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TUC

Creating a secondary annuity market

Response to HM Treasury and Department for Work and Pensions call for evidence

TUC

Introduction

The TUC welcomes the opportunity to respond to this call for evidence. We represent more than 5.5 million members organised in more than 50 trade unions. We are the leading representative consumer voice on pension policy issues.

The failings of the annuity market are well documented. Repeated attempts to promote "shopping around" – encouraging savers to compare prices and types of policies from a range of providers before making a purchase - have foundered on the hurdles of disparities of information, consumer inertia and industry reticence to change. This has led to many people buying poor value or inappropriate products and therefore securing lower standards of living in retirement for themselves and their dependants than might otherwise have been achieved.

It is admirable that the government is seeking to address the consequences of these longstanding problems. However, we believe that facilitating the sale of annuities in a secondary market should be approached cautiously to minimise the risk of more people facing hardship in old age and the undermining of trust in pensions more generally.

This means that the government should seek to phase in annuity re-sales starting with only the smallest contracts, and with robust consumer safeguards. In this way evidence can be gathered about those who might benefit from selling an annuity while ensuring that the impact of any early problems are minimised.

Currently there is little evidence on the characteristics of those who would seek to sell an annuity. This makes it very difficult to assess the wider social impact of annuity re-sales.

Likewise, we do not know of the demands of potential buyers, raising the question of whether the sorts of annuities they might wish to buy chime with the types of annuities that potential sellers would seek to dispose of.

Such weaknesses on the seller and buyer sides make it very possible that a secondary annuity market may not take off. Another risk is that a market does emerge in limited form with thin buyer demand and the resultant poor pricing means that the only sellers would be the desperate and the poorly informed.

Those on the lowest incomes could be particularly badly affected by poor decision making. People who receive means-tested benefits may find that they lose certain entitlements and risk hardship in old age if they sell an annuity. Women, who are more likely to be the surviving party of a joint annuity and on lower incomes in retirement, could suffer hardship if insufficient account has been made of their life expectancy.

The following measures would give some protection to individuals participating in this market:

- Phasing in of the regime, starting with small annuities;
- Compulsory regulated financial advice for those who seek to sell an annuity of more than minimal value;

- Requirements for provision of information to potential sellers including comparison tables of sample sale prices.

Seller-side

The weak consumer position in financial services, and pensions in particular, has been well documented.

The Office of Fair Trading's Defined Contribution Workplace Pension Market Study of two years ago highlighted that employees often lack the capability or the incentive to assess value for money in defined contribution workplace pensions.

The Financial Conduct Authority's Retirement Income Market Study published earlier this year also identified barriers to savers getting a good deal when buying annuities. These included issues with the length and complexity of information provided.

Selling annuities will be an even more complex task than purchasing annuities or other pension products because it is a new market with no historic prices and other sources of data that would allow sellers to know if they are getting a fair deal. Sellers will also have to consider issues such as life expectancy, the consequences of living longer than average and the potential impact of inflation and investment returns on savings.

As highlighted in the consultation paper, behavioural finance shows that people tend to attach insufficient importance to long-term factors and therefore often over-value a lump sum compared to a stream of future payments.

Therefore any exploration of a secondary annuity market should be approached with consumer protection the foremost consideration.

Indeed, as set out above, given the weight of evidence around these factors, and the inevitably high levels of complexity sellers participating in any new market will face, we believe the government should only facilitate the creation of a secondary annuity market if significant steps are taken to safeguard consumers' interests.

It would be more appropriate for sellers to be required to receive financial advice rather than guidance (**Question 10**). The system of guidance established in April is general in its approach. The risks and complexity attached to selling an annuity have more in common with transferring money from a defined benefit to a defined contribution scheme, for which financial advice is required for pensions of more than £30,000, than with more general pensions freedom actions. For example, in the cases of both annuity sales and DB transfers investors are surrendering the protection of longevity risk sharing.

It is important that those on means-tested benefits understand the impact an annuity sale might have on future entitlements (**Question 16**). It is hard to envisage that general information from a buyer or from a guidance service would be sufficient to meet that requirement, further underlying the need for quality advice to be provided

Likewise it seems most appropriate for the costs of advice to be met by the annuity holder (**Question** 12). If borne by the buyer it is likely that the costs would be reflected in the price offered for the annuity (reducing the value to the seller of the transaction) with the added risk that advice would be skewed towards encouraging a sale.

Anecdotal evidence from the early days of pensions freedom suggests that a high proportion of those seeking to withdraw money from their retirement savings are doing so to deal with financial problems. It may well be that people suffering short-term financial shocks seek to sell their annuities. However, the impact of doing so could be felt on their standard of living for decades. It is therefore important that sellers fully understand the consequences of disposing of a policy.

Partners and other dependants of annuitants (who are far more likely to be women) could be vulnerable in a secondary annuity market (**Question 14**). We are concerned at the suggestion in paragraph 2.27 of the consultation paper that it will be for the annuity provider to decide whether and what confirmation is needed from secondary beneficiaries. This risks overlooking family dynamics. A report 'Unequal, Trapped and Abused' published by the TUC and Women's Aid earlier this year highlighted the underreported and poorly recognised problem of financial abuse which can affect women across the income distribution spectrum. The sale of an annuity could be undertaken to assert control over secondary beneficiaries, particularly if their consent is not required.

More broadly, many women currently in retirement have little in the way of pension provision themselves and evidence as to the extent of female pensioners' reliance on joint annuities is hard to come by. According to one recent survey, women retiring this year expect retirement income of £14,300, 25 per cent lower than that of men.[1] There is thus a risk that, if proper protections are not introduced, facilitating a secondary market in annuities could make women even more vulnerable to financial hardship in old age especially if insufficient account is taken of their life expectancy.

Mandating the taking of financial advice would be one way of giving some protection to women in retirement, as would ensuring that formal permission is required from secondary beneficiaries. But even if formal permission is required, some dependants could face considerable pressure within a family setting to relinquish their rights and staff at purchasing institutions should be alert to evidence of financial abuse.

Buyer-side

We agree with the recommendation that providers should not be able to buy back annuities they issued (**Question 3**). We know that savers already tend to use the provider with whom they held their savings when it comes to purchasing an annuity, and therefore that they often receive a worse deal than if they shopped around. We think the problem of a captive market in buying back annuities would exacerbate that problem and could lead to annuity holders accepting less

[1] Class of 2015, Prudential

for their policies than if they were nudged towards comparing offers from a range of institutions. We believe this disadvantage outweighs the potential benefits of providers already holding information on the customer and the reduced cost of commuting an annuity rather than continuing to pay it.

The government is correct to identify institutional investors rather than retail investors as the appropriate buyers of annuities in the secondary market (**Question 2**). Investors will face a number of costs including, potentially, underwriting expenses. It is reasonable to expect that those who suspect they have a reduced life expectancy would be more likely to seek to sell an annuity than others and this may encourage individual underwriting (and/or reduced pricing to mitigate this risk). The ease with which institutional investors will be able build large diversified portfolios will depend on the characteristics of the annuities being offered for sale.

There are also a lot of remaining uncertainties about the regulatory backdrop including the role of the Financial Services Compensation Scheme which could place a further barrier to entrants into the market. In addition, there is a risk of reputational damage to buyers if it turns out that those who sold annuities made misjudgements or were badly advised and suffer hardship in later life. This further reinforces the importance of sellers receiving financial advice.

Safeguards

There is little evidence of the likely consumer demand for a secondary annuity markets, and if it exists, which groups in society would utilise the market and to what ends. We also do not know the appetite of potential buyers and whether their investment priorities chime with the types of annuities likely to be sold on.

The likelihood of poor decision-making by sellers and the impact of those decisions are unknown. Members of lower income groups, including benefit recipients and female pensioners, could be particularly susceptible to a reduced standard of living in old age.

If the government is to progress with its plan, we believe that several safeguards need to be put in place.

1. We believe there is a strong case for phasing in the secondary market, beginning with smaller annuity pots. It is likely that these would not be central to any seller's retirement income and the impact of poor decision-making would not be so great on the seller's standard of living.
2. Those selling annuities of anything more than minimal value should be required to take financial advice. We regard selling an annuity as similar to making a decision to transfer funds from a defined benefit to a defined contribution scheme, which already requires financial advice for pension pots of more than £30,000. Both transactions involve surrendering longevity insurance which could affect the future standard of living of the person concerned and their dependents.
3. Potential sellers should be provided with a table setting out sample prices for annuities of different sizes and duration. The lack of an established

market means there s little transparency on pricing making hard to assess what a fair deal would look like. Providing such information would give a potential seller an idea of the likely price they would receive for an annuity before bearing the expense of financial advice.