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QUANTUM ADVISORY
The Actuaries and Employee Benefit Consultants

Creating a secondary annuity market

Quantum Advisory - Consultation Response

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Contents

Introduction

The introduction of greater freedom and choice for pension savers in April this year has, in our view, been a positive step and will hopefully increase the attractiveness of pensions to existing and potential retirement savers alike.

However, we do not view the government's proposal to allow annuitants to assign their annuities to third parties in respect for an alternative method of income, especially a lump sum cash payment, as a responsible policy. We understand the government's desire to establish equality across the population of individuals who have utilised their pension savings (pre and post April 2015). Whilst we view this as admirable we also view this approach as being designed to dodge the difficult decision to 'draw a line in the sand' and distinguish between pre and post April retirees.

In conclusion, we believe that the potential negatives far outweigh the positives and as a consequence we do not support the government's proposal.

The following pages provide our input to this call for evidence concerning the creation of a secondary annuity market.

18 June 2015

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A2. A new secondary market for annuities

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

We are of the opinion that annuity assignment will not be in the interests of the vast majority of annuitants. However, there will be instances where annuity assignment and the receipt of a lump sum cash payment, flexible annuity of flexi-access drawdown could potentially be viewed as a more suitable option e.g.

- individuals who have retirement income(s) from other pension arrangements and/or investments that provide adequate income to meet core financial demands;
- individuals who have an annuity that pays a minimal income and whose financial needs would best be served by the payment of a more substantial lump sum cash payment instead; and
- individuals with shortened life expectancy.

Our concerns about allowing annuitants to assign their annuity revolve around the following:

- the cost of assignment to annuitants; this could be in relation to the administrative costs of assignment, or the cost pricing in a profit margin for assignees/intermediaries;
- an inherent bias to gravitate towards a lump sum cash payment over a regular known income, without proper consideration of which option best suits an individual's specific circumstances; and
- annuitants underestimating their longevity.

Each case should be based upon an annuitant's specific circumstances. As such, we believe that annuitants should be required to obtain and evidence receipt of financial advice as a requirement of annuity assignment.

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 to purchase annuity income and why?

We agree with the government's proposed approach of allowing a wide range of corporate entities to purchase annuity income. This should promote competition, resulting in greater choice and hopefully more attractive terms for annuitants looking to assign their annuities.

We also agree with the government's proposal to prohibit the purchase of annuity income by retail clients given the complexity and risks associated with such a product.

The bulk purchase of a portfolio of annuities is unlikely to be sufficiently attractive to all but the largest pension funds. This is predicated on the inheritance of mortality risk and cost.

The bulk purchase of a portfolio of annuities may prove to be more attractive to insurance companies as a result of their size relative to that of pension funds and their considerable experience in this area.

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 are of the opinion that if annuity holders are allowed to assign their annuity then they should also have the option of terminating their contract with their existing annuity provider; prohibition could result in annuitants receiving a less than optimal deal.

Furthermore, we do not believe that allowing 'buy back' would result in a captive market. Legislation surrounding the pension freedoms introduced in April of this year requires pension schemes to inform members, in prescribed form, of the full suite of retirement options available to them at retirement. We see no reason why the same approach could not be applied to the 'buy back' of annuities. ***(Please refer to our response to Question 13 which is also relevant to this Question).***

Finally, we appreciate that allowing 'buy back' could adversely impact upon a provider's investment strategy and solvency. However, we do not feel suitably positioned to comment on this aspect in any great detail.

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?

Whilst no solution is 100% fail safe, we believe that the onus should fall upon the annuity provider, on the basis that they would have the greatest interest in making sure that annuity payments are not paid unnecessarily.

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

This seems a logical and sensible approach. What is of upmost importance is that the approach taken is equitable, enforceable and transparent and above all in the interests of annuitants.

6. Do you agree that the scope of this measure should be annuities in the name of the annuity holder and held outside in an occupational scheme?

We agree with the government's rationale for limiting the measure to annuities in the name of the annuity holder and outside an occupational pension scheme.

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

Not to our knowledge.

A3. Legislative changes

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?

As assignment terms will not simply equate to the initial purchase price less pension instalments received to point of assignment, it is hard to see how one could achieve parity. However, the government's proposal does provide quasi parity in as much as that it affords annuitants choice as to how they utilise their pension savings.

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

We think it unlikely that an individual will choose to assign their annuity for tax avoidance purposes.

A possible solution to ensure that individuals pay the appropriate amount of tax if they decide to receive a lump sum cash payment upon assignment would be to require them to submit sufficient information to the paying entity to enable an appropriate deduction and remittance to HMRC to be made.

Individuals who choose to assign their annuity in order to purchase a flexible annuity or to use flexi-access drawdown should have a 'transfer value' representing the assignment value paid directly to the flexible annuity/flexi-access drawdown provider by the assignee.

A4. Consumer protection

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 financial advice should be a requirement for annuity assignments in excess of a certain value e.g. similar to the requirement in place for defined benefit to defined contribution transfers.

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

Expanding the remit of Pension Wise to provide guidance on annuity assignment makes sense as the infrastructure is already in place. However, the success of this approach is likely to be dependent upon the allocation of additional resource.

Initial guidance from Pension Wise will enable annuitants to assess whether the assignment of their annuity might be appropriate for them. This approach would reduce the incidence of incurring unnecessary costs in respect of obtaining financial advice.

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?

We fail to see who else would, or should, meet the cost of an exercise initiated by the annuitant. This is likely to make assignment less attractive for some annuitants. All costs should be clearly disclosed to the annuitant at outset.

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?

There is no guarantee that individuals will be able to obtain a number of quotes, especially in a free market. Therefore, we believe that evidence of a provider unwilling to quote should also be counted.

The case for allowing 'buy back' would be strengthened by requiring an annuitant to obtain a number of quotes, as the terms offered could easily be compared to alternative providers for competitiveness.

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?

The government seems to be relying on annuity providers wanting to protect themselves from claims from dependants rather than actively protecting dependants.

Some annuities may have named dependants whereas others may just have a definition. It may prove to be more difficult to obtain agreement from a dependant under the latter, or if an annuitant has divorced since the annuity was bought. There is the potential for a knock-on effect on means tested benefits for dependants. However, written consent appears to be the only solution, as assignment of the primary annuity holder only is likely to prove to be too costly for providers and ultimately annuity holders.

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?

We have no objection to this approach. However, we believe that this will prove to be too costly, a cost that the primary annuity holder will ultimately assume.

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 impossible to ensure that annuitants in receipt of means-tested benefits understand the potential impact of assigning their annuity. However, it is perfectly achievable to ensure that annuitants are furnished with appropriate materials to assist them in their understanding of the potential consequences of assignment.

A form of assignment/discharge could require annuitants to declare that they have read and understood the potential impact of assigning their annuity. However, there is no way of assessing if this is the case, or if the annuitant has merely ticked the box and signed on the dotted line in order to receive a lump sum without careful consideration of the implications for doing so.

Ultimately, the ability to assign an annuity will expose annuitants and the tax payer to the possibility of financial hardship/risk. It is for this reason that we do not agree with the government's proposal. It is short-sighted and unnecessary.

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

No. We have based our opinion on concerns over tax payer protection.

However, we accept that there will those who would argue the opposite.

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.

We have no submission to make for this question.