SCOTTISH WIDOWS

HMT/DWP Consultation on the Creation of a Secondary Annuity Market

Scottish Widows Response

Scottish Widows approaches the proposal to create a Secondary Annuity Market with caution. There will be benefits to some annuity holders from lifting restrictions; however the complexity of the factors that need to be considered when applying a valuation on the annuity makes the decision process for the annuity holder and their dependant(s) extremely difficult. This risk may be further compounded by factors such as age, health and dependant's provision.

We would like to know more from the Government on what consideration will be given to changing the law, in particular relating to Unfair Contract Terms. As a provider, we would have to consider whether such an amendment would cause significant imbalance in the parties' rights and potential for detriment of the customer. We want there to be appropriate safeguards put in place to ensure a fair outcome for customers who choose to exercise this option.

We strongly believe that regulated advice should be a mandatory part of the process. However, our concern is that costs associated with this may inhibit the annuity holder from seeking such advice.

Clear guidelines on regulations and tax treatment must be given to the annuity holder and market participants to enable the delivery of the level of support needed and avoid some of confusion that arose during Pension Flexibility.

We fundamentally believe there is a significant risk that annuity providers will be unable to meet the April 2016 deadline, and consider that there is a strong case for delaying implementation beyond April 2016. This will ensure delivery is achieved in an orderly way with appropriate consumer protections in place. We are very concerned about the possibility of consumers making decisions that they later regret.

Consultation Questions

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

Scottish Widows believes assigning one's rights to their annuity income will be appropriate for some who have a greater need for a lump sum than for regular income, subject to them obtaining a fair price. Many who purchased an annuity did so because they wanted the security of a regular income stream but their circumstances may have changed, while for others the size of their pension pot limited their options. We believe these factors could lead customers to opt to take cash.

To protect the annuity holder from making an ill-informed choice they need to understand the implications of their decision. We think this will be best served through a regulated advice process.

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?

To enable a competitive market, a number of entities need to be involved. However, factors involved in providing a fair valuation on annuity income are likely to be complex – those who choose to participate in this market should be regulated financial institutions and investment houses. The policing of this market needs to be robust – however, we would caution against building too many layers of complex regulation. If too many restrictions are imposed by regulators this will result in fewer participants and a less competitive market. If this market is to develop successfully, there must be a reasonable number of participants involved from the start.

A common set of clear principles and regulation is needed to protect all participants. The annuity holder must be protected from the less scrupulous who may take advantage of the fact many will be vulnerable due to age and deteriorating health.

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?

There are some benefits in allowing buy back for a small proportion of individuals. The administrative costs of future annuity payments and the associated capital requirements for the provider are removed, and not having a third party buyer involved in the process will further reduce costs and should result in a better deal for the annuity holder.

However, Scottish Widows considers the risks associated with 'buy back' outweigh benefits as outlined in the consultation document.

In particular, the annuity holder must have the means and information to shop around for the best price. Comparing the experience when it comes to annuity purchase, we know there is a general inertia shown by consumers despite best efforts by providers to encourage them to shop around. This risk can be mitigated if consumer has to obtain advice before proceeding. If this market is to develop successfully then it must learn from the past.

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?

Scottish Widows believes whilst the proposals put forward merit further discussion, death notification is best resolved by market participants. Annuity providers will be most at risk so they should lead in defining what this approach should be.

Existing processes are in place to guard providers against however, they are not foolproof and will need reassessed. The likely cost of enhancing tracing/tracking will ultimately be borne by the policyholders.

We believe this to be significant issue and would like to see more clarity from the Government on the proposed death register. A single source of information such as this could provide an effective service.

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

Scottish Widows agrees there is a need to provide a level of protection for consumers regarding fees and charges.

However, given the relatively low number of annuity providers a relatively light-touch approach should be sufficient to give confidence on this. Fees and charges are required as this introduces new functional costs which must be fair but also recoverable from those wishing to trade.

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 work scheme?

We believe that in principle the same flexibility should be offered to those receiving annuities from occupational and personal pension schemes. We do not understand why assigning an annuity bought by an occupational pension scheme should affect the economic health of the scheme because the trustees have no discretion to remove the member's entitlement and use annuity payments for other purposes.

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

Consideration could also be given to allow Scheme Pensions in the public and private sector to be assigned.

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?

We agree with the principles outlined in chapter 3, but would like more detail of how they will be implemented in practice. For example, it is suggested that the third party buyer could set up flexi-access drawdown or flexible annuity for the individual, which would only be possible if the buyer was or operated a registered pension scheme. It is also unclear how legislation will allow a third party to pay money into a pension scheme and not have it treated as a contribution.

Consideration must be given to providers' existing scheme rules and policy provisions, as they may not permit the assignment or surrender of benefits under the scheme. In such circumstances we assume there will be a permissive statutory override to allow the schemes/providers to offer this assignment option.

Clear guidance on tax treatment and safeguarded benefits for market participants is a priority.

We believe the proposed obligations should sit with the buyer of the annuity, however we also argue this strengthens the need to make regulated advice a compulsory part of the process

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

Scottish Widows believes it is not our role as provider to comment on this.

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?

Scottish Widows believes that annuity flexibility is more complex than pension flexibility, driven by the intricacy of the factors that need to be taken into account when placing a value on the annuity. Further, a significant number of annuitants will be older than those accessing pensions flexibility and could be considered more vulnerable. As a result they may be more susceptible to making a wrong decision either on their own or encouraged by family/friends.

Appropriate safeguards to mitigate this are essential but responsibility for this should not be down to the provider.

We believe that a similar approach to that adopted for transfer at retirement for defined benefit schemes may be appropriate. We would expect all individuals wishing to sell their annuities to take independent financial advice and would suggest a minimum threshold applied of at least £15,000.

How this value is derived will need careful consideration. The value could be placed by the purchaser however this is not without risks as we could see a lot of annuities valued at just under the £15,000 threshold. We suggest a safer option would be to use the level of yearly annuity and use a conversion factor of around 20:1 to value it. This would generally cover all conditions and in practice may be lower risk.

We would like to see a more clarity on the expected level of support required from the annuity provider before assigning the annuity holder's benefit to a third party. We support the second line of defence where the annuity provider gives appropriate risk warnings in cases where the instruction is not received via an independent financial adviser.

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

Whilst Scottish Widows believes the approach to implementation should be broadly consistent with safeguards brought in for pension flexibilities, this does not go against our strong belief that regulated advice should be compulsory part of this process. Lessons learned from pension flexibilities should be included to ensure each participant is clear on their role and responsibilities. This would include Providers, Third Parties (Buyers) Intermediaries, TPAS, TPR, and Pension Wise whose remit needs to be widened. Consideration should also be given to role that could be played by organisations such as Age Concern.

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?

Scottish Widows believes the costs of any advice or guidance should be borne by the annuity holder.

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?

It is highly desirable that consumers should receive a number of quotes because valuations could vary widely. However, we do not believe that insurers benchmarking a selling price would be appropriate.

Scottish Widows believes competitive pricing is a fundamental aspect to making annuity flexibility successful. Shopping around and the provision of multiple quotes will also be crucial factors and must be easily accessible. Promotional material must be clear and include information on where annuity holder can obtain the support they need. One of the most challenging aspects will be managing the annuity holder's expectations on life expectancy and their perception on what is a fair valuation price. These complications will need to be addressed by all market participants.

Provision of an accurate valuation of annuity income will be extremely difficult. Calculations will need to take into account factors such as age and health - the latter may not have been needed or available when the customer purchased the annuity. Further, the valuation of safeguarded benefits and those of investment linked annuities adds another layer of complexity. Specialist underwriting/longevity and investment analysis may be needed in some circumstances.

This means benchmarking 'selling price' will be difficult – the consumer needs to be provided with a realistic value and providers need to ensure they avoid the risks associated with providing a benchmark that is too low. If such benchmarking was considered, we believe it would be better offered through an organisation such as the Money Advice Service, because annuities are fairly standard and this would ensure consistency across the industry. Our view, though, is that it is likely to be impractical.

An additional argument for consumers receiving a number of quotes is that it reduces the likelihood of consumers being pressured into selling by unscrupulous firms. We believe that, where there has not been independent advice, it would be realistic for providers to ask whether the consumer has shopped around, but not realistic to validate the response.

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?*

Scottish Widows agrees ensuring the rights of any dependants are appropriately protected. Obtaining written consent from the dependant does not feel sufficient and creates potential risks to provider if the dependant later challenges the assignment arguing they were not made fully aware of what they were giving up. Providers must be given clear guidelines on their responsibilities to any dependant to avoid this.
We would like to see an approach that would ensure that the dependant was given access to advice and/or guidance particularly where they may be giving up rights to a significant sum of money. Many dependants may be frail and vulnerable and need the same level of protection given to the annuity holder.
Pensions Flexibility brought in a second line of defence for providers to follow. A similar approach should be considered for Annuity flexibility not only for the annuity holder but for their dependant too.

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?

Scottish Widows thinks this option should be allowed.

Where the contract is set up as an annuity for the individual and a separate reversionary annuity for the dependant, it should be relatively straightforward to achieve this.

Where there is a single joint-life annuity, there may be difficulties in enabling this, not least contractual changes and the administrative costs related to partial assignment of annuity which may ultimately prove too complex and costly to execute.

Decisions like this should be left to the discretion of the parties involved in the transaction. It is critical that they understand that the costs involved will probably be borne by them. Implications of such a transactions should be evaluated by the annuity holder and dependants when they consider assignation – hence the requirement for advice and guidance for both parties.

16. How can any 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?

Scottish Widows believes that any advice or guidance should make the annuity holder and dependant aware that accessing annuity flexibility may impact their eligibility for benefits, as well as other considerations such as tax. The provider will also have a role to play in protecting the annuity holder, an approach similar to the risk warnings implemented as part of pension flexibility could provide an effective measure. However, the details of means-testing are complex, and realistically the provider can only highlight the issue without providing detailed guidance.

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

Scottish Widows believes this decision is one that is best taken by the Government. It is not our role as provider to influence the tax and benefit treatment of such consumers.

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.

Scottish Widows believes we are not best placed to provide an answer on this.