



Consultation response: Creating a secondary annuity market

June 2015

Introduction

Royal London is committed to working with Government to make sure customers get the best outcomes at retirement. The policy initiatives announced in the consultation have the potential to reflect the changing needs of retired customers in a rapidly changing 21st century.

We have approached our response to this consultation with a positive agenda to make it happen. We have a number of key areas of concern – both where we think there is a danger of unintended consequences and additional follow-up actions we believe are necessary to deliver the policy objective.

Advice/guidance

The increased flexibility in dealing with a previously purchased annuity suggested by the consultation may be useful to the annuitant, however, this will involve an increase in complexity as they attempt to understand their options, understand the consequences of any decision and navigate the market.

Wealthier customers will typically be well supported by advisers and may find it relatively straightforward to identify a suitable solution. However, there is a serious risk that mass market customers and those who are not financially aware may make poor decisions that result in a significant population of under-resourced retired customers

We believe that regulators need to focus on principle based regulation and outcomes based measures of success, rather than product or input based regulation. The emphasis must be on the suitability and robustness of the outcomes for different customer segments.

We believe that advice/guidance has a critical role to play in helping customers understand and navigate the proposed market. We are strongly supportive of the need to develop guidance that is freely available to all customers, delivered independently and impartial from any provider or adviser firm.

Engaging with customers in the right way at the right time is critical – elderly annuitants may be less comfortable than younger non-retired individuals in basing decisions solely on internet based guidance.

Although guidance may help customers understand their options, it will not be a substitute for advice. Indeed, we believe that guidance will lead to customer demand for advice. Currently the cost and complexity of offering advice in the retired area will make it too expensive for many customers. Consequently for the Government's proposal to be successful there is a real need for FCA to help the industry simplify the current advice model to enable advisers to provide robust, regulated advice to customers at a lower cost with a reduced liability risk.

- Customers should have access to an industry level list of advisers who are willing to give secondary annuity market advice, the services they offer and typical fees.
- Customers should have access to an industry level list which allows them to see which annuity providers are willing /able to allow the annuity assignment envisaged.

- Customers should have access to an independent on-line tool that enables them to understand the approximate value of the annuity they have (See response to question 13.)

Impartiality

We firmly believe that guidance must be seen as impartial and sufficiently comprehensive if customers and the media are to have confidence in it. Whilst Pension Wise, Citizens Advice, etc. all have strong impartial credentials, Government funding to ensure that they have the resources and trained personnel to deliver comprehensive advice will be crucial.

In the longer term the most important thing will be the quality of the guidance given.

Issues to be addressed

We assume that the Government's aims are for the secondary market to develop and for annuity holders to receive the maximum amount possible in exchange for their annuity. Consequently the Government needs to;

- Decide a single approach for the whole market which resolves the issue of the annuitant's continued existence,
- Determine a practical method to safeguard dependant's rights,
- Resolve the issue of historical non-assignability clauses, and
- Remove rules/restrictions that will either add to costs or restrict companies from participating in the market.

We have suggested possible solutions to these issues in our responses to your various questions.

Answering the questions you raised

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

There are no blanket situations where it would always be appropriate to assign annuity rights. The individual circumstances must always be fully considered.

The government should consider carefully the situation in respect of surviving dependant's rights. What right does one person have to sell, for their own benefit, the future income of another person? What might the legal, reputational and political consequences be for institutions, regulators and politicians who enable such events to occur? (see question 14)

2. Do you agree with the governments 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?

The annuity market operates only due to the pooling of risks; hence it is unlikely that any single retail investor could properly assess the risks associated with an individual annuitant. Consequently we agree that individuals should be prevented from purchasing secondary annuities.

There is no obvious reason why any corporate entity subject to UK tax legislation should be prevented from participating in this market. However there may be grounds, including loss of revenue to the UK authorities, for excluding entities not subject to UK tax legislation.

Before such a market could be established, the Government, regulators and auditors would need to identify how any secondary annuities were to be valued within the corporate purchaser's accounts.

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 believe that 'buy back' should be allowed.

The aim from the annuitant's point of view is to maximise the cash sum received in exchange for the future payments. Section 2.16 of the consultation showed that excluding the annuity provider from participating in this market whilst requiring the provision of detailed information, possibly to a number of third parties, plus adjustment to existing systems and records will imply additional costs and hence a lower net cash sum received by the annuitant. The Government would need to explain to annuitants why it thinks that this legislative change is beneficial to the public whilst simultaneously reducing the amount the public receive.

The consumer protection risk identified in section 2.15 could be prevented by requiring that FCA specified wording about shopping around be prominently stated at the top of any buy back quotation.

The provider risk impact appears to be based on the assumption that providers back their annuity portfolio with illiquid assets. In general annuities

are backed by gilts or corporate bonds i.e. highly liquid assets.

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?

No, relying on market participants is not a good solution.

If this market is to be encouraged, then all the parties; providers, annuity purchases and those that have sold the annuity, need to understand how to ensure that payments are correctly made. This implies that a single method applies for the whole market from the start before computer systems are adjusted. Only the Government can impose such a decision.

Once an annuity has been sold, then neither the original provider nor the purchaser will have contact with the ex-annuitant and their spouse. In practice the only way to prevent false payments will be to require the ex-annuitant and their spouse to provide proof of existence on at least an annual basis to the annuity purchaser who would be required to confirm existence to the annuity provider. If no proof is received then the provider should be entitled to cease payment immediately.

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 agree that Government and FCA should be able to monitor providers' fees and charges. A published table based on standardised examples might be appropriate.

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?

We agree that annuities purchased in the name of the trustees and held within a defined benefit occupational pension scheme should be excluded.

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

When an occupational pension scheme is wound up a member will, historically, have received a deferred annuity or an immediate annuity. A scheme member may have used a transfer value to purchase a Section 32 deferred annuity. In each case these would be purchased by the scheme trustees, but are in effect owned by the individual not by the trustees. It would be logical to include such annuities within the reforms.

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 flexibility and those who will be able to access their annuity flexibility? Are there any other tax rules which the Government would need to apply to individuals who had assigned their annuity income?

Rather than new legislation attempting to mirror all the conditions of the Pensions Freedoms legislation, (particularly since the Pensions Freedoms legislation may be altered in the future) it may be simpler to alter the Pensions Freedoms legislation to include the annuity at the point of sale as a flexible benefit. This would ensure that all the annual allowance, tax requirements, information obligations and anti-avoidance measures apply equally.

The consultation does not address “non-assignability” conditions written into contracts to reflect the historical legislation. Unless the Government enacts over-riding legislation to allow a provider to ignore these conditions then the secondary annuity market is unlikely to develop.

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

See response 8 above.

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?

Guidance will be essential given the complex effects of tax, on welfare benefits and in assessing the quoted value. Advice is highly desirable but could only be made a requirement if it can be provided in a cost effective manner. We have seen from the recent experience under "Pensions Freedoms" that the costs of advice can be disproportionate to the value of the fund.

The Government should not seek to design its safeguards based solely on the value of the annuity. In particular focus on the "advice required only for values over £30,000" approach for DB to DC transfers is inappropriate since;

- The annuity value will decrease with age, but the need for advice increases with age.
- Small annuities are more likely to be held by individuals in receipt of welfare benefits, for whom the need for advice on the consequences for their benefit entitlements will be more important.

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

We would support the expansion of Pension Wise's remit to cover secondary annuity purchase, but stress the need for Pension Wise to be funded appropriately to carry out the role.

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?

The costs of advice should be met by the annuity holder, but guidance by Pension Wise or CAB etc. should remain free to the user.

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?

A requirement for multiple quotes will increase the costs to the quoters, which will be passed on in lower prices for those annuities that are purchased. It is not clear that mandated additional costs will assist the Government to develop this market, particularly for smaller annuities.

The Government could promote competition by providing an on-line tool allowing the annuity holder to see an approximate value of their annuity based on their current age(s), assumed average health, and perhaps post-code, prior to

any expenses of selling the annuity. The site could explain that some people will live longer or shorter periods which would increase or reduce the price offered. Such a reference value might allow the annuity holder to judge an offered price and hence the expenses being incurred, thereby promoting more effective competition.

14. Does the Government's approach sufficiently protect the rights of dependants upon assignment? If not, what further steps should the Government take?

It is not clear from the consultation that the Government has taken any steps to protect the rights of dependants. Reliance on consent is likely to be misleading, given that any dependant's annuity is only likely to come into payment many years after the purchase is completed.

If the Government is concerned about dependant's rights, it could legislate that on the sale of the annuity;

- The purchase value is split between the annuity holder's benefit and the dependant's benefit, and
- The value of the dependant's benefit is paid to the dependant, not the holder.

Such over-riding legislation would protect the dependant in situations where a divorce may be about to happen, or if the holder is subject to bankruptcy proceedings.

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?

Such an approach would add additional expenses to the process, reducing the amount paid to the seller. There is a significant risk that the dependant would lose sight of the annuity and that the dependant's annuity would not be claimed. The splitting arrangement suggested in 14 above would be a more sensible option.

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?

There is no method by which understanding of the effect on means-tested benefits can be assured. In particular, the entitlement for the means-tested

benefits may occur many years after the annuity sale when conditions on entitlements may have been changed by a future Government.

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

If, as indicated in the introduction to the consultation, the Government believes that individuals should be free to use their asset as they wish, then whether they are on means-tested benefits or not is irrelevant

18. What are the likely impacts of the Government's proposals on groups with protected characteristics?

No comment.

