Pension Income Choice Association

response to

HMT and DWP consultation on the secondary annuity market

About PICA

The Pensions Income Choice Association (PICA) is a membership funded group set up in July 2009, representing a diverse group including product providers and advisers who operate in the annuities and retirement market.

The Association is run by a management group which has representatives from Just Retirement, LV=, Making Sense of Retirement, MGM Advantage and Partnership Assurance with Tom McPhail, from Hargreaves Lansdown, as chair.

PICA is dedicated to promoting the importance of reviewing pension assets at retirement to determine the most appropriate solution for the needs and circumstances of every individual.

PICA welcomes the opportunity to respond to the HMT and DWP consultation on the secondary annuity market.

Overview and Executive Summary

The pension freedom changes introduced from 6 April 2015 gave people unprecedented choice around how and when they can use their retirement savings. This consultation proposes extending this freedom by allowing retirees who have already purchased an annuity to sell the right to their future income stream in return for a cash lump sum.

We are in support of the creation of a secondary annuity market if the necessary conditions are established to ensure: (i) customers are protected; (ii) that there is a transparent and competitive marketplace; and (iii) the accounting treatment of the future income in the hands of the purchasing insurer is capital efficient.

If a secondary annuity market is introduced, there should be customer safeguards sufficient to create a competitive market, help people understand the value of the income stream they are receiving and protect people against making poor decisions.

Currently not enough people are choosing the most beneficial retirement income option at the best price. This is partly due to buyer ignorance and too few people receiving advice, but it's also a consequence of provider bias. Every year hundreds of thousands of individuals at the point of retirement are not taking up their right to shop around to secure the best possible income for their retirement. This process of shopping around can potentially increase income in retirement by thousands of pounds over the course of a typical retirement. Accessing shopping around services usually results in a higher proportion of people achieving benefit structures and income shapes that are more appropriate to the individual and their family than if they had purchased directly from their ceding pension scheme.

The failures that have existed for decades within the "internal" annuity market should alert policymakers that the same defects are likely to be repeated in a secondary annuity market. Consequently, in establishing a successful secondary annuity market we believe HMT should establish the following conditions:

1. Establish compulsory trading channels by authorising a number of trading bureaus

The benefits to be achieved by shopping around for the highest annuity income can be substantial. For example, research conducted by Life & Pensions Moneyfacts for MGM Advantage as at 2 January 2015 showed the best income achievable for a £50,000 pot (for a 65-year-old) was £2,854.00 while the worst open market rate was £2,488.80, a potential increase in income of nearly 15%. Many people will be able to receive even higher rates if they disclose health and lifestyle conditions to annuity providers. The highest rate for someone with 'moderate' health conditions was £3,438.36, 38% above the 'worst' income.

If a secondary annuity is to be viable and competitive (while helping customers attain the best value for their annuity), we need a step-change in the way consumers engage with and are served in the current retirement income market. Establishing authorised bureaus would create a service where annuity customers would be presented with a whole of market price (see answer to Q13 below for further information).

2. Regulated financial advice

It is well recognised that those taking advice or help make better decisions regarding their retirement income solution. The guidance service, Pension Wise, should provide another channel through which people are equipped to make better choices.

One simple option would be to require everyone to take advice. However we do not believe that this is realistic. There is unlikely to be sufficient numbers of regulated advisers willing to provide advice for cases valued below £30,000. And there is unlikely to be demand by consumers to have to take (and pay for) advice if the value of their annuity is low.

An alternative is to require those people who have more substantial income to take regulated advice. People who wish to transfer out of a defined benefit scheme to access the new pension freedom must take advice if the value of their benefits is above £30,000. The government should consider whether it is necessary to mandate that advice is required above a defined minimum level.

However, if this route is adopted people will generally not know the capital value of the income they are receiving and therefore the market will need to provide a mechanism to deliver a personalised value to the individual within a reasonable tolerance e.g. +/- 20 per cent, without the customer incurring costs. We believe a bureau model could deliver this service.

Specific question in the consultation paper

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?

Many people are likely to be better off financially by keeping the stable and guaranteed income they are receiving from their annuity. However there are a number of situations where people could benefit from assigning their rights.

(i) *People wanting to reconfigure their benefit structures*: e.g. those who purchased single life annuities may now wish to add protection for a spouse, people who have guaranteed income may wish to convert to flex-access drawdown to provide access to irregular fund withdrawals

(ii) *People with eligibility to guaranteed annuity rates*: defined contribution pension savers approaching retirement who have a need for a lump sum may create more value by accepting the annuity and trading this in the secondary market rather than taking the cash value of the accumulated pension savings

(iii) *People wanting to preserve value for the next generation*: people who did not add value protection to their annuity benefit structure may wish to transfer the secondary market value into a new retirement product to enable the savings to be passed to the next generation

(iv) *People who have a need for a lump sum*: people who have sufficient income from other sources to satisfy their regular outgoings may wish to generate a lump sum from an existing annuity arrangement

(v) *People with very small annuity income*: some people may have previously had no choice other than to convert a very small pension fund into an annuity. The income stream may not be material and would benefit from converting the value into a lump sum.

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?

PICA believes the government should encourage sufficient institutional purchasers to participate such that a competitive market is created. We believe the government should ensure purchasers are regulated businesses by the Financial Conduct Authority, Prudential Regulation Authority or international equivalents. Having businesses with these credentials would provide greater confidence that the necessary conditions to protect consumers and to ensure strong industry protocols are adhered to in the operational aspects of administering the market.

The accurate and fair valuation of an annuity in payment is not a straightforward task. It requires an assessment of the time frame for continued payments and therefore needs to take into account factors such as age, previous occupation, where they live, health and lifestyle. Taking all of these factors into account is likely to lead to better customer outcomes, but means specialised individual underwriting knowledge and processes are required, as well as links to reputable reinsurers.

It is unclear whether a safe market could be created to enable retail investors to access this style of asset. It may be possible for asset management companies to create collective investment funds and for them to be structured to enable retail investors to participate. A packaging bureau (see comments on bureau in question 13) may be required to facilitate this opportunity for an asset manager.

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?

PICA believes insurance companies should be allowed, but not required, to participate in 'buy back' under specific conditions to ensure the customer has access to the best value (existing providers may be best placed to offer best value for very small pension annuities).

People should only be enabled to trade their annuity income on the open market, through authorised bureaus (see comments on bureau in question 13). To avoid the risk identified in chapter 2, the existing annuity company should only be permitted to offer a price via the bureau but not directly to the customer. The bureau would adopt a blind bid system when presenting a value to the customer, which would further mitigate the risks.

There should be no marketing allowed by existing companies to their own customers and there is an argument that customers who are eligible for commutation should be required to use an authorised bureau to ensure they achieve the best price.

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?

This is a key issue for existing providers when deciding whether to allow their annuitants the opportunity to participate in any secondary annuity market. The holding provider will be paying an income to a third party but based on the original annuitant's lifespan. Clearly it is essential that the provider is notified when the annuitant dies, and payments should cease (or continue at a lower level).A central 'death register' would appear to be the most simple way for providers, but we agree this would appear a time-consuming task to set up. It is not our view that this is an essential requirement. An option which requires, as a condition of the annuity assignment, the annuity holder to put in place arrangements to instruct the executor of their estate to notify the annuity provider upon their death may be feasible. However work needs to be undertaken around this issue, to determine how it can work from a legal perspective.

PICA believes if the market participants are all regulated businesses (see answer to Q2) then an effective set of protocols could be created by market participants. It may be helpful for the government to appoint a chairperson to lead the development of these protocols with representatives from the various industry trade bodies.

If the government determines non-regulated entities will be eligible to participate then it would be appropriate for government to enable companies involved in the market to access a central government administered database. Currently, relatives are required by law to register deaths and we would expect that the 'Tell Us Once' system already in operation to assist with the cessation of State Pension payments on death could play a role. Therefore, an expansion of and extension to insurers' access to this database would negate the death notification issue quickly and with minimal cost. If not, whilst a central death register may incur some initial costs, we believe that such a system will have added use outside this specific 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?

We broadly agree with this approach and it is right that HMT and the FCA should monitor how a fees and charges regime develops within the new market. However, there are important factors that need to be borne in mind when thinking about a potential new fees and charges regime.

The cost of assessing the value of an annuity and the viability of an assignment could be high, involving specialised medical underwriting, as well as the costs of general administration of payments to the third party by the provider.

Fees and charges could be further complicated by the size of the annuity involved, and in the event that the market allows an assignment of a portion of an annuity, varying fees and charges could apply depending on whether a portion or the full annuity is assigned. The regulatory approach therefore needs to be proportionate and take account of the overheads generated by the operation of the market and potential complexities, such as dividing up an annuity stream if this is deemed permissible. It is crucial any regulatory approach promotes a level playing field for all prospective purchasers on the disclosure and monitoring of charges, irrespective of whether they are an annuity provider or not.

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?

Customers will not be aware of how their annuity is legally established. Neither will they draw any distinction. It is simply a retirement income which they are receiving. Therefore if the government draws an arbitrary line which allows some people to trade their income and others not to do so, there are likely to be some disgruntled customers who are not able to take advantage of the pension freedoms who had perhaps been led to believe they would be able to. This decision needs to be handled carefully with clear communication given by government on the reasons behind any decision.

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

This is a very difficult line to draw as experience suggests there are grey areas – both in a customer's understanding of what contract they have, and in the legal definition of some contracts. It is important there is clarity well in advance of any changes being introduced, so that both providers and customers have a clear distinction in what may or may not be allowed, as well as ensuring consistency of approach across all providers.

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?

While we understand the desire to allow people to have control over their retirement income, we believe the introduction of a secondary annuity market could create risks for consumers. Some people may make poor decisions.

Further detailed information and risk warnings on the tax treatment of the annuity in the hands of the buyer should also be provided. Otherwise there is a real risk that uncertainty in this area will deter potential buyers and hinder creation of the market.

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

There needs to be clear rules in place to prevent any connected transactions, and ensure any purchaser is at arms length from the seller. This can partly be achieved by ensuring those participating are reputable and appropriately (FCA/PRA or equivalents) regulated entities.

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?

We believe that ideally, every customer should seek regulated advice. The guidance service, Pension Wise, should provide another channel through which people are equipped to make better choices.

However individual regulated advice is unlikely to be a realistic scenario for those with smaller income streams, as there are unlikely to be sufficient numbers of advisers willing to provide advice for smaller cases. And there is unlikely to be demand by consumers to have to take (and pay for) regulated advice if the value of their annuity is low.

People who wish to transfer out of a defined benefit scheme to access the new pension freedom must take advice if the value of their benefits is above £30,000. The government should consider whether it is necessary to mandate that advice is required above a defined minimum level.

However, if this route is adopted people will generally not know the capital value of the income they are receiving and therefore the market will need to provide a mechanism to deliver a personalised value to the individual within a reasonable tolerance e.g. +/- 20 per cent, without the customer incurring costs. We believe a bureau model could deliver this service.

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

Yes. Pension Wise should have a key role to play in helping those who may wish to assign their annuity make the right choice. In addition it is crucial consumers are given access to clear and accurate information which helps them understand this part of the market – as it is fundamentally different from taking benefits from an uncrystallised pension fund.

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?

If Pension Wise is expanded to encompass the secondary annuity market then the delivery of guidance should remain free at point of contact. We agree that the cost should be borne by the annuity holder after the customer has reached a certain point in the customer journey. We do believe that customers should be able to access the secondary market via a bureau service and to receive an estimated valuation (this may be within a +/- 20 per cent range) without incurring fees or charges.

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, we believe it should be compulsory for customers to shop around for the best possible deal before they can trade their annuity.

PICA believes the government should introduce a requirement that customers should only have access to the secondary market via authorised bureaus. The bureaus would be established to create a transparent open market with access to valuations from all participants.

A bureau model would enable existing annuity companies to participate in buy-backs and mitigate the risks identified in chapter 2 by operating a blind bidding system, where the customer is not presented with the brand of the winning bidder until later stages in the customer journey.

A bureau model would enable scale to be established relatively quickly and standards to be defined that would deliver confidence to the industry regulators. Bureaus could operate competitively within the market and offer a range of additional services that would enable them to differentiate their offer in the market whilst maintaining a minimum set of operating standards.

There are issues that would need to be considered in designing a blind bid system (for example companies identify their own clients), but these are not considered insurmountable.

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?

It is crucial to avoid potential customer detriment in future if at all possible – and it is easy to envisage a case where a dependant is expecting a retirement income to commence following their partner's death, but finds out that no income is in fact payable as it was traded a number of years ago.

However preventing this from happening is not straightforward. In some instances a dependent or beneficiary has contractual rights. If so it may be simple for a provider to obtain written consent from the dependent or beneficiary to the assignment.

There are scenarios though where it may not be feasible – or legally permissible – to obtain consent. Providers are bound by data protection laws and may not be able to give information to a third party in some situations. For example, some joint-life annuities are written on an "any spouse" basis, so no individual dependant has an absolute right to that benefit. And on occasion the dependant who may have expected to receive the benefit may not have been a dependant when the annuitant traded the annuity.

There are also situations where the dependant may be elderly or have reduced mental capacity when written consent could be challenged at a later date. Further consideration needs to be given to this area, to ensure clarity and good consumer outcomes.

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 is an important aspect and also raises questions around whether an annuitant could assign only part of their annuity instead of all of it.

As the consultation paper highlights, the complexity and cost of partially assigning an annuity could be high. And therefore providers may be less willing to offer this option to customers.

If it were to be allowed, it makes an already difficult decision even more complex for consumers, in attempting to weigh up the flexibility, guarantees, tax implications and potentially higher fees and charges for undertaking this, as well as the impact on their entitlement to means-tested benefits.

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?

It is absolutely crucial that consumers are fully aware of any potential impact on means-tested benefits before they make a decision. Means-tested benefits are a complex area and this is not a straightforward task. But it seems inconceivable that we can ask consumers to make a difficult decision while not having full information on a key aspect of their future financial wellbeing. Pension Wise may have a valuable role to play in alerting people to this issue. It should also be the responsibility of the regulated authorised bureaus to highlight the impact on means tested benefits when people are considering assignment of annuities

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

This is a difficult position. It is easy to envisage that those most likely to see benefit in trading their annuity are those with a very small retirement income. Giving up a small monthly income in return for a four figure lump sum may well be attractive to people, who perceive greater value from the lump sum than the insignificant regular income. But these people are more likely to be receiving means-tested benefits, and so seek greater state benefits in future.

However if the government draws an arbitrary line which allows some people to trade their income and others not to do so, there are likely to be some disgruntled customers who are not able to take advantage of the pension freedoms who had perhaps been led to believe they would be able to.
It is also a difficult decision working out where to draw that line. Should only people who are already in receipt of means-tested benefits be prevented from trading their annuity? What about people

who don't currently receive means-tested benefits but could do so once they 'give up' their regular income stream?

This decision needs to be handled carefully with clear communication given by government on the reasons behind any decision.

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.

It is our view that the measures in place that govern the sale of annuities generally should also be applied to any secondary market for annuities.

Further information

If you would like further information regarding the our submission please contact –

Or