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Dear Sirs

Creating a secondary annuity market: consultation response

This is the response of the Punter Southall Group to the above-named consultation paper. The Punter Southall Group was founded in 1988 and provides a unique range of financial services including actuarial consulting, administration, employee benefits consultancy, independent financial advice and investment services for pension funds, corporates and individuals. We advise over 1,000 pension schemes, companies and organisations from a broad spectrum of UK businesses, charities, unions and institutions and also have 4,000 private clients.

Positive response to the broad aims of the proposals

We welcome the aim of the proposals contained in the 'Creating a secondary annuity market' paper, which we believe will allow current annuitants, who were perhaps forced to purchase an annuity where it may not have been the right choice for them, an option to have more flexibility in how they fund their retirement and brings their choices in line with new retirees post April 2015. We do expect however, as noted in the paper, that most annuitants will continue to value the stability and security of an annuity income.

From the point of view of our Defined Benefit ("DB") pension scheme clients, the main impact that a secondary annuity market might have on them is in respect of their investment strategies. There are two reasons why they may seek to purchase these annuities through the secondary market:

- to expose themselves to longevity as a return-seeking investment, or
- to provide a broad asset to match their liabilities.

We think that is unlikely that our DB clients will seek to use these annuities as a return-seeking asset; however, it is possible that our DB clients may wish to bulk-buy these annuities to provide themselves with a broadly matching asset. Currently the only way for schemes to hedge their longevity risk is through the use of bespoke or index based longevity swaps, which many perceive to be an under-developed market due to prohibitive costs. Should the prices for bulk buying annuities through the secondary market be competitive with longevity swaps, DB pension schemes may have a demand for them as a more cost-effective way to helping to manage their longevity risks.

Furthermore we expect that a secondary annuity market will aid bulk annuity writers themselves with their investment strategy as they may be able to use these as a matching asset, in particular for those providers specialising in underwritten annuities.

From the point of view of members of our Defined Contribution (DC) schemes, we think this could partially reinvigorate member interest in purchasing annuities at retirement as the risk of tying themselves in to an inappropriate investment for decades would be reduced.

Outside of occupational pension schemes, we understand there has been a desire for several years to offer longevity risk to capital markets as an alternative return-seeking investment and as a true diversified investment versus other major asset classes. A secondary market in annuities may help to standardise how longevity risk is more widely and generally packaged and priced.

Concerns about the operation of such a secondary market

We have two main concerns with the proposals set out in the consultation. Firstly we feel that there is a material risk that the secondary market for annuities will be limited or fail to emerge at all, due to the potentially significant problems of 'adverse selection'. Our suspicion is that those institutions that wish to purchase annuities in the secondary market are likely to be very cautious in their valuation of the annuities, expecting that only those annuitants in poorer than average health are likely to want to access a lump sum. This would therefore mean that very few annuitants are likely to feel they are being given a fair value for their annuity and we question whether a sufficiently developed secondary market will be able to form in order to create the "bulk" market that DB pension schemes may wish to invest in instead of the already established (though still relatively undeveloped) longevity swaps market.

Our second concern regards the practical implementation of these reforms. Whilst the 2015 flexibilities introduced in the 2014 Budget were well received, it is being widely reported that many insurers are simply not offering the full suite of options available to members and therefore limiting the effectiveness of the legislation. Whilst recently the Pensions Minister has urged critics, in particular the media, to give the 2015 reforms a chance, it may be sensible to consider deferring any further reforms pending evidence that the initial 2015 reforms have indeed been effective in giving pensioners more flexibility in their retirement income.

Lessons from history

Whilst there are clearly differences, the Government may want to revisit the issues that the secondary market in endowment policies raised.

Responses to questions

We have set out some further points on the questions raised in the consultation document in the Appendix.

Yours faithfully

Appendix: Response to consultation questions

A.1 In addition to addressing the specific questions set out in this annex, respondents are encouraged in their responses to add any additional information they feel is relevant to this consultation.

A new secondary market for annuities (Chapter 2)

A.2 The government welcomes views on how it envisages the secondary annuities market working, and its proposed approach on the scope of these reforms.

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

There are clearly a range of specific circumstances where an individual and any associated dependents may have value in converting their annuity in to an alternative form.

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 that a wide range of investors would be desirable for these annuities if a sufficient secondary market is to develop. We agree that restricting retail investors is sensible due to the complexity of these products and the potential for mis-selling.

3 Do you agree that the government should not allow annuity holders access to 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?

It is our opinion that buy back might be the only cost effective way of implementing the changes in this consultation. We feel that it is likely that it will be members with smaller annuities that are likely to wish to convert them into a lump sum and the costs involved with redirecting the annuity income might be prohibitive.

Any risk of members thinking they have to buy back through their original provider could be mitigated by regulated communications and competitive pressures.

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

We agree there is a very real risk that annuity providers will pay an annuity to a third party after the individual has deceased due to a lack of notification. We agree that a central death register is disproportionate to this risk and that this risk is best resolved by the market.

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

It would seem sensible for the government and the FCA to monitor the fees and charges by annuity providers to prevent them from using their 'veto' position to leverage unfair profits from their customers.

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?

Many of our DB pension scheme clients have buy-in policies, which provide an income for specified members but held under the Scheme rather than with the individuals covered. If a secondary annuity market was to form there may be some desire for DB pension schemes to cash out their buy-in policies in order to re-structure their investment strategy or to purchase new insurance policies that provide a better match to benefits (e.g. modern polices can be more effective at mirroring complex benefit structures).

Whilst we feel that most of our DB clients are unlikely to want to cash out their policies, allowing them to do so may aid in the development of the secondary market. In addition, we see no reasons for the explicit restriction given the highly governed environment that trustees of DB schemes operate in.

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

Legislative changes (Chapter 3)

A.3 The government welcomes views on how it proposes to change the tax rules relating to the assignment of annuity payments.

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?

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

It is our opinion that an appropriate balance will be met by treating those who access their pension flexibly and those who access their annuity flexibly equally from a tax point of view.

Consumer protection (Chapter 4)

A.4 The government welcomes views on how it proposes to ensure consumers are appropriately informed when making decisions relating to the assignment of their annuity income.

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?

In our opinion it is sensible to introduce safeguards dependent on the value of the annuity being surrendered for a lump sum. As previously mentioned, it is our opinion that small annuities will be the ones most likely to be surrendered and legislating that everyone must seek independent financial advice may be prohibitive.

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

Pension Wise would seem an appropriate implementation route, but we would be interested in seeing the success the organisation has with managing the initial flexibilities introduced on 6 April 2015 before expanding its remit.

12 Should the cost 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?

The concept of costs being borne by the annuitant would seem fair and consistent with the treatment of annuity purchase at retirement.

13 Do you agree 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?

Mirroring our comments above, regulated communications are the best way to ensure members receive information about the options available to them. Small annuitants may be put off by having to shop the market for a set number of quotes and are likely to favour surrendering their annuity with the original provider.

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 minor or following a divorce or dissolution of a civil partnership?*
- *Are there specific equality impacts that should be considered in this context?*

It is our strong opinion that annuities with an attaching dependant benefit should only be fully converted if permission is granted by all directly affected parties.

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?

See 14. Such flexibility in theory may help to improve the development of the market, but introducing partial assignments is further complication that is likely to be unwelcome and one that could increase cost on the individuals.

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?

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

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?