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Pension
Protection
Fund

Creating a Secondary Annuity Market Consultation

In March 2015 the Department for Work & Pensions and HM Treasury published a consultation paper "Creating a secondary annuity market". The Pension Protection Fund ("PPF") welcomes the opportunity to respond to the consultation. Below are the PPF's responses to the questions raised in the consultation, where we believe our role in the UK pensions system and the skills and experience we have developed enable us to provide relevant insights and information.

PPF Background

The PPF was established to pay compensation to members of eligible defined benefit pension schemes, when there is a qualifying insolvency event in relation to the employer and where there are insufficient assets in the pension scheme to cover PPF levels of compensation.

The PPF is a statutory fund run by the Board of the Pension Protection Fund ("the Board"), a statutory corporation established under the provisions of the Pensions Act 2004. The PPF became operational on 6 April 2005.

On 10 July 2009 the Board of the PPF was also given the responsibility of being the scheme manager for the Financial Assistance Scheme (FAS). FAS provides assistance to members of eligible underfunded defined benefit schemes that started to wind-up between 1 January 1997 and 5 April 2005, or between 6 April 2005 and 27 March 2014 where an employer insolvency event occurred before 6 April 2005.

PPF Response - "Creating a secondary annuity market"

A new secondary market for annuities (Chapter 2)

Q1. In what circumstances do you think it would be appropriate to assign one's rights to their annuity income?

The extent to which the circumstances detailed in paragraph 2.4 of the consultation document are appropriate depends on the degree of fairness in the conversion terms that annuity holders receive when assigning their annuity income. However, we would note that even if the conversion terms are reasonable, it may not be appropriate for individuals to assign annuity income due to their own particular circumstances and commitments.

To determine what constitutes fair conversion terms, the government would need to consider how the conversion terms should compare with the conversion terms when members transfer out of a pension scheme prior to retirement, as well as cash commutation factors when members commute tax-free cash from their defined benefit pensions on retirement.

Q2. 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?

The successful emergence of a secondary annuity market will require sufficient encouragement from the government and opening the market to a wide range of corporate entities is one way to do this. Retail investment could be permitted for expert investors who understand the complexities of the product and the associated risks, to further encourage the successful emergence of the secondary annuity market and to help establish competitive pricing. The considerations for retail investors are similar to annuity holders but in reverse. In both cases it is important that informed decisions can be made and the government may find it instructive to consider the approach taken on enhanced transfer value exercises.

To enable a wide market to develop, the government should consider how to ease any concerns third parties have over being accused of mis-selling by annuity holders in the future. It may be instructive to examine the progress made in the development of the market in CPI-linked bonds.

The government will need to consider whether the treatment of with profits annuities should be different given the differing nature of these annuity contracts to annuities without a profit element.

We are open to considering new investment opportunities so will watch how the secondary annuity market develops and give due consideration to any investment opportunities it provides.

Q3. 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?

Pension schemes are required to discharge and secure money purchase benefits outside of the PPF prior to transfer to the PPF. In our experience, schemes find it difficult to discharge small money purchase pots outside of the PPF as annuity providers aren't willing to provide annuities for comparatively small pots due to the disproportionate costs and effort involved. We think that annuity holders with small annuities may encounter similar problems in trying to assign their annuities to willing third parties.

In our view, the annuities that annuity holders are most likely to want to assign are ones where the annuity income is small relative to total retirement income. For example, members with defined benefit promises who paid additional voluntary contributions that were used to secure small annuities. There may therefore be significant numbers of annuity holders who experience possible issues in trying to assign their small annuities.

To mitigate possible liquidity issues associated with buy backs, the government could permit annuity providers to be given time to buy back the annuities after the annuity holders have initially requested the buy backs.

Q4. 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?

It is important for the death notification process to be sufficiently robust otherwise this would act as a barrier to market development, particularly if the assigned annuities are able to be subsequently traded by the third parties. Claiming back overpayments due to late notification of deaths is an administratively costly exercise for annuity providers, which would be exacerbated if these annuities were sold and resold.

It is in the interests of annuity providers to have robust death notification processes in order to minimise overpayments due to late notification of deaths. If death notification processes are not sufficiently robust then annuity providers may be reluctant to allow annuities to be assigned to third parties as it may increase the extent and likelihood of the annuity providers making overpayments.

We would be happy to share our knowledge and experience of identifying when members have died, as we believe the approach we take for our membership is well developed and robust. We can also provide contact points for companies that offer death tracing services as they have mentioned to us previously that they would be happy to speak with the government.

We hold annuities with a wide range of annuity providers, which has arisen because annuities in the trustees' name transfer to us when schemes transfer to us. Our experience is that most annuity holders and their dependants will report changes of circumstances, including deaths, to annuity providers. We are then dependent on annuity providers to claim back any overpayments. This dependence can be reduced but this requires significant active effort, which we are putting in by our plans to bring administration in-house and set up effective systems relating to death notifications.

Intermediaries in the secondary annuity market would find themselves in a similar position to us but with the added challenge of not having ties to the original annuity holders. Consideration will need to be given to ensuring dependants know who to report deaths to when annuity holders die.

Q6. 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?

We agree that annuities bought by the trustee of an occupational pension scheme shouldn't have the ability to be assigned, due to the detrimental impact this could have on the funding position of schemes if the annuities are assigned for a poor price, the increased level of risk in going from a more matched position to a less matched position and the possible resulting increase in dependency on the sponsor covenant.

Consumer protection (Chapter 4)

Q10. 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?

The extent of the consumer safeguards could vary depending on the size of the annuity, where the proportion of annuity income to total retirement income (or total expected retirement income if not retired yet) could be used.

The government could consider using similar safeguards to those utilised for members close to retirement when companies run enhanced transfer value exercises.

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