TOWERS WATSON

18 June 2015

Annuity consultation
Insurance and UK Regulatory Authorities Team
HM Treasury
Horse Guards Road
London
SW1A 2HQ

Dear Sir,

We are pleased to provide Towers Watson's response to the consultation on the creation of a secondary annuity market. Towers Watson is a global consulting firm with a particular strength in UK pensions. We advise occupational pension scheme trustees and sponsoring sponsors, administer occupational pension schemes, and provide actuarial advice to insurance companies including all of the specialist UK annuity providers.

We note that the consultation is about the details of policy and that the principle has already been settled.

The foreword to the consultation describes the Government's aims as "removing barriers and challenging industry to create a market". Participation in any market must be voluntary and Government must accept that responding to the consultation does not commit respondents to ensuring the creation of a vibrant market by bidding for annuities.

Throughout this response, we make various references to buying and selling annuities; this is merely short-hand for buying and selling the income stream attached to the annuity.

Overall comments

- If people accessing their pensions from 2015 are to have complete freedom over how they use their pension savings, it is hard to justify an outright ban on converting into capital those annuities that had been bought slightly earlier. (The Government has previously suggested that the new State Pension system made pension freedom possible by providing a non-means-tested floor – this might imply that restrictions on the use of private pension savings remain appropriate for people reaching State Pension Age under the old system because they may have a lower State Pension to fall back on. But a majority of people reaching State Pension Age in the first few years of the new system will have a State Pension below the full 'single-tier' amount and will be free to exchange their contracted-out alternatives for accessible capital; moreover, many existing annuitants will have State Pension incomes far in excess of the full 'single-tier' State Pension.)

- Removing the tax/legislative barriers to assignment does not mean that people will be able to sell their annuities for what they consider a good price. Operational costs, profit margins and fear of adverse selection are all likely to push down prices. We expect that prices will also be lower if providers are not allowed to buy back their own policies (although we agree that consumers may not get the best deals if this were the default option). It is important that people understand that there are good reasons for a spread between buy and sell prices; this does not mean that they are being "ripped off again", though it does count as a reason not to sell. It should not be seen as a policy failure if this remains a niche market because buyers' and sellers' valuations are too far apart.

- Annuity providers should not have to suffer losses on account of facilitating assignments – they should be able to charge policyholders for this. There is a case for regulation to ensure that providers do not use the proposed veto power to levy excessive charges.

- We agree that annuity providers should not be forced to offer surrender options –this would both increase the capital they need to hold in respect of annuity business and risk forcing a 'fire sale' of illiquid assets.

- However, subject to how the PRA would apply capital rules in this situation, annuity providers should be allowed to buy back their own policies. They may be able to offer better prices – buying back a policy would deliver administrative savings and release capital and the existing provider may have some information that others do not. We think the consumer protection fears raised in the consultation can be overcome. For example, providers could only be allowed to buy back their own policies if they would also permit assignment and consumers could be steered towards brokers/auction houses.

- As well as annuity providers, defined benefit (DB) pension funds are potential purchasers of annuity income streams. However, these annuities will only provide an imperfect hedge against longevity risk – annuities cover different lives with different spouses' benefits and indexation provisions – and that will affect the price that DB schemes are willing to pay.

- There is any number of ways in which annuities could be bundled together by intermediaries and sold on to end investors. Investors would need to have confidence in intermediaries' underwriting processes, especially if they did not retain "skin in the game".

- Detailed medical underwriting may be more necessary in the secondary annuity market than in the primary market. Annuity sellers will be older on average than annuity purchasers and a failure to report health problems would otherwise improve the price they could get. In the enhanced annuity market, a number of leading providers use a common quotation form to supply prices (though some may request further information or require a medical assessment); this runs to 13 pages. Unless people are to be charged for a quote, those who proceed to sell their annuity (which could be a small minority) will pay for underwriting in respect of those who choose not to sell.

- Purchasers of annuities will need to be attracted into the market based on the risks and relative returns associated with this type of asset and other asset classes. We can envisage that such purchasers could include institutions that have offsetting risk profiles, such as pension schemes and insurance companies that have written lifetime annuities themselves. In order for there to be sufficient demand from such institutions (as well as from other asset managers), the returns available from second-hand annuities will therefore need to be seen to be broadly comparable to those available from other assets these investors are typically utilising at present, including gilts, investment-grade corporate bonds, infrastructure assets, commercial mortgages and equity release assets. As a matter of economic and commercial reality, this will therefore mean there is likely to be a spread between the prices for original purchase annuities and second-hand annuities, and this should not be considered to be indicative of any 'failure' in the market for second-hand annuities.

- We expect that all annuitants whose policies were bought with defined contribution savings would want this option, even if they didn't exercise it; the Government should therefore look at ways in which it could be extended to members of occupational schemes where annuities have been purchased in the name of the trustees using DC and AVC funds (via assignment to individuals if necessary).

- We do not agree that annuitants whose policies result from defined benefit scheme buyouts need to be excluded.

- Having granted pension freedom to existing annuitants, the next group of people likely to lobby for the reforms to be extended to them are defined benefit pensioners. (Similarly, some DB members approaching retirement may not want to have to transfer in order to access cash in excess of their tax-free lump sum.) This is a policy decision that should not be rushed, but an indication of when the Government will consider this may be welcomed by individuals who need to decide whether to transfer before retirement (and by employers and trustees if the policy could be implemented in a way that will affect their cashflows). This future consultation could also consider whether recipients of Pension Protection Fund and Financial Assistance Scheme compensation should be able to cash out their income streams on terms that should be favourable to levypayers and taxpayers respectively.

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

The consultation paper says that "for the vast majority of people, continuing with their existing annuity will be the right choice".

What is "the right choice"?

An obvious definition might be the choice that turns out to maximise the resources that the individual receives over their lifetime. Clearly, this is something that will only be known with hindsight. On this basis:

- If selling an annuity were an irreversible "now or never" decision, whether a sale increased or reduced someone's lifetime resources would depend on whether they ended up living longer than the break-even lifespan implied by the sale price and market interest rates. (It would also depend on how the sale proceeds were invested and on whether the pace of withdrawals affected their tax liability.) At least initially, prospective buyers may either overcompensate or undercompensate for selection when setting prices, which will affect the number of people for whom selling turns out in retrospect to be the "right" decision on this basis.

- Whether resources are maximised over a lifetime will depend not just on whether someone sells their annuity, but also on when they do so (and on whether/when they subsequently buy another annuity policy – prices may change in the interim and the value of their investments may not move in parallel).

But there are several reasons why the choice that proves to be the resource-maximising one with hindsight may not in fact be the "right" choice even in retrospect – and especially not at the time it is made:

- Part of the value of an annuity is the insurance it provides against the cost of the additional goods and services that the policyholder will consume if they live longer than expected – it is the uncertainty surrounding lifespans, not just expected lifespans, which matters when assessing an annuity's value. Not needing to make an insurance claim does not mean that it was a poor decision to have purchased the insurance.

- People may value money today more highly than money in future. For example, they may want to spend it on things that they will only be able to enjoy while they remain comparatively healthy – maximising lifetime resources is not the same as maximising lifetime welfare. People will also prioritise spending while they are definitely alive above potential spending when they might be alive. The extent to which this is the case will vary across individuals. Alternatively, people who have relatively high lifetime incomes but little accessible capital may prefer to give up an annuity even on terms that they do not regard as good value. Selling an annuity is more likely to look like the "right choice" when people want to exchange income for capital than when they want to swap once income stream for another. However, where these are the motivations, borrowing may sometimes be a better way of increasing resources in the short term.

- Retaining an annuity may be welfare-optimising if someone would otherwise fret over how they will manage their wealth or if they would otherwise make bad decisions later in life when affected by cognitive decline. Conversely, selling an annuity may give some peace of mind to people who worry about their resources being lost to their family if they die unexpectedly soon.

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It would be interesting to know why this question has been asked. If the intention were to assess whether people are making what appear to be right/wrong decisions and (for example) adjust the guidance regime in response, it would be helpful for that to be made clear.

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?

By reducing demand, any restriction on who can buy annuities is likely to reduce the price that annuity holders can expect to receive. The premise of the consultation is that a trade at an agreed price should be welfare-enhancing to both parties. In that case, the main reason for restricting who can buy second-hand annuities should be to limit opportunities for tax avoidance or other unwanted activity.

Institutional investors (insurance companies and pension funds) should provide a more natural home for second-hand annuities than retail investors, both because of their need for assets that hedge the risks attached to their liabilities and because the greater scale of their investment makes it easier for annuities to be bundled together.

At the individual transaction level, the decision on the "right" price to pay for a second-hand annuity is complex and will involve informational asymmetries and computational complexities that are likely to be beyond the capabilities of most retail investors. Given the correct structuring and appropriate disclosures in marketing literature, we do not consider that retail investors should need to be excluded from buying 'packaged' second-hand annuities from appropriate intermediaries. However, recent fines issued in connection with life settlement investments may make advisers nervous about advising retail investors in this area.

If the policy intention is to prevent individuals from buying second-hand annuities but to permit institutions to do so, consideration would have to be given to the position of defined contribution pension schemes where investments are held by the trust but where it is individuals who select the investment and shoulder the risk in the accumulation stage. Is it the intention that DC schemes should be prohibited from offering investment options where contributions are used to buy units in a fund owning second-hand annuities?

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 note that the former Pensions Minister, Steve Webb, who co-signed the foreword to the consultation paper, recently said that he thinks insurers should be allowed to buy back their own policies. We agree with him on this.

There are three main reasons why the existing annuity provider should sometimes be able to offer a better price.

First, the existing provider is the only prospective buyer that could reduce its administration costs by completing this transaction, and for relatively small annuities this could be a significant proportion of the value that could be made available to the consumer.

Second, buying back an annuity would eliminate the need for the existing annuity provider to hold capital against these liabilities. The same capital advantages would not follow for another insurer buying an annuity policy issued by the original provider. For major annuity writers, the longevity and credit stresses are generally the main drivers of capital requirements under Solvency II:

- The longevity stress under the standard formula applies to liabilities; it may not apply to annuity assets. (Internal models used by some larger insurers can take account of how longevity stresses would affect assets).

- The insurer buying a second-hand annuity would take on exposure to counterparty risk (particularly if the Government decides not to extend FSCS protection to traded annuities).

We agree that insurers should not be compelled to offer surrender options. The consultation paper is right to warn of the capital consequences of this. We do not think that these need be a concern where surrender options are merely optional but firms would need to be able to justify their ability to reject a surrender request, in line with any PRA rules on this. We expect that the Government will have spoken to the PRA about how it would be likely to regard such options. (The consultation paper voices fears that public pressure could force providers to offer to buy back the annuity. It could help if the Government made it very clear that this was not the intention and that there are good reasons why an individual's own provider may not wish to buy back the annuity at all or may not offer as good a price as someone else. This will be particularly important following recent ministerial interventions expressing disappointment at pension providers who have not made the full range of pension flexibilities available to customers directly.)

Third, some information that only the existing provider will have – for example, knowledge of its sales practices at the time the policy was written – can be relevant to the price.

Beyond solvency concerns, if annuitants had a right to surrender their policy, the main objection to buy backs offered in the consultation paper is a "consumer protection" argument: people may end up accepting a poor price from their provider either because they falsely believe that this is their only option or because the provider would block assignment to anyone else.

If necessary, there are interventions that the Government could make to avoid this sort of consumer detriment. Most weakly, providers could be obliged to inform consumers that they may be able to get a better price elsewhere. Alternatively, they could be permitted only to bid against others on an exchange rather than offering policyholders a price directly; if one of the pieces of information supplied was the existing provider, an insurer may bid more for one of its own policies than for an otherwise identical policy, reflecting anticipated administration savings and capital advantages. Or consumers could get the best price elsewhere and then ask their provider if they want to beat it.

It would presumably be possible to regulate providers such that they could only accept annuity surrenders in cases where they would also permit an assignment, so they cannot force desperate customers to accept a poor price. (More generally, the Government could discuss with insurers whether a requirement to permit assignment subject to reasonable cost recovery could assuage concerns about the possible consequences for them of consenting, or whether they value a veto power.)

The final issue highlighted in the consultation paper is the possibility that, if annuities were cancelled rather than assigned, annuity-backing assets may be dumped on the market. As things stand, we do not think that this need be a major concern: most annuitants will not sell at all; not all of those who do will sell to their existing provider; and there is pent-up demand for liability matching investments from pension funds, as well as the strong incentives present in Solvency II for insurance companies to ensure that remaining annuity (and any other Matching Adjustment related) business is supported by assets that are closely cashflow matched. Obviously, if market sentiment towards bonds changed and a government with a significant borrowing requirement found it harder to sell gilts, this may become more of a concern.

It is not clear how a ban on providers buying back their own policies would work in practice. For example, if an individual sold their policy to an intermediary, would the provider be banned from purchasing it from this intermediary? Would the provider be banned from purchasing the income stream off a second insurer who had bought it? If an individual sells an annuity policy written by Insurer A to Insurer B, what happens if Insurer A then merges with or takes over Insurer B?

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?
Services for tracing deaths (using death registrations) already exist and are used by pension scheme administrators and insurers.

Any additional cost associated with greater reliance on these services following assignment could legitimately be passed on to consumers.

It can take up to six weeks for deaths to be identified using tracing services linked to General Register Office records. If assignment means that annuity providers do not learn of deaths as quickly, they may only permit assignment to organisations that they would trust to return any overpayments. (Alternatively, an allowance for irrecoverable payments could be incorporated into the assignment fee; obviously, the Government would want to ensure that such fees were proportionate. The shorter an annuitant's life expectancy, the bigger this part of the assignment fee would be in relation to the cash sum offered.)

Any additional facility that the Government chose to create would not only be of use in the secondary annuity market, but also for insurers and pension schemes paying out non-assigned pensions.

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. Any cap on charges must be set at a level that allows insurers to recover any costs; without this, they may block assignment if they have this option (or suffer a loss if the Government changes its mind on this point). We agree that there is a case for regulation to ensure that the desperation of some individuals to sell is not exploited through the charges for permitting assignment.

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?
Annuities held by a DB scheme as part of a buy-in should not be assignable by individuals – although these annuities pay out based on the lives of specific people, they are assets held by the scheme to help meet the cost of its obligations to all members. Most schemes are significantly underfunded on a self-sufficiency basis, so allowing individuals to take the value of "their" annuities would see a transfer of scheme assets to these individuals from the remaining members, whose exposure to the employer covenant would then increase.

Some annuities that are in the name of the annuity holder and held outside an occupational scheme may nonetheless be scheme pensions. This will be the case where defined benefit rights have been bought out (rather than the trustees simply retaining the annuities as liability matching assets following a buy-in). We understand that the intention is that such annuities should not be tradeable (at least unless and until the government permits flexibility for defined benefit pensioners to exchange their pensions for cash sums).

It is not obvious why the chain of events that led to an individual holding an annuity (saving in a DC pension vs having a DB pension entitlement that was bought out) should determine whether this annuity can be assigned – in neither case does the scheme hold a liability to pay the pension. If the argument is that the reform is intended to put existing annuitants in a similar position to people retiring post-April 2015, we would note that DB members can elect to transfer out before drawing their pension (sometimes subject to the scheme permitting non-statutory transfers) just as DC savers can choose not to buy an annuity. However, as the Government does not intend to allow annuity providers an exclusive right to buy back their own policies, permitting assignment in these circumstances is unlikely to reduce the cost of buyout to pension scheme sponsors (which might be an objective if the Government were concerned that legacy pension risk was hampering business competitiveness).

Some occupational schemes have historically bought annuities for individuals in the name of the trustees – including where DB members have money purchase AVCs. Often, the annuity payment will be made directly to the member by the annuity provider, rather than being routed through the scheme. Although changes to accounting rules discourage this and give schemes a reason to assign annuities where possible, it might be a significant legacy issue. Individuals in this situation would expect to have the same options as other annuitants. The Government should seek to make this possible (either directly or, if necessary, after the annuity policy had been formally assigned to the individual by the scheme).

7. Are there any other types of products to which it would it be appropriate for the government to extend these reforms?
It appears that the reforms would apply to newly purchased annuities as well as to the existing stock. Although we would expect the effect to be marginal, doing something about the irreversibility of annuity purchase may remove one behavioural barrier to this.

Would deferred annuities that have not yet come into payment be in scope? These may be a more significant part of the pensions landscape in future than they are today and they may look rather different. For example, rather than purchasing an annuity at 65, someone may choose to purchase a deferred annuity that starts being paid out at 80 and know that their remaining pot only needs to last for 15 years. Alternatively, people may purchase deferred annuities that will begin paying out at their intended retirement age (in some cases, such deferred annuities could be held by people below minimum pension age).

The Government could usefully clarify how it sees the reform working in the case of guaranteed annuity rates. If someone is approaching retirement with a very advantageous guaranteed annuity rate but prefers capital to income, they may have to assess whether they would do better to give up the GAR before retirement or allow the income stream to come into payment and then sell it. Subject to the advice requirements around the secondary annuity market, it may be that one course of action would incur advice costs and the other would not.

There are some other types of products that also offer benefit payouts as income rather than as lump sums, including income protection policies (both short- and long-term), periodic payment orders (typically arising from motor vehicle accidents) and Family Income Benefit policies. We would not consider it appropriate or necessary to extend these reforms to these types of products, for various reasons. The income protection policies typically provide cover during 'working age' (e.g. up to age 65) rather than throughout life. The short-term cover typically provides regular monthly payouts for periods of up to 12 months while the policyholder is temporarily unable to work (either through disability or through unemployment) while the long-term cover typically provides regular monthly payouts for the extended period (often through to age 65) if the policyholder becomes permanently disabled and is unable to work. Periodic payment orders are assessed to be relevant to a policyholder claimant's needs by the Court following a motor vehicle accident and have been specifically introduced to better protect the claimant, compared to the previous lump sum awards that were previously made. Family Income Benefit policies already typically have a commutation facility at the time a claim is payable (the death of the insured person) and the alternative 'conventional' Term Life Insurance coverage (which is designed to pay a lump sum rather than a regular income) is already available.

As noted above, we think that any moves to extend pension freedom to defined benefit pensioners should only proceed after a separate consultation.

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?

The tax treatment will be the same for people accessing pension freedom before or after annuitisation. Some people should expect a loss of value as a result of buying an annuity and then selling it, particularly if prospective buyers assume that the latter decision says something about how long they can be expected to live.

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

The consultation paper does not make clear precisely what tax avoidance opportunities the Government has in mind. The consultation paper proposes that, where a lump sum is taken, tax will be deducted at source through PAYE, which suggests that only entities that can do this will be able to purchase annuities. There may be tax leakage if people who would otherwise be taxed on annuity income keep the sale proceeds within a flexi-access drawdown account and pass these on tax-free on death (either because they die before 75 or because the beneficiary is a non-taxpayer such as a grandchild), but this does not appear to be contrary to the policy intention if the idea is to give existing annuitants parity of treatment with people retiring under pension freedom.

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?

If DB members must take advice before transferring, the same should be true of annuitants wishing to sell – both are giving up a lifetime income stream in return for accessible capital.

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The Pensions Minister has suggested that the £30,000 threshold for DB-DC transfers without advice is too high (she favours a figure around £10,000) but that a threshold of around £30,000 might be appropriate for the secondary annuity market. Her argument is that DB pensions come with indexation and dependants' benefits whereas many individually purchased annuities do not – and hence that the decision to transfer out of DB is more complicated and involves giving up more longevity protection.

We are not convinced by this. First, some annuities do have these features and some DB members do not have spouses or other dependants. Second, limited price indexation and a 50% dependant's pension should not make a DB pension worth three times as much as a single-life level annuity with the same starting value. Third, annuities will typically be more secure than DB pensions. (We also do not agree with proposals to lower the threshold for DB to DC transfers. If advice costs £1,000, this could be 10% of a £10,000 transfer value; in some cases, it can cost more than this.)

Whereas a DB member can ask the trustees for a transfer value which tells them how much they would get if they did transfer out, an annuitant cannot ask their provider for this – even if the provider is permitted to bid, this may not be the best price. Individuals would therefore have to approach the market in order to learn what their annuity was "worth" before knowing if they would need to take advice before being permitted to sell it. If advice costs the best part of £1,000, someone determined to sell would be far happier to receive a quote for £29,900 than for £30,100! Alternatively, the requirement to take advice where policy values exceed a certain threshold could be based on a prescribed valuation method – but, in that case, some people would be forced to take advice before selling an annuity that would fetch less than the threshold, whilst others could receive more than the threshold for an annuity that they would be permitted to sell without advice.

We expect that the Government's intention is that people who are advised not to sell should be able to do so anyway. As with DB to DC transfers, the Government could look at what reassurance it could give providers and advisers dealing with insistent customers (for example where someone wants to sell an annuity and put the proceeds into a flexi-access drawdown fund) will be protected against compensation claims.

DB-DC transfers must take place before the pension starts being paid out. In practice, most are likely to take place shortly before retirement. With annuity sales, the average age of potential sellers will be older and there will be more dispersion of ages. Other things being equal, annuities will be worth less when someone is older because fewer payments are left. So, for a given annual income, older annuitants (who may be more likely to have suffered cognitive decline) may be able to sell without advice whereas younger annuitants could not. If the Government were concerned about this, it could set a threshold based on annual income rather than capital value – but that would raise further questions, such as whether thresholds should be different for level and index-linked annuities.

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

As stated above, if advice is required for DB-DC transfers it should (despite significant practical difficulties) be required for annuity sales where the annuity has a similar value.

An expansion of a fully and effectively functioning Pension Wise service would not only help people who would not be required to take advice; it could also be useful for people who would need advice but who want to understand their choice a little better before committing to advice costs.

The funding base for Pension Wise is supposed to reflect which organisations will potentially benefit from supplying services linked to the new pension freedoms. If Pension Wise's remit changes fundamentally, this should be reviewed. (However, this comment is more applicable to the proposal that Pension Wise be extended to provide whole-of-life financial guidance than to the proposal that it covers annuity sales.)

Guidance could helpfully explain that, when interest rates are low, annuities will look expensive (and price quotes for secondary annuities high) because it costs a lot to produce that income stream. If someone was offered more than they paid a few years ago when interest rates were higher, this would not necessarily mean that they were getting a good deal – merely that buying the annuity they never really wanted turned out to be a good interim move on the way to cashing out. The chance of living to old ages will be another important issue to cover.

The age profile of annuitants means that, sadly, a minority will have reduced cognitive abilities; a policy based on the idea of treating people like adults and letting them make their own decisions becomes more challenging as they lose the ability to do this. The government could usefully clarify whether it envisages any specific safeguards in this area.

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?

Yes – if advice is required, the recipient of that advice should pay.

With DB-DC transfers, sponsoring employers will sometimes offer to pay for advice (and can be required to in some circumstances) – generally because they would welcome settling liabilities at less than buyout cost where members decide to transfer. There could only be an equivalent offer in the annuity space if insurers could buy back annuities and stipulate that anyone taking up their offer to pay for advice could only sell to them; this seems a long way from the Government's intention.

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?

We're not sure that shopping around needs to be mandatory as long as the potential loss from not shopping around is properly communicated. Of course, this comes down to the balance between treating people like adults and protecting them from themselves.

Any policy intervention should aim to steer sellers towards the best price. In sections of the annuity market, several providers will write an annuity if the rate is low enough, but two or three offer much keener prices. The same could be true in the secondary annuity market. Requiring people to get three or four quotes, all of which could be bad ones, will not help.

Prospective purchasers cannot be forced to set prices using the same pieces of information but competitive pressure will be greater if multiple quotes can be generated by entering the same pieces of information into a central database. Annuity brokers already do this and algorithms that providers have set up to calculate the price mean that quotes are delivered instantaneously. (However, the secondary annuity market may be more like the enhanced annuity market in terms of the level of detailed information that individuals must provide, given the older age profile of sellers and likely informational asymmetries that would otherwise exist between the seller and the prospective purchasers.)

In theory, the same pieces of information could be used to generate both "buy" and "sell" quotes – i.e., the individual could see the terms on which they could convert income into capital alongside the terms on which they could convert capital into income. The spread between these numbers would reflect costs, profit margins and the extent to which market participants believe that a desire to buy/sell an annuity conveys useful information about life expectancy over and above what is known from the personal information collected.

The consultation recognises that annuity providers will want to recoup the costs associated with assignment. Annuitants would want to see any charges alongside the prices they are quoted, or to see a net figure. Setting out charges in a clear and transparent manner might appear to support consumer protection, but many potential sellers may be interested in little other than "how much will I get"?

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?**

The consultation paper appears to say that annuity contracts will often be worded in a way that means dependants would not have to consent to assignment, but that it nonetheless expects insurers to seek consent. If this is something that it wants insurers to do, that should be clear in guidance.

- **Are there particular classes of beneficiary which require special consideration, for example minors or following a divorce or dissolution of a civil partnership?**

If there is a pension earmarking order on an annuity, it may be contrary to the intention of this order if the annuitant could sell their annuity without the former spouse's informed consent, which may include an advice requirement.

There will be particular complications where dependants cannot be identified at the time of the sale – such as where an annuity provides a spouse's benefit to whoever is married to the annuitant at the time of their death.

The Government may also want to consider how the consent of child dependants would be secured, particularly if the annuitant was the legal guardian.

- **Are there specific equality impacts that should be considered in this context?**

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 decision should be left to the parties' discretion. We agree that, in practice, insurers are more likely to consent to the whole annuity being assigned and are likely to wish to secure the consent of dependants. Again, it should be made clear that there is nothing wrong with an insurer agreeing to assignment on an "all or nothing" basis, and that those who do so are not thwarting the Government's policy intention. In the event that the parties do want to retain the dependants' (contingent) income stream with the provider of the principal annuity holder's benefits, then it is likely that the costs of doing so would be reflected in the terms offered by the provider for the principal annuity holder's benefits (i.e. the amount offered would be lower than for an identical single-life only annuity, as the provider would then need to cover the administration and other expenses of the dependants' annuity both during its 'contingent' state and once in payment).

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?

Benefits can be withheld where a claimant has deliberately deprived themselves of income or capital and where a "significant" motivation for this was to increase the benefits they are entitled to.

It remains unclear how – and how consistently – decision-makers will apply these rules in relation to pension freedom. A tough approach could leave significant numbers of people with a standard of living that is unacceptably low. But a lenient approach that permits "double dipping" would reward deprivation of income/capital and be unfair on people who retired in similar circumstances but acted more prudently.

With annuity assignment, as with pension decisions more generally, it is hard for people to understand the impact when benefit awards will reflect the judgement of decision makers rather than just the application of a formula. More official guidance, including examples, would be helpful.

17. Should those on means-tested benefits be able to assign their annuity income?
The reason given for consulting on supplementary measures in relation to annuity assignment is to "protect the taxpayer" (paragraph 4.27) – rather than to avoid situations where pensioners have to live on insufficient resources, or to spare decision-makers from having to adjudicate.

This indicates that the Government believes there could be a financially material number of cases where existing claimants could assign annuities and not be held to have deliberately deprived themselves of income.

Prohibiting annuity assignment by existing benefit claimants has the virtue of simplicity. Moreover, it will usually be better that people do not need to claim enhanced benefits in the first place than claim them, have their claim rejected, and then have to live on too low an income.

However, it may appear unfair if (poorer) pensioners already claiming means-tested support are banned from "double dipping" whilst their slightly richer contemporaries are able to assign their annuities and (to the extent permitted by deliberate deprivation rules) fall back on the taxpayer. Alternative/parallel measures could include tightening the deprivation rules and/or introducing some kind of Minimum Income Requirement (though we note that the Government rejected the latter approach in relation to people who access their pension wealth, from April 2015).

Those likely to be claiming means-tested benefits (or to claim them in future) are, perhaps, likely to be in receipt of modest annuity income and thus likely to be under any advice threshold. Yet these individuals may be amongst those most in need of advice because of the potentjal impact on their means-tested benefits. If there were a requirement for people claiming means-tested benefits to seek advice before selling their annuity, the cost of that advice would be likely to uneconomic. As a minimum, the Pension Wise service should address this situation explicitly. (Potentially, grants could be made to cover the cost of financial advice for pensioners claiming means-tested benefits – though the Government may not want to use taxpayers' money to help people make choices that may increase future greater costs to the taxpayer.).

Whatever the Government chooses to do here, it appears that there will be some discrepancy between the treatment of at least some existing annuitants and the treatment of people retiring under pension freedom.

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.
Other things being equal, a woman will be expected to live longer than a man of the same age. The fair value of her annuity will therefore be higher.

It is for lawyers to say whether purchasers would have to bid on a gender-blind basis, given the existence of the EU Gender Directive. If so, women may be offered less than their annuities are "worth" (despite having paid a gender-specific price where these were bought before the UK began implementing the Directive in accordance with the Test Achats ruling), while men would be offered more than theirs are "worth".

Knowing this, it would then be rational for prospective buyers to assume that a greater proportion of male annuitants will sell and to price on this basis. Together with the likelihood that more annuities were written for men to begin with, this could bring the unisex price close to what a free market would set as the male price. This would leave female annuitants to choose between selling at a discount and not selling at all. (With annuity purchase now much more voluntary, the opposite problem may be encountered in that market: unisex pricing makes it more rational for women to buy annuities and sellers know this.)

Yours faithfully,

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