Standard Life

Standard Life plc

Response to:

Creating a secondary annuity market

18 June 2015

Response

Executive Summary

Standard Life supports strongly the Government's agenda of giving pension savers greater freedom and choice over how and when they access their retirement income. Allied with key reforms like automatic enrolment, we believe the changes introduced on 6 April 2015 have the potential to transform long-term savings in the UK and secure more prosperous retirements for millions of individuals.

We understand the proposals put forward in this consultation paper seek to build on the wider freedom and choice agenda, and we recognise the logic of providing consumers with the option of surrendering their annuities in return for a cash payment.

However, as the consultation paper acknowledges, this proposal entails significant challenges and risks. In particular, the viability of a secondary market – i.e. where such a market provides good value to those who would most benefit – appears highly questionable. Put simply, while it might make sense for someone in poor health to seek to 'cash in' their annuity, it is difficult to envisage a third party buyer wanting to participate in such a transaction either at all, or at a rate that is palatable to the individual.

Our response seeks to expand on these challenges and risks. In particular, we would draw your attention to the following key issues:

- Requirement to take independent financial advice – while there are some scenarios where assignment might lead to positive outcomes for particular customers, we have concerns that behavioural biases may lead to poor outcomes for a number of individuals. This risk is particularly acute for customers whose short-term need or desire for a lump sum outweighs proper consideration of the long-term benefits of their annuity.

  This underscores the need for strong consumer protection measures, including a requirement for individuals to take financial advice before surrendering their annuity. It would make sense if these safeguards were broadly consistent with those set out by the FCA in its policy statement PS15/4 regarding the treatment of safeguarded (DB) pensions in relation to pension transfers.

  However, even with this additional level of protection, the risk remains that some individuals will make poor decisions. Similar to the current advice process for DB transfers, it is possible that some individuals will want to proceed with the transaction despite receiving financial advice to the contrary, with obvious detriment risks to them as a consequence.

- Conditions attached to terminating annuities – we support the proposal to prevent annuity holders from terminating their annuity contract with their existing provider. In addition, life companies should not be obliged to terminate annuity contracts upon request from the 3rd party purchaser. Allowing terminations in either of these scenarios would likely result in a deterioration in the terms offered to customers as a consequence of increased capital requirements for providers and/or reductions in available yields.

- Provider charges - We broadly agree with the proposed approach of the Government working with the FCA to monitor the fees and charges applied by providers when facilitating a transfer. Clearly any fees and charges that annuity providers impose would need to align with the financial and conduct risks they are being asked to undertake and the services they are being asked to provide - e.g. the extent to which the original annuity provider is responsible for ensuring the overall transaction is compliant and appropriate to the customer and their circumstances. We disagree, however, with the suggestion in the consultation paper that providers may simply absorb some of the related administrative costs and would question strongly the justification for this.

Enabling original annuity providers to 'buy back' annuities – The original annuity provider may be able to offer more favourable terms given its existing relationship with the customer and its associated knowledge of the customer's circumstances.

The fixed overheads associated with managing annuities on an ongoing basis and incurred by the incumbent provider may mean that the existing provider can offer the 'best' price for customers, especially where relatively small amounts are concerned. Given this, the Government should consider establishing a triviality limit (in the region of, say, £10k), below which the original provider is allowed to participate in buy back.

We recognise, however, that certain measures would be required to properly protect the consumer and in particular to guard against potential customer inertia with regards to shopping around.

- Extending the rights to others - In the interests of fairness and developing a healthy market, the Government will need to consider extending these rights to other sources of lifetime income, in particular members of occupational pension schemes.

  As a secondary market essentially involves the redirecting of income from one source (the individual) to another (the third party buyer), there would appear to be limited/no impact on the economic health of the scheme, and it therefore seems difficult to justify the exclusion of individuals in such schemes. Enabling members of occupational schemes to participate would potentially support the needs of a wider group of consumers and could serve to maximise competitive pressures in any market that develops.

  This also raises the question of whether people in DB schemes should have the ability to reassign their income to a third party. Like annuitants, DB members have a fixed income stream for life and, as with occupational pensions, reassignment would appear to have limited impact on the scheme itself.

- Supporting good customer outcomes – There is a growing perception that annuities represent poor value, but the secure income for life that an annuity provides will remain an appropriate option for many new and existing retirees. Extending freedom and choice to existing annuitants may reinforce the perception of annuities offering poor value, resulting in customers making choices based on preconceptions rather than properly informed judgements.

  As a consequence, the extended freedoms need to be balanced with a responsibility to educate and raise awareness of the value of a secure income for life as one of the retirement options a saver needs to consider, and also to give assurance to those retaining their annuity that it can deliver a good outcome. There is a clear role for the Government to help deliver this message, in partnership with key organisations such as the Pension Wise service.

- Implementation – Given the complexity of the issues identified, it is important to allow sufficient time for any changes to be implemented. As such, we feel that the provisional implementation date of April 2016 may be too soon, particularly as the wider industry continues to adapt to the introduction of the new pension flexibilities. Indeed, the challenges that have arisen following the 6 April changes highlight the benefits for all parties – government, regulators, industry and, above all, consumers -- of a longer implementation timetable.

Responses to questions

Chapter 2: A new secondary market for annuities

1) In what circumstances do you think it would be appropriate to assign one's rights to their annuity income?

The case studies outlined in box 2.A of the consultation paper illustrate examples of where it might be appropriate to assign rights to annuity income.

In both cases the customers are otherwise financially secure and the annuity is not their main source of income. An annuity might have been the right option at the point in time that the original purchase was made, but the customer may now want to take advantage of the more flexible options that were not previously available. We would question, however, the extent to which the type of customer described in the case studies is representative of the wider population.

Assigning rights may also be appropriate for customers who require a lump sum at a particular point in time due to a change in personal circumstances. The suitability of this, however, would be highly dependent upon the individuals' circumstances. For example, the option to commute the annuity value into a flexi-access drawdown plan will be particularly appealing to customers who may benefit from lower overall taxation by managing their tax position while alive, or passing assets on to dependants on their death.

In all cases, we agree with the principle that customers should receive financial advice to help ensure they are making the right decision (see response to Q.10).

2) Do you agree with the Government's proposed approach of allowing a wide range of corporate entities to purchase annuity income in order to allow a wide market to develop, whilst restricting retail investment due to the complexity of the product? What entities should be permitted and not permitted to purchase annuity income and why?

We agree with the Government's ambition to create a wide market to stimulate competition, as this is fundamentally in the best interests of the consumer.

However, we are concerned that there may, in reality, be a very limited market of 'good' third party buyers due to a combination of factors including scale issues, inefficiencies in gaining credit exposure to providers and limited hedging characteristics. The upshot of this may be the prevalence of 'bad' buyers who seek to exploit information asymmetry with customers who are anxious to cash in their annuity.

We also think it would be sensible to restrict retail investment due largely to the complexities of initial risk assessment. As a possible way of stimulating further competition, we suggest the Government should consider options such as pooled investment vehicles for sophisticated / informed retail investors.

The corporate entities that are allowed to participate in this market should be determined in large part by their capability to meet the requirements and to support a properly functioning and orderly market. We would expect organisations interacting with retail customers (either acting in isolation or collectively) to have proper and robust processes in place, such as underwriting and governance & controls, and to be fully regulated. The Government will also need to give careful consideration to the company's statutory ability to participate, whether by extending existing permissions or creating new ones.

3) Do you agree that the Government should not allow annuity holders to access the value of their annuity by agreeing to terminate their annuity contract with their existing annuity provider ('buy back')? If you think 'buy back' should be permitted, how should the risks set out in Chapter 2 be managed?

We agree strongly that the Government should not give annuity holders the right to terminate their annuity contract with their existing provider. In addition, life companies should not be obliged to terminate annuity contracts upon request from the 3rd party purchaser. Annuities are not valued on the basis of the customer being able to surrender them and much of the value passed to customers depends on this being the case. Allowing termination rights would undermine this benefit and in all likelihood lead to increases in capital requirements, reductions in available yields and, ultimately, a deterioration in terms offered to customers.

We would question, however, the proposal to prevent the original annuity provider from 'buying back' an annuity, particularly in cases where customers have very small pots. The original annuity provider may be able to offer more favourable terms given its existing relationship with the customer and its associated knowledge of the customer's circumstances.

The fixed overheads associated with managing annuities on an ongoing basis and incurred by the incumbent provider may mean that the existing provider can offer the 'best' price for customers, especially where relatively small amounts are concerned. Given this, the Government should consider establishing a triviality limit (in the region of, say, £10k), below which the original provider is allowed to participate in buy back.

We recognise the need to prevent and guard against customer inertia and to properly protect the consumer in such circumstances. This risk could be managed and mitigated by a number of controls, for example:

- regulation to ensure customers are encouraged to shop around; and/or
- promoting the means to do so (e.g. via the use of a panel).

4. Do you agree that the solution to the death notification issue is best resolved by market participants? Is there more the Government should be doing to help address these issues?

Original annuity providers will have to continue to run their own checks to attempt to identify deaths and manage the consequences (including reclamation of overpaid sums). However, we think it should be incumbent on the annuity buyer/purchaser to ensure notification of death, underpinned by a legal responsibility to do so. In the absence of this, it seems that reliance must be placed on alternative means of identification such as the death registration process. Government would need to take steps to ensure this operates effectively.

We believe it is impractical to make the customer responsible for notification of death and the proposed solutions outlined in the consultation document are unlikely to be effective. Having 'sold' their annuity contract, customers are removed from the situation and therefore have no compelling reason to maintain contact.

Bank account notifications work for annuities because the bank account used is usually the customer's main account, and even if they move banks, the annuity will 'move' with it. In the event of an annuity being sold on, however, there will no longer be a direct connection between the customer's account and the annuity, so the annuity provider cannot rely on the bank providing notification of death.

Even if the provider pays a nominal amount to the customer as suggested in the consultation paper, it is not obvious that this will resolve the issue: customers sometimes change their bank account and this "nominal account" might just fall into abeyance rather than being closed; post death an executor might not even know the account exists and it could continue for years before the bank notices (providers would then need to undertake work to determine what happened to the payments, which potentially could have changed hands). We do not believe that offering a financial incentive represents a viable solution to address these fundamental issues.

5. Do you agree with the proposed approach of the Government working with the FCA regarding the fees and charges imposed by annuity providers?

We broadly agree with the proposed approach of the Government working with the FCA. Any fees and charges that annuity providers impose would need to align with the financial and conduct risks that the provider is being asked to undertake and the services that they are being asked to provide - e.g. the extent to which the original annuity provider is also responsible for ensuring the overall transaction is compliant and appropriate to the customer and their circumstances.

We disagree, however, with the statement in 2.23 of the consultation paper that "annuity providers may absorb some of these [administration] costs." Whilst, as noted above, suitable scrutiny is required to ensure fees are reflective of actual costs, we would question strongly the notion that providers should have to shoulder any costs.

6. Do you agree that the scope of this measure should be annuities in the name of the annuity holder and held outside an occupational pension scheme?

The underlying need of customers for whom assigning income is both appropriate and attractive does not depend on the source of that income per se.

Although demand amongst annuitants for such a service might appear high, it is likely in our view that the number of customers for whom such a transaction will be both appropriate and valuable may in reality be limited. In addition, recent developments in the retirement market suggest that future growth in demand for such a service will also be limited.

On the specific issue of occupational schemes, we believe there is a case for including members of such schemes within scope – please see our response to Q7 for details.

7. Are there any other types of products which it would be appropriate for the Government to extend these reforms?

In the interests of fairness and developing a healthy market, the Government will need to consider extending these rights to other sources of lifetime income, in particular members of occupational pension schemes.

There are three principal reasons for this:

- Excluding occupational (and DB) schemes reduces the size and, consequently, the potential viability of the market.
- Customer needs in these schemes are broadly the same as those in contract DC arrangements, so members of such schemes risk being unfairly penalised by not having the same options available to them.
- As this is a secondary market, there is no material impact on the economic health of the occupational (or DB) scheme, except identifying when the individual has died (i.e. any financial 'risk' resides with the third party buyer, not the scheme itself).

Specific legal points

In addition to our responses above, we would like to make the following comments and observations on some specific legal points that the consultation raises.

<u>Paragraphs 2.19 to 2.22 on ceasing payments</u>

Given that the annuity provider is less likely to receive a timeous notification of death, the provider needs protection against scheme sanction charges for unauthorised payments of annuity. The current protection (see link below) lasts six months after death and would in our view be inadequate. We would instead suggest that a two year period is appropriate.

http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM09108020.htm

2.23 and consent to assignation

The paper acknowledges that annuity providers might have concerns about agreeing to assignations without express consent from named secondary beneficiaries.

Providers would also be concerned about agreeing to an assignment when this is contrary to a prohibition that was included in the policy wording in accordance with the statutory requirements at the time and at the express request of the trustees who proposed for the policy. This could probably be addressed by introducing an overriding 'permissive' provision that allows an annuity provider to consent to an assignation (along the lines of the flexibility 'permissive' provision).

Given that it is intended to prohibit the assignation of pensions (that are not secured by an annuity) and annuities held by the trustees, trustees might be uneasy about agreeing to policy terms that allow an annuitant to do so outside of the scheme. This could be covered by altering the legislation to expressly allow trustees to agree to these policy terms.

Chapter 3: Legislative changes

8. Do you agree that the design of the system outlined in Chapter 3 achieves parity between those who will be able to access their pension flexibly and those who will be able to access their annuity flexibly? Are there any other tax rules which the Government would need to apply to individuals who had assigned their annuity income?

We agree that the design offers broad parity. We have not identified any tax rules that the Government would need to apply but the position with Capital Gains Tax needs to be explained and our view is that the legislative amendments to DWP pension statutes would need to be more extensive.

9. How should the government strike an appropriate balance between countering tax avoidance and allowing a market to develop?

The imposition of responsibilities on the buyer to inform the seller of the tax consequences and the buyer's requirement to deduct/account for tax on lump sum payments should not, in themselves, impede the development of a market.

Specific legal points

3.1 and amendments to legislation

The consultation paper is correct that the main impediment to assignation is in the tax rules and some DWP secondary legislation. There are however other DWP pensions law provisions that need to be considered including section 159 of the Pension Schemes Act 1993 (prevents assignation of guaranteed minimum pensions), section 91 of the Pensions Act 1995 (prevents assignation of pension rights under a scheme (and, by implication requires the trustees to follow that through into the terms of immediate annuities in the pensioner's name)) and section 19/81 of the PSA93 (covering buy-outs).

3.3 and the status of the purchase price received by the annuitant

We would welcome clarity on the following issue: If the purchase price of a flexible annuity is paid by the buyer (on the individual's behalf) without it being routed through a registered pension scheme, can an insurer apply the premium to its pension business under sections 57 and 58 of the Finance Act 2012?

Chapter 4: Consumer protection

10. What consumer safeguards are appropriate?

Decisions regarding annuity assignment are highly complex and consumers will need appropriate support to ensure that their decision is suitable. There are some scenarios where assignment might lead to positive outcomes for particular customers. However, we have concerns that behavioural biases may lead to poor outcomes for a number of customers. This risk is particularly acute for customers whose short-term need or desire for a lump sum outweighs proper consideration of the long-term benefits of their annuity.

It is important that facilitating the assignment of annuities is fully regulated and HMT and the FCA should review and confirm that the existing Regulated Activities Order is sufficient to capture this activity. Clear regulation is critical, as this market could attract purchasers/facilitators who are new to the financial services market.

It is our view that annuities should be treated consistently with safeguarded benefits in pension transfers. As such, a consumer should be required to obtain advice where the annuity provides benefits of c. £1,500 or more per annum. This is approximately the income that a £30,000 pension pot would provide and would be in line with the requirement to seek advice where a pension pot with safeguarded benefits attached exceeds £30,000.

It would also be consistent if safeguards similar to those set out by the FCA in their policy statement PS15/4 were applied to annuity assignment. It is our view that the annuity purchaser or the intermediary promoting the assignment should take responsibility for this disclosure. The firm providing the annuity should not have responsibility for the transaction, including customer disclosure, as this would act as a disincentive for providers to consent to assignment. It does not seem reasonable that a party with limited interest in the transaction should take regulatory responsibility for it. The imposition of regulatory responsibility on providers may lead to some providers deeming assignments as exceeding their risk appetite.

While consistency with the rules relating to DB transfers is vital (i.e. a regulatory bias in favour of "don't do"), a likely consequence is that we will encounter the same 'insistent customer' issues that we have seen with consumers wanting to transfer out of DB and the related problems this creates for advisers. As such, many advisers may be reluctant to offer advice in this area. Moreover, given the potential complexities of the issues/decisions involved and the level of actuarial and medical knowledge that is arguably required, it seems reasonable to question whether there are sufficient numbers of suitably qualified advisers to operate in such a marketplace.

11. What is the best way to implement these safeguards?

As stated above, a similar approach to PS15/4 should be taken to ensure there are additional safeguards.

12. Should the costs of any advice or guidance be borne by the annuity holder?

Yes. It would be consistent with the rules regarding safeguarded benefits for the annuity holder to bear the cost of the advice.

13. Should the government introduce a requirement to obtain a number of quotes?

A requirement to seek advice for annuities over c. £1,500 per annum would give protection to some customers and ensure they received the most competitive price. In addition, there could be a requirement on annuity purchasers to disclose their quotation ranking, similar to that proposed by the FCA as part of the Retirement Income Market Study for annuity sales. There should be no obligations on annuity providers as this might act as a disincentive for them to consent to assignment.

14. Does the government's approach sufficiently protect the right of dependants on assignment?

The rights of dependants could be covered in a similar way to the approach taken in PS15/4. However, the responsibility for this disclosure should not sit with the annuity provider as this might act as a disincentive for providers to consent to assignments. Responsibility for disclosure should sit with the annuity purchaser or intermediary facilitating the transaction.

The legal position regarding annuities with third party rights attached is more complex. It may be that providers would need to see evidence that relevant third parties had waived any rights before giving consent to assignment. The third parties could include minors, disabled dependants and 'spouse at date of death' (rather than a named spouse) so it will not always be possible to obtain the consent of the third party. Alternatively, it is possible that providers would deem assignment of annuities with third party rights as exceeding their risk appetite.

15. Should the government permit the principal annuity holder's income to be assigned while dependants retain their own income stream?

We believe this would be complex and expensive to administer, resulting in increased costs for consumers. As such, we would not advocate this approach.

16. How can impact on means tested benefits be understood?

This is a very complex area. It is covered at a high level for customers at retirement in terms of PS15/4. Pension Wise also provides further detailed information.

17. Should those on means tested benefits be able to assign their annuity income?

Those on means-tested benefits have no restriction on how they take their pension benefits. A consistent approach should be taken to those seeking to assign their annuity. Clear information should be available from the DWP or Pension Wise as to the impact on means-tested benefits.

18. What are the likely impacts on groups with protected characteristics?

We have no specific comments to make other than those already set out in our response.

About Standard Life

For further information contact: