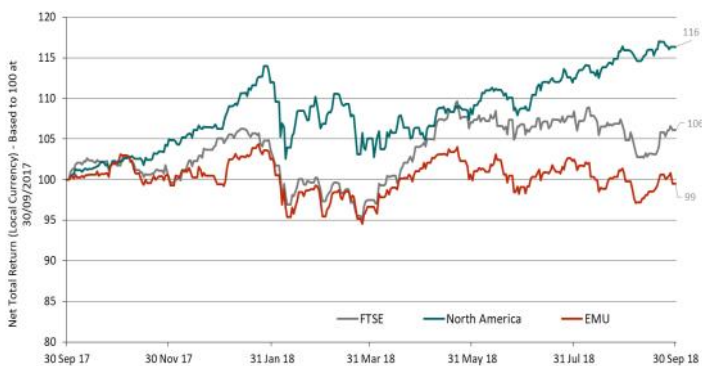


Chart 2: Sterling Credit Spreads

Spreads were stable over the month.



Chart 3: Gilt Yields

Nominal gilt yields for both 5 and 25 year bonds rose over September, while real yields ended the month largely unchanged from their yield at the end of August.

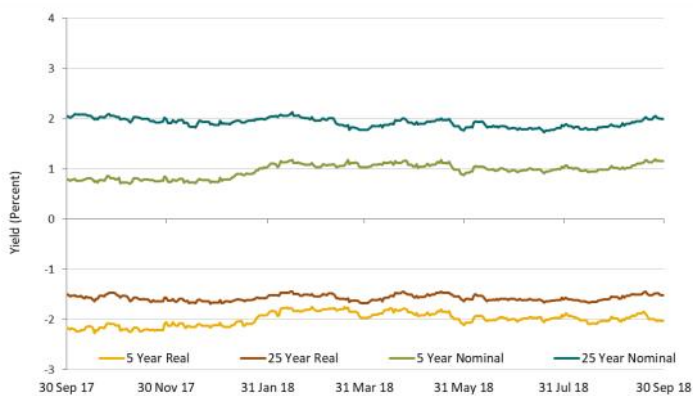
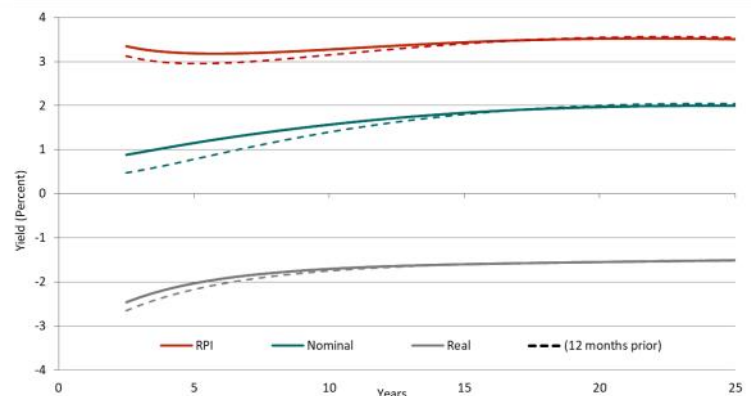


Chart 4: Gilt Spot Curves

The inflation and nominal gilt yield curves increased over September. At shorter durations, the real yields fell over the month, but was more stable for the longer durations.



Source: Bloomberg, Business Insider, MSCI, Merrill Lynch Bank of America and Bank of England.

	Latest	Previous		Latest	Previous
CPI (annual change)	+2.4%	+2.3%	Base rate	0.75%	0.75%
PPF 7800 funding ratio	97.7%	96.1%	\$/£ exchange rate	1.30	1.30
Halifax house prices (monthly change)*	-1.4%	+0.1%	VIX (volatility) index	12.12	12.86

For monthly published indices "Latest" and "Previous" refers to the two most recently published statistics, otherwise numbers are quoted as at the month end.

Pensions Freedom – 3 years on

Introduction to pensions freedoms

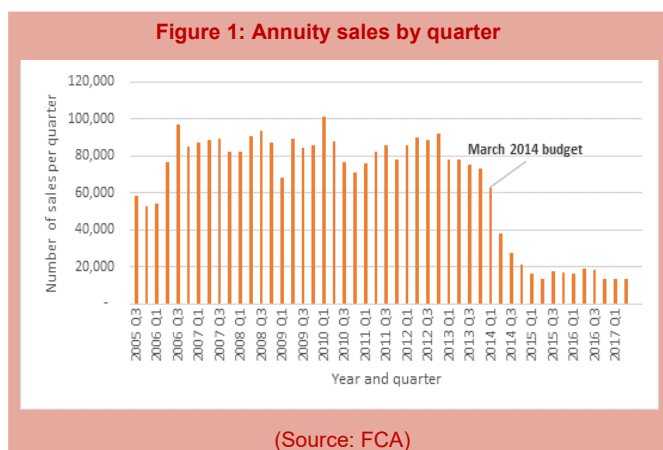
In the budget of March 2014, then Chancellor of the Exchequer, George Osborne, announced plans to remove restrictions on how pensioners could access their Defined Contribution (DC) pensions from April 2015. This gave pensioners greater freedom on the amount and timing of drawing their pension. Importantly, this meant that pensioners no longer had to purchase an annuity with their pension pots.

Shortly after the announcement, the FCA published its early views on what it saw as possible innovation areas in the retirement income market resulting from the pension freedoms legislation. Areas it thought providers might focus on were individually underwritten annuities, managed drawdown products and hybrid guaranteed products that offered varying degrees of guarantees on capital and income.

Effect of freedoms

Since April 2015, pensions flexibilities have been highly utilised and this continues to grow. Her Majesty's Revenue and Customs (HMRC) figures show the number of flexible payments made from pensions has increased from 516,000 in 2015/16 to 1,791,000 in 2017/18 and the total value of these payments increased by 48% over the same period. By contrast, sales of annuities have fallen. Data published by the Financial Conduct Authority (FCA) shows an immediate and sustained fall in annuity sales after the March 2014 Budget (Figure 1) and that from October 2015 to March 2018, only 13% of people accessing their pensions purchased annuities.

Figure 1: Annuity sales by quarter



It should be noted that the fall in annuity sales is also linked to the state of the annuity market. Due to consistently low interest rates and gilt yields over the past few years, annuity rates offered have been low, which will undoubtedly reduce demand for these products.

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Furthermore, with interest rates expected to gradually rise in the coming years, many pensioners may be waiting for annuity rates to improve before choosing to purchase these products. Thus, Pension Freedom may be allowing them to postpone an annuity purchase until it will provide a greater benefit and if annuity rates rise we may see an increase in annuity sales.

What can we expect in the future

In a House of Commons Work and Pensions Committee report 'Pension Freedoms' (published 5th April 2018) the FCA stated that "product innovation has been limited to date". The report also found that whilst sales of drawdown products have increased, innovation has remained largely absent which is surprising given the high take-up of Pensions Freedoms.

Some providers have started to make small changes to their existing offerings, such as guided pathways (or lifestyle strategies) to help consumers explore retirement options.

There is expected to be further development of automated advice – or "robo-advice". Robo-advice can be used to reduce advisor costs, both to non-advised consumers and those receiving professional advice. Robo-advice offers economies of scale and efficiencies, whilst helping to deliver consistent standards of advice to the mass market. There are some financial advice networks which are upgrading their platforms to provide robo-advice to their clients.

The FCA is considering introducing rules to ensure that providers' default investment pathway does not simply move a consumer's pension to cash or cash-like assets as they approach retirement and will instead require pension providers to develop ready-made investment pathways.

These would be standardised products designed to meet consumer objectives, such as providing an income in retirement, taking money over a short period of time or keeping money invested with occasional access. The FCA believes that these outcome-focused pathways will lead to better consumer outcomes.

The pensions industry is developing the pensions dashboard which is due for launch in 2019. This dashboard aims to allow consumers to look at their total pension wealth across all of their pension pots and help them decide what to do with them at retirement. Combined with the above innovations, this should help guide them towards the best options.

Conclusion

Pensions Freedom has led to vast changes in how consumers access their pensions, with huge reductions in annuity purchases and greater flexibility in access. Whilst product innovation has been slower than expected the incentives to innovate are growing and should result in more options for consumers in future.

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