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Response to Consultation: 'Creating a Secondary Annuity Market on behalf of Prudential UK & Europe

We appreciate the opportunity to respond on the proposals for a secondary market in annuities.

We support the concept of allowing individuals to sell their annuity income as it appears to be a natural 'next step' to the flexibilities implemented in April 2015 and will bring about a degree of parity between those who began to access their pension savings pre and post this date.

We feel strongly that customer protection will be a key element in the successful implementation of this policy. Many of those considering selling annuities will be of advanced years and, unfortunately, this may increase their vulnerability to poor deals or scams. The primary vulnerabilities (likely linked to age but not necessarily as a result of) are financial difficulty, ill health and a lack of understanding about the ultimate outcome of decisions made.

We believe that for some customers the ability to exchange an ongoing income for a lump sum will be beneficial and provide them with increased flexibility and choice in older age.

However for other customers there is an increased risk of consumer detriment in the selling of an annuity income. We believe that there are two primary areas of concern:

Provision of information / advice. This will be a new and potentially complex market in which the information asymmetry between potential sellers and potential buyer will be high. The development of such a policy is to enable consumer choice and we support this aim but believe that as much as possible must be done to ensure that those considering selling their annuity are able make an informed choice. This may be achieved through the provision of information from a source such as Pension Wise or, in some cases, through a requirement to seek advice but it is important that potential sellers are able to gain enough information or help to reduce the risk of detriment through sub-optimal choice.

It is also important that the provision of information / advice recognises the needs and requirements of older consumers.

Market regulation. We appreciate the government intention that the market in secondary annuities be as open as possible in order to increase competition. However we are concerned that without suitable regulation the danger of consumer detriment is increased. It would be inappropriate to put regulatory requirements in this area on either the customer or the original annuity provider and therefore we believe it is important that the buyer side of this market is regulated. In addition it seems likely that brokerage services would offer consumers assistance in this area and we believe that this is a positive move but that they too should be subject to appropriate regulation.

In addition to the customer benefits of market regulation we believe it will also be beneficial to the formation of the market as some potential buyers of annuities may be reluctant to enter a market with an increased risk of consumer detriment as the taint of such detriment may spread to the whole market – reputable and less reputable alike. A more regulated market is more likely to encourage participation by firms that would be more likely to place consumer satisfaction high on their agenda.

Consultation Question Responses

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

   Unless there are any overriding government concerns then, in line with the principles of pension flexibility, this is very much an individual choice based on current and expected future circumstances. For some, turning their income into a lump sum to provide a mortgage deposit for a family member may be a reasonable financial choice, for others this same choice may be financially problematic but have non-financial benefits while some individuals may find it is simply the wrong choice. It is difficult to introduce flexibility and then suggest restrictions based on non-tangible measures.

   The consultation document recognises that for many, keeping a regular income would be the most appropriate approach but beyond this, the suggested circumstances set out in the document appear to be valid positions where an individual may choose to forgo a future income in favour of a lump sum, though there will of course be other scenarios where a lump sum may be appropriate. However for some individuals even in the suggested scenarios, a lump sum in exchange for their lifetime income may ultimately prove to be the wrong choice.

   The consultation document also, rightly, recognises the importance of the individual understanding what they are giving up and what the implications may be – which is a necessary approach.

   Whether such a decision is 'appropriate' or not will often depend on various factors which can include those unknown at the time of making the decision. Therefore it must be clear that this is an individual's choice to be made once they have sought the appropriate information and / or advice.

   However, were the government minded to place limitations on flexibility, then allowing flexibility only above a minimum guaranteed income would be one feasible approach – though this would be inconsistent with the flexibilities offered to those who had not yet annuitised.

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 suggestion that this is likely to be a complex market and therefore may be unsuitable for retail investors to engage in on an individual basis.

   As mentioned in our introductory comments we believe that in this market buyer-side regulation is important and, though this may serve to limit those who wish to enter the market it is our belief that this will be in a positive way. Other than this regulatory oversight and a requirement to abide by the regulations we do not see a need to limit participation in the market, though the government may wish to consider the regulatory approach where potential buyer organisations are based in territories outside of the UK.

   The paper is silent on the subject of a tertiary market and whether retail investors would be able to take part in it i.e. annuity buyers repackaging the products into an investment product. As this will potentially have an impact on the demand side, it is an area which may need further consideration.

   The size of the 'buyers market' is also likely to depend on how annuities purchased by a third party are treated in relation to requirements such as solvency.

   Finally, it is important that adequate care is taken to ensure that this market does not offer the potential for money laundering and terrorist funding. Paying a 'lump sum' in exchange for an ongoing income is one way to layer money into the system and those wishing to operate in this way could offer the 'best' price because they do not mind losing money on the deal. It is not clear who would be expected to 'police' such transactions from the point of view of money laundering as it seems inappropriate to place this requirement on either members (who are selling their annuity) or annuity providers (who are not fully party to the transaction). The danger of breaching UK or international legislation in this area (by inadvertently assisting in illegal practices) could be enough to put some providers off the idea of allowing their customers to sell their annuities and therefore this area needs to be looked at with extreme caution.

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 be managed?***

We believe that it is vital that annuity providers are not forced to buy back annuities as this could lead to issues of financial sustainability and have significant knock-on effects on financial markets given the wide variety of areas in which UK pensions are invested.

However whilst we agree with the principles of the arguments as to why annuity providers should be unable to buy back annuities, we feel that this is a complex area and that there are equally valid counter arguments.

Such a prohibition would mean that an individual may be unable to get the best deal (offered by their existing provider). This is compounded by the fact that the existing provider may be more likely to offer a better price because their 'purchasing' it would save on costs which could be factored into the price offered.

Whilst it may be difficult for providers to explain to a consumer why they are not offering the service, or why they do not offer the best price, it will be equally difficult to explain why, although they offer the best price, they cannot transact with the individual.

At present a provider may offer a cash buy out of an annuity in payment up to triviality limits (subject to tax and contract terms) and it would seem strange to remove this in the name of increased flexibility.

Additionally if a tertiary market in annuities does develop, where annuities are packaged up and sold on, would this prohibition still apply? It could be that in a package of 1000 annuities there are one or two which originate with the organisation considering purchasing the package. This would have implications on the formation of such a market.

Finally, allowing an existing provider to buy back an annuity would, depending on decisions made around regulation of the market, potentially increase the level of consumer protection as annuity providers are regulated companies who must comply with FCA requirements.

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 this issue?***

We understand the reasons behind the solutions put forward and for the reluctance to implement a centralised, government led solution. However we believe that there would be benefits to such a solution which go beyond the secondary annuity market and would have advantages for both private and public organisations.

We feel that when considering the feasibility of such a solution these other, wider, benefits should be considered. What may not appear financially appropriate when looking at only one area which would benefit may be less so when all other benefits are considered.

In relation to the alternative solutions:

- Splitting the payment will incur extra costs on the original provider who will need to pass these on to the annuitant (a charge for selling an annuity in payment).
- Requiring ongoing proof of life beyond a certain age will also incur costs which will need to be picked up somewhere in the chain and may be seen as intrusive by individuals who, in their eyes at least, no longer have any link to the ongoing income. Further, this method may be inaccurate, for example it may be discovered that the original annuitant died some years before the check is made and therefore overpayments would need to be recovered from the new recipient.

It is clear that there is no perfect solution in relation to this issue as each proposal will impose additional costs somewhere in the chain and will increase the chance of overpayments being made.

We believe that to come to an appropriate decision in this area a wider review of the alternatives, and the potential benefits beyond a secondary annuity market should be considered.

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

As above (question 8) it is not clear what tax avoidance opportunities the government envisages arising from this scenario.

While some annuitants may pay less tax than they otherwise would because they live longer than expected and therefore would have received more in an ongoing annuity than a lump sum, others will pay more because of the converse situation and for some the increase in their marginal rate of taxation will result in more tax being paid than would otherwise have been the case.

10. ***What consumer safeguards are appropriate – is guidance sufficient or is a requirement to seek advice necessary? Should the safeguards vary depending on the value of the annuity?***

Under the legislation implementing pension flexibility, those with a safeguarded benefits – defined benefit, guaranteed annuity rate etc. are required to seek advice. It would seem strange that this requirement did not apply where the guaranteed income was in the form of an annuity and would open up loop-holes (for example someone with a guaranteed annuity rate could purchase an annuity and then sell it to access the lump sum without the need for advice – working around the policy intention).

Advice would also be able to cover the need to shop around – especially if the market involved buyers not currently considered to be in the retirement market or even in financial services. Guidance may be less able to cope with an expanded buyer market (which may well include non financial services regulated companies).

However it must also be recognised that full advice is expensive and this may prove to be a barrier.

Basing the requirement on the value of the annuity is also potentially problematic - the value of the annuity in this market will depend on what someone is willing to pay for it. Basing the value on the annual amount may be inappropriate as someone aged 60 with a normal life expectancy, a £5,000 a year annuity may have more imbedded value (and possibly greater implications) than someone aged 80 with a £20,000 year annuity and a significantly reduced life expectancy.

It may also be said that those with smaller annuities may be in greater danger of losing out – for example someone aged 60 receiving £200 per month may be more tempted to sell their annuity for less than its true worth.

Some of this will depend on the regulation of the buyer but, for example, a 'cash for annuities' market could target those on smaller annuities who may not be able to appreciate the long term value of the product and, when offered £1,000 cash in hand instead of £100 per month, may be tempted into making a poor choice.

However, there is also a question as to who would be responsible for ensuring a consumer has received advice – the agreement being made is between the seller and the buyer, it would therefore seem less than appropriate for the original annuity provider to be responsible for checking as, essentially, they are not party to the agreement. This would suggest that the buyer market would need to be regulated which may be a significant undertaking and limit market entry – which is likely to increase consumer protection but may not be in line with the proposed policy of an open market.

11. ***What is the best way to implement these safeguards? Should the safeguards include expansion of the remit of Pension Wise?***

See response to question 10.

Whilst guidance is an option the potential issues are highlighted above. As with an advice requirement there would be a question of who would be responsible for encouraging / requiring the individual to seek guidance.

Should this become a function of Pension Wise it would seem appropriate that the additional funding this would require should come from those engaged in buying annuities as they will be benefitting from it.

As suggested above it seems that the most viable way to ensure safeguards is to have a regulated buyers market.

12. ***Should the costs of any advice or guidance be borne by the annuity holder (mirroring the arrangements for conversion from a defined benefit scheme)? If not, what arrangements are appropriate?***

As above (question 11) the cost of guidance (if provided through Pension wise) should be funded by the buying market as this would be reflected in the prices they offer.

Should the requirement be for advice then it should be paid for by the individual looking to take advantage of the flexibility.

13. ***Do you agree that the government should introduce a requirement on individuals to obtain a number of quotes? How else should the government best promote effective competition to ensure consumers obtain a competitive price?***

Whilst we agree with the principle of an individual being required to obtain a number of quotes we are unsure how this would work in practice. This will be partially dependent on the regulatory regime put in place around the sale of annuities.

We feel that although it is possible to encourage individuals to obtain multiple quotes it would be difficult, in practice, to enforce this and for the customer to provide evidence.

One suggestion may be the enforced formation of an online service which offers quotes. However this would likely be expensive to set up with the costs passed on to sellers, may significantly restrict market entry especially if it is a single portal and may further complicate the regulatory regime.

In line with responses to other questions the most suitable approach may be to require advice, perhaps in some specific, simplified way, which could also allow the individual to get a number of quotes (via the advisor). This does however raise a further concern of an individual deciding to proceed with a sale when their adviser has recommended against it which would need to be dealt with in any regulatory regime.

14. ***Does the government's approach sufficiently protect the rights of dependants upon assignment? If not, what further steps should the government take? Should the government or FCA issue guidance to annuity providers about protection for dependants? Are there particular classes of beneficiary which require special consideration, for example minors or following a divorce or dissolution of a civil partnership? Are there specific equality impacts that should be considered in this context?***

While the intention behind this proposal has sensible foundations there is a difficulty here in that the contract remains between the provider and the annuitant, until such time as the beneficiaries payments become actualised they only have a contingent right to payments under the policy. It is common for contracts to exclude third party contractual rights and as such these contingent beneficiaries, such as spouses and dependents, do not have any rights to enforce the contract at the point in time being considered. There are further challenges in that not all annuities will name a secondary beneficiary. For example a spouse's annuity may pay out to a named individual or it may pay out to 'any spouse' at the time of death. In the latter case it is not clear how a potential future spouse could be included. A spouse or beneficiary is not necessarily involved in the original annuity purchase and is unlikely to have contributed directly into the pot of money which purchases the annuity. It is also worth noting that a spouse would not need to be involved in the decision to take a lump sum rather than an income under the new pensions freedoms.

It is also unclear what would happen if a beneficiary (not party to the contract) refused to agree with the sale, this could be someone other than the spouse, including a minor. We agree that a minor would likely require additional protection but it is unclear how this would be achieved and what the additional cost may be. The law around entering contracts and varying legal rights is complex for a minor and it is not clear how this would work.

An alternative would be to restrict flexibility to single life annuities only but this would restrict the market, lead to consumer dissatisfaction and could skew the market going forward by encouraging people to take single life annuities.

There is also a question of whether any restriction in this area would also apply to a fixed term annuity which may be used as an alternative to a joint life / dependants annuity in certain individual circumstances. Imposing conditions and requirements on the sale of the annuity which did not exist when it was purchased (i.e. the inclusion of permission from any beneficiaries or potential beneficiaries) may prove problematic.

15. ***Should the government permit the principal annuity holder's income to be assigned while dependants retain their own income stream? Should the decision on whether to do so be left to the discretion of the parties to the transaction?***

This would potentially solve the problems identified in response to question 14 (though it would share the same issue of involving someone who was not party to the original contract) but may prove to be highly complex – especially in terms of pricing. It also has potential social implications, for example, a couple one of whom has sold their annuity for a lump sum and who has subsequently run out of money would know that on their death the other half of the couple would get an increased income. Would they potentially make certain decisions regarding care they would otherwise not have made? Equally the purchaser of the annuity has a vested interest in their ongoing survival – as this is a valid financial interest would they have any say in matters of care? We believe that this would be a public policy issue and that the courts would seek to avoid upholding such terms but thus doesn't mean that unscrupulous buyers wouldn't try it and clarifying at this early stage may save problems arising later.

These potential social issues would need to be addressed clearly to avoid them being subject to legal decisions further down the line which may have significant impacts.

16. ***How can the proposed consumer protections for the assignment of annuities ensure that any impact on means-tested entitlement is understood by those deciding whether to assign their annuity income?***

As mentioned below (in the response to question 17) the impact on means-tested benefits may not always be clear at the point an annuity is sold.

It also seems strange that someone who opts to take a pension as cash instead of an income may not be excluded from means tested benefits but someone who sells an annuity will be. In order to aid consumer understanding there should be consistency between these issues which have a similar outcome.

In terms of consumer understanding advice or guidance would cover the issues – though this would have to be enforced in all cases to ensure the message was put across.

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

It seems strange that the policy in relation to the selling of annuities is different from that relating to the wider freedoms allowing someone to take cash which do not have any check about means testing (though there may be some effect on rules relating to the depreciation of capital).

It is also difficult to predict how this would work in practice – would someone looking to sell their annuity need to provide proof that they would not become reliant on means tested benefits as a result of doing so? If so who would need to gather this proof?

Would it simply look at the immediate situation regarding means testing or would it look at potential future outcomes – for example someone below State Pension age with an annuity and employment income may sell their annuity without falling onto means tested benefits, but if they then lose their job they may end up being means tested. Similarly someone on State Pension with an annuity and a small income from employment may eventually have to stop working and then end up on means tested benefits some time after they sell their annuity. It is. of course, important to remember that many of those with annuities will not be receiving the new flat rate State Pension and may therefore be more likely to rely on means-tested pension related benefits.

18. ***What are the likely impacts of the government's proposals on groups with protected characteristics? Please provide any examples, case studies, research or other types of evidence to support your views.***

Those buying annuities are likely to base their offer price on a number of factors which would include personalised factors such as current state of health and, quite likely, more generic factors such as age. Being unable to use such factors is likely to result in poorer value for consumers across the board as buyers would need to make increased allowances for risks.

As mentioned in our introductory comments we believe that the age profile of some of those considering utilising a secondary annuity market may lead to an increased number of vulnerable consumers.

There may also be some issues regarding previous market practices (acceptable at the time but since changed) such as whether an annuity was sold on a gender neutral or gender specific basis.

Other points of note

In addition to our responses to the questions asked we would like to raise some additional points which we feel should be considered, and where possible deal with, before this policy is implemented. We appreciate that some of these concerns may take some time to resolve, and possibly further consultation with wider stakeholders but we believe that resolving them before the market is formed would be of significant benefit.

- ***Market Developments:*** One of the key aims of the pension flexibilities introduced in April 2015 was to allow the development of retirement income products which better meet the changing needs of older consumers. Although this market is yet to mature, newer products may contain additional benefits which create new complexities in a secondary annuity market – for example products which offer certain guarantees, death benefits or other valuable features may either be incompatible with the secondary market or may make the decision on whether to sell more complex. While it would be relatively simple for the providers of these products to refuse to allow people to sell them on the secondary market, this may influence people's decisions earlier in the process. For example, an individual may decide not to buy a product with valuable features (which is actually the best fit for them) because it precludes a feature (the ability to sell on the secondary market) which they may or may not use in the future (and which may be financially detrimental). This may lead to a lack of development in the retirement income product market.

- ***Alternatives***: At some point in the process it should be made clear to those considering selling that, depending on their needs / reason for selling there may be alternative routes. For example if the customer is looking for a lump sum for a particular reason and this is why they want to sell their annuity it may actually be cheaper / more efficient for them to take out a short term loan rather than to sell their annuity. An individual may not realise this because they may consider a loan more expensive than bringing forward income payments but given the potential costs of selling an annuity (perhaps including advice) a load may be a real alternative. This sort of consideration increases the need for adequate guidance / advice which goes beyond the decision about whether an income stream or a lump sum is more appropriate.

- ***Wider Impacts:*** There are various wider impacts which should be considered at this early stage. While some of these may seem unlikely to occur, they should be looked at if only to provide reassurance for all parties. These include, but are not limited to:

    - *Insurable interest* – purchasing someone's ongoing income gives the buyer an insurable interest in that individual's life. Is it envisaged that a secondary life market could develop alongside the secondary annuity market.
    - *End of Life Decisions* – will a purchaser be able to insist on a contract with the individual with certain provisions being made such as a requirement that the individual does / does not make an expression of wish with relation to end of life. Issues in this area may be of greater concern if the 'buy side' of the equation is not regulated as the developing market may attract unscrupulous entrants.
    - *Breach of Contract* – if an annuity contract is sold to a third party but that third party does not fulfil their end of the agreement what resolution would be available. The original annuity provider would not be in a position to make a decision – would a breach of contract claim through the courts be an appropriate method of resolution for the consumers involved? Further we would be interested in whether it is envisaged that there would be an ombudsman (either an extension of the remit of an existing ombudsman or a new ombudsman) to deal with complaints in this market?