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Response to H M Treasury consultation paper Cm 9046 March 2015:

**'Creating a secondary annuity market'**

Date: 17th June 2015

## THE PERSONAL FINANCE SOCIETY

The Personal Finance Society (PFS) is the largest professional body for the financial advisory profession and supporting roles in the UK. We promote the highest standards of professionalism for technical knowledge, client service and ethical practice across the entire financial advice community for the ultimate benefit of the consumer.

Our mission is to serve the public by guiding the financial advice community towards higher levels of professionalism. This is exhibited through ethical and behavioural standards, interpersonal and business skills and technical knowledge. We support our members, with achieving this goal through a wide programme of activities, including advocacy, guidance, publications and related tools, training and educational events.

The Personal Finance Society is part of the CII Group and we therefore share the CII's Royal Charter to secure and justify public confidence and trust in our members and the sector in general.

With over 35,500 members of whom 4,690 are Chartered Financial Planners, the Personal Finance Society augments the highest standards of professionalism.

**Positioning statement from the Personal Finance Society**

Whilst broadly welcoming the introduction of Pension Freedoms following the 2014 Budget, the Personal Finance Society has very real concerns from a public interest perspective about the extension of such freedoms to those who have already committed to an annuity. These concerns include (amongst others) how a secondary annuity market would be subject to effective regulation; how the majority of consumers would be enabled to make an informed choice; how consumers would be protected from the increased risk of 'scamming' ; and whether the re-sale or surrender value of annuity contracts will offer them good value.

Furthermore, if the proposal is an implicit attempt in part to deal with poor value annuities, by then being offered a poor value cash lump sum, which is taxable, this will not address the issue of an inappropriate original sale and will lead to significant consumer detriment.

Whilst much of the Treasury's paper 'Creating a secondary annuity market' (March 2015) has both ambition and merit, we don't believe the proposed timescales lend themselves to full consideration of solutions to the significant practical obstacles that will need to be overcome in the effective creation of such a market. We do, however, see the consultation as an opportunity to explore concerns and assess what is possible.

The Personal Finance Society is available to work with HM Treasury to find appropriate solutions and help to mitigate the risk of unintended consequences.

**A new secondary market for annuities (Chapter 2)**

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

Whilst giving up a guaranteed income for life is a bad idea in principal, there will be some instances where it could benefit individuals to assign their rights to their annuity income. This would include:

1. Where the annuity is providing such a small level of income such that for practical purposes it is worthless
2. Where the annuitant is paying for a benefit they or their dependants are unlikely to benefit from due to a change in circumstances e.g. a joint life annuity where the annuitant's partner/souse has predeceased them.
3. Where the annuitant purchased an annuity because they had no choice but need the money now to repay debts or pay for health or care needs or other urgent spending.
4. Where the annuitant has other pensions and for whom the annuity is not an important source of their retirement income.
5. Where the annuitant has need to purchase a more flexible pension income product instead

In such circumstances, measures to protect the rights of any other beneficiaries under the policy would also need to be considered – for example, some form of consent to the assignment. The proposal that written consent of any dependants be obtained before an annuity can be assigned (where contractually appropriate) should be explored with annuity providers and on the face of it seems an easier and less costly route than the possibility that only the rights of the primary annuity holder be assigned, with the rights of the dependant remaining in place so that payments revert to that dependant on death of the primary annuity holder.

**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?**

Yes, although given the likelihood that institutional investors/corporate entities will only want to purchase in bulk, there may be a need for intermediaries to enter the market in order to purchase individual annuities, repackage them and sell them on to the end investor. Such intermediaries however, are an added source of cost and will need appropriate expertise in underwriting and longevity, so consideration could be given to the creation of a not-for-profit intermediary to fulfil this function with a clear consumer remit. Alternatively, an independent centralised 'bureau' could be created with appropriate expertise to act as third party buyer, more easily subject to higher standards and controls, potentially resulting in greater consumer confidence.

The width of market development may also be restricted given the provision in the proposals to allow annuity firms providing income the right to refuse to re-assign.

Annuity income streams may become particularly attractive to trustees of pension schemes as a way to protect themselves from rising life expectancies – if the price is right.

**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 are managed?**

We agree that the risks of allowing 'buy back' outweigh the benefits. Whilst it would remove a potential tier of cost and complexity, deriving a cash value from the original annuity provider may well increase the consumer view that having received a bad deal when annuitising they are being 'ripped off' yet again, especially by individuals who have bought their annuity recently who are likely to assume that a fair rate will be close to the purchase price minus any payments (and not consider legitimate changes in value such as those caused by economic circumstances or deterioration in health). They may also find it difficult to determine what level of fee is reasonable for a purchaser to seek to compensate for their costs and risks.

Allowing 'buy back' would also potential be divisive, creating a fractured or limited market given that some annuity providers may well choose not to participate whilst others may do so with a level of appetite that might be considered worrying from consumer protection perspective.

**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?**

How providers will be able to keep track of when the original annuitant dies is clearly an issue. In the short term, we agree that the solution is best resolved by market participants with further consideration given to making notification of death to the annuity provider a condition of annuity assignment. In the longer term, and in the face of experience of the nature, growth and size of the secondary annuity market, developments such as central register as part of the proposed development of other centralised initiatives such as pension dashboards could be considered – for example to incorporate some means of linked death notification.

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

Yes, but the scope of such work should be extended to third parties who administer pensions in payment, to prevent them seeing the development of a secondary annuity market as an opportunity to charge greater fees to the annuity provider.

Consideration should also be given to third party validation of rates e.g. independent actuaries judging and quantifying the "fair value" of the annuity, based on specific individual underwriting and actuarial assumptions that are set by the Government Actuary Department.

**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?**

Yes.

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

Not at this stage. Given the extent of change brought about as a result of Pension Freedoms, a period of bedding–in is required going forward so that the impact of existing changes can be properly assessed before any further extension of reforms.

**Legislative changes (Chapter 3)**

**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?**

If the objective in creating a secondary annuity market is parity between those who will be able to access their pension flexibly and those who will be able to access their annuity flexibly, then broadly 'yes'.

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

No comment.

**Consumer protection (Chapter 4)**

**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?**

Appropriate consumer safeguards should be those that are able to protect consumers without imposing disproportionate costs.

To this end, consumers will require more than just information or guidance to fully understand the options available – they will want to know the numbers (including impact of taxation and possible loss of welfare benefits) and whether it's the right thing to do. The process involved in assessing the value-for-money of an annuity sale is too complicated for people who do not use an adviser or simply rely on Pension Wise. Judging the value of an annuity in payment is particularly complex and subject to behavioural biases and mental 'capacity' issues where older, more vulnerable clients are looking to access the cash value of their annuity, even if pricing is fully transparent. Some form of back-testing could be considered to enable consumers with capacity to understand the cost today of providing an equivalent level of income and to assess whether they feel it a reasonable deal.

As such, there is a strong case for an advice step with consideration given to extending the £30,000 threshold used for DB transfers as the parallels between trading an annuity and a defined benefit transfer are clear ( although this would mean approximating the value of an annuity in advance of the advice which may be problematic). But if advice is to be made compulsory in such circumstances, as already argued by the Personal Finance Society, regulated advisers need enhanced protection in the face of 'insistent clients'.

In terms of the cost of such advice, consideration should be given to the introduction of a subsidised voucher scheme funded by regulatory fines.

In terms of the nature of advice, high standards need to be applied to those advisers operating in this new market and as a Professional Body we could develop a publically recognised standard and kite mark.

For consumers with an annuity below the £30,000 threshold, new 'second line of defence' rules could be broadened to help people understand the new annuity sale option.

For older consumers where a greater risk exists in terms of their subsequent ability to replace lost income, consideration should be given to further safeguards for this group.

Longer 'cooling off' periods should be considered for all transactions involving existing annuities.

Consumers should receive a benchmark indicative price, then subject to underwriting which should include a medical/PMR early on in the process.

Guidance alone won't cut it – make advice compulsory and give clients a voucher to pay for it. An agreed process and safeguards also need to be introduced from both a consumer and industry perspective.

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

It seems sensible to develop the remit of Pension Wise, but the issues involved are sufficiently complex and subject to increasing levels of behavioural bias/mental capacity issues that make guidance alone inappropriate. As such, the best way to implement these safeguards is to make regulated advice compulsory at a certain trigger point and to widen the 'second line of defence' for those below it. Access to and capacity of advice will need to be considered and a clear process introduced to avoid future problems where consumers are insistent to act against advice.

**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?**

No - we think it is reasonable to argue that those within DB schemes are likely in most cases to have the means to pay for regulated advice. There is a greater possibility of this not being the case for many annuitants, particularly if 'adverse selection bias' results in those more likely to be seeking to sell being those of limited means, poor health and with smaller pensions who most likely will not get much for their income stream (as recently suggested by the Institute of Fiscal Studies).

Whilst the cost of advice could be taken into account when declaring/deciding on the cash value equivalent payable, consideration should be given to a subsidising voucher scheme funded through regulatory fines.

**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?**

Yes – subject to sufficient buyers in the market or an independent central 'bureau' acting as third party buyer. Either way, there will be a need for an independent actuaries judging and quantifying the "fair value" of the annuity, based on specific individual underwriting and actuarial assumptions that are set by the Government Actuary Department.

**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? - Yes
- Are there particular classes of beneficiary which require special consideration, for example minors or following a divorce or dissolution of a civil partnership? – Yes - divorce or dissolution of a civil partnership
- Are there specific equality impacts that should be considered in this context? – No comment.

**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?**

The proposal that written consent of any dependants be obtained before an annuity can be assigned (where contractually appropriate) should be explored with annuity providers and on the face of it seems an easier and less costly route than the possibility that only the rights of the primary annuity holder be assigned, with the rights of the dependant remaining in place so that payments revert to that dependant on death of the primary annuity holder.

**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?**

A complete minefield! The interaction between annuity income, capital and the deprivation rules in the welfare, social care and council tax reduction systems are extremely complex and in the case of social care often applied inconsistently and subjectively in practice by local authorities.

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

No. Given that the Government does not intend to compensate individuals through welfare for any loss of income resulting from assigning their annuity to a third party, it seems the most pragmatic route to exclude those on means-tested benefits from being able to assign their annuity income. Furthermore, this consumer segment in the main is less likely to be able to deal with the complexities of choice involved.

**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.**

The payment of 'due regard' to those annuitants that have developed mental capacity issues needs to be specifically addressed. Reference to the UK age profile of dementia sufferers in 2014 (source: The Alzheimer's Society) indicate that in the age group 70-74 1 in 33 females and 1 in 32 males suffer from dementia potentially impacting negatively on their ability to make an informed decision. For those in the age group 85 – 89, these figures increase exponentially to 1 in 5 females and 1 in 7 males.