Book Review

Annuity markets

Edmund Cannon and Ian Tonks

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This is a good and thorough study of the development and aspects of annuity markets. The authors have set out, according to the preface of the book, to provide a broad overview of annuity markets for academics, researchers and practitioners – and they have succeeded in producing a volume that gives a detailed exposition of the various aspects of annuity markets and that includes a lot of useful statistical analysis and data.

The treatment of the subject matter is academic in places, and this probably reflects the authors' own approach. They are themselves academics: Cannon is a reader in economics at Bristol University, and Ian Tonks is a professor of Finance at the University of Exeter. This shows in the way the book has been put together: as the authors put it in the introduction, the book could serve as a text for an advanced undergraduate or Masters level unit on annuities or pensions. The structure as set out in 11 chapters would fit neatly into a single semester.

The reason why a book on this subject is timely will be obvious to anyone involved in the pensions industry. As the authors explain in their preface, governments around the world are shifting their pension policies away from pay-as-you-go systems towards individual savings schemes, which need to be converted into pensions at retirement. It is this function that is provided by annuity markets, and as the provision of retirement benefits in more and more countries is being shifted towards private sector provision, the importance and relevance

of annuity markets (in an international context) grows.

As mentioned above, the book is divided into 11 chapters. Chapter 1 provides a brief explanation of what annuity markets are, and puts the concept into the broader pensions context. Chapter 2 gives a helpful overview of the different types of annuities available on the market (with an emphasis on the UK market).

Chapter 3 provides a short history of annuities from classical times up to the present day. It makes an important general point: compulsory purchase of annuities has become more unpopular over time among those wishing to take retirement, due to the decline in annuity rates since the 1980s. Despite its relative unpopularity, the UK government, for instance, remains committed to using annuities for a number of reasons. One is that it is a good way to pool risks, but annuities also ensure that people continue to receive an income from their savings no matter how long they live, while tax relief on pension contributions ensures that people can save for an income in retirement – not for any other purpose.

Chapter 4 reviews the relevant actuarial background to the annuity market, with Chapter 5 setting the annuity markets in an international perspective. Not surprisingly, it is those countries with a developed private occupational pensions sector that have large annuity markets. Countries in which state-provided pensions cover most of the workforce tend to have small to very small annuity markets. This chapter contains useful statistical material on the extent to which the

life insurance industry (as providers of annuities) has penetrated the relevant countries' domestic economy as measured by the share of a country's GDP taken up by gross premiums paid in the life insurance industry. Just to give an idea: whereas for 2004 this figure expressed as a percentage for the United Kingdom stands at 9.8 per cent, in Germany (where in 2001 annuities formed only 1.5 per cent of pensioners' incomes) that figure stood at a much lower 3.9 per cent.

The remaining chapters, 5–10, are among the most technical chapters in the book. This is perhaps not surprising, as they are in large measure concerned with the economic theory of annuity demand, including the regulation of annuity providers.

Chapter 11 provides the authors' conclusion, in which they draw the main strands of the previous 10 chapters together. One point is worth emphasising: annuity markets are likely to grow in size in future, as more countries try to strengthen the private occupational element of pension provision. Clearly, as this sector grows, various issues will need to be resolved. For example, annuity markets are highly regulated and

highly concentrated, and in the United Kingdom one firm accounts for 23 per cent of the annuity provider market. As annuity demand grows, it may be difficult for a small number of annuity providers to absorb the extra capacity. Clearly, this is a case of 'watch this space', but it would be good if in any future edition of this book Cannon and Tonks were to update the readers on whether and how this question might be resolved.

It should be said that the book is not always easy to read due to the technical nature of its content (and the liberal use of mathematical formulae in places), although this is to be expected in a book that was produced partly as an academic treatment of its subject matter.

On the whole, however, this is a worthwhile work to have as part of any pension practitioners' library – if only to dip into as a reference point for useful information on the subject of annuity markets.

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