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Retirement Advantage response to HMT and DWP Secondary Annuity Market consultation

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.

While we understand the desire to allow people to have control over their retirement income, we believe the introduction of a secondary annuity market would create significant risks to consumers. Retirement Advantage is an expert in this area, and we have the necessary skills and experience to participate in a secondary annuity market. Despite that opportunity, our belief is the risks outweigh the benefits to customers - it is likely many more customers will lose out than gain.

If a secondary annuity market were to be introduced, there would need to be significant customer safeguards introduced to create a viable competitive market and to help people understand the value of the income stream they are receiving, so they understand the consequences of their actions.

At the moment much of the annuity market is dysfunctional. Not enough people are choosing the best retirement income option at the best price. This is partly due to buyer ignorance and too few people getting advice, but it's also down to provider bias. Every year hundreds of thousands of individuals at the point of retirement are missing out on 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. It can also make sure the income shape and benefit structures chosen are the right ones, therefore helping people choose the right option not just for themselves but also for their partner and family.

If that scenario exists within the mainstream annuity market then it is highly likely to also be part of any secondary annuity market unless the Government implements strong practical solutions to protect customers and make sure as many people as possible get the best outcome. If the Government decides to implement a secondary annuity market we believe it should introduce the following customer protection measures -

1. **Compulsory open market option**

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 Retirement 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.

It's also worth noting the 'worst' rate available on the open market could be far from the lowest level of income a consumer may receive. Many customers have pension savings with providers who don't disclose the annuity rates they offer to internal customers, but the likelihood is many will be substantially below the worst publicly available rate.

The same principle will apply in the secondary annuity market where an incumbent provider may offer poor value, and the customer will benefit significantly by shopping around. We believe it should be compulsory for customers to shop around for the best possible deal before they can trade their annuity.

2. **Introduce a blind bidding system through a bureau**

If a secondary annuity is to be viable and competitive while also helping customers simply and easily gain the best value for their annuity, we need a step-change from the current market. A simple alternative would be to create a one-stop-shop bureau style system – administered by an independent third party - where annuity customers receive 'blind bids' from each party interested in purchasing their annuity.

The customer (and/or their adviser) could input their basic personal details such as age, postcode and occupation. Alongside this, details of the income they are receiving each month, plus any attaching benefits such as escalation or benefits for partners would be required. Finally health and lifestyle details would be required. The annuity industry already has an agreed template to collect these details – the common quotation form (CQF) – which could be used. However it should be noted that underwriting older lives with potentially multiple and more involved medical conditions is complex. The CQRF may not be detailed enough for such cases and a report from a Doctor may be more appropriate. It seems likely that far more GP reports would be required than are necessary in the traditional annuity market, which would further increase complexity and cost.

Each potential purchaser would then be operating on a consistent basis with all the required details, and could submit a bid of the amount they are willing to pay the customer in exchange for the rights to their future annuity income. This should be on a one-off basis, so each potential purchaser has one opportunity to submit a bid – and each should be done with no sight of the other bids being made, i.e. a 'blind bid' system. This reduces the timescales involved, removes any possibility of 'horse-trading' and substantially increases the possibility of customers receiving better outcomes. There would to be a definition of 'shopping around', eg does getting a quote from one other provider suffice or are multiple quotes necessary.

3. Independent financial advice

It is well recognised that those taking advice or help make better decisions regarding their retirement income solution. Retirement Advantage believes that ideally, every customer should seek professional help and one-to-one advice. 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 is a realistic proposal. There is unlikely to be sufficient numbers of 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 independent professional 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. We believe a similar cap should be put in place for the secondary annuity market.

However, people will generally not know the capital value of the income they are receiving. So there needs to be a simplistic measure so that people know at the outset of the process whether they need to take advice or not. This could, of course, be open to abuse from providers or consumers. Therefore the Government should introduce a simple measurement or set of tables illustrating levels of income at different ages below which a transfer can take place without advice.

Retirement Advantage response to specific consultation questions

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?

Retirement Advantage is an expert in this area, and we have the necessary skills and experience to participate in a secondary annuity market. Despite that opportunity, our belief is the risks outweigh the benefits to customers - it is likely many more customers will lose out than gain.

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?

There is a balance to be struck between creating a viable and competitive market, and ensuring those participating are reputable and properly regulated entities. Given the complexities and risk involved we believe retail investors should be excluded.

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.

Therefore all participants should be properly regulated by the Financial Conduct Authority or the Pensions Regulator.

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?

On balance, if a secondary annuity market is introduced, we believe the holding annuity provider should have an option to offer to 'buy back' the annuity. However there is a clear potential customer detriment if this were to be the case. So strong customer safeguards are required. This should include requiring customers to shop around before accepting any offer. And having a 'blind bid' bureau system where all prospective purchasers operate using the same information and have one opportunity to make their best offer for the right to the future income stream.

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. Therefore, 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.

If all market participants are regulated by the FCA and all participate in a bureau style bidding process, then it is feasible an agreement could be reached by all, jointly undertaking to inform each other as deaths occur. Further investigation of this option would be needed.

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 would create significant risks to consumers. It seems inevitable that some people will make poor decisions, and that fact needs to be accepted and understood in advance of any decision being made.

Further detailed information on the tax treatment of the annuity in the hands of the buyer should also be provided as a priority. 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 properly regulated entities.

It is also important to recognise that there would be a strong incentive for annuity holders to under-disclose medical and lifestyle factors. Consideration should be given to the level and amount of information that is held on customers, and recourse should it arise inaccurate information has been deliberately provided.

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 professional advice. The guidance service, Pension wise, should provide another channel through which people are equipped to make better choices.

However individual 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) 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. We believe a similar cap should be put in place for the secondary annuity market.

However, people will generally not know the capital value of the income they are receiving. So there needs to be a simplistic measure so that people know at the outset of the process whether they need to take advice or not. This could, of course, be open to abuse from providers or consumers. Therefore the Government should introduce a simple measurement or set of tables illustrating levels of income at different ages below which a transfer can take place without advice

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, and the valuable guarantees which they are giving up, potentially for both them and their family. 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. If people use professional financial advice then the individual should pay for any advice provided in the normal manner.

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.

If a secondary annuity is to be viable and competitive while also helping customers simply and easily gain the best value for their annuity, we need a step-change from the current market. A simple alternative would be to create a one-stop-shop where annuity customers receive 'blind bids' from each party interested in purchasing their annuity.

The customer (and/or their adviser) could input their basic personal details such as age, postcode and occupation. Alongside this, details of the income they are receiving each month, plus any attaching benefits such as escalation or benefits for partners would be required. Finally health and lifestyle details would be required. The annuity industry already has an agreed template to collect these details – the common quotation form (CQF) – which could be used.

Each potential purchaser would then be operating on a consistent basis with all the required details, and could submit a bid of the amount they are willing to pay the customer in exchange for the rights to their future annuity income. This should be on a one-off basis, so each potential purchaser has one opportunity to submit a bid – and each should be done with no sight of the other bids being made, i.e. a 'blind bid' system. This reduces the timescales involved, removes any possibility of 'horse-trading' and substantially increases the possibility of customers receiving better outcomes.

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. From an administrative point-of-view it further increases complexity, and would require new contracts to be developed, as generally annuity providers have a contract solely with the first life, not the dependant.

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.

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.

About Retirement Advantage

Previously known as MGM Advantage and Stonehaven, we are a well-established company that can trace its roots back over 150 years. In 2015 we changed our name to Retirement Advantage – merging our retirement income and equity release divisions, to help us provide those who are in, or approaching, retirement with a range of simple, secure and flexible products to suit their needs.

We are one of the fastest growing businesses in our sector, with over £1 billion of funds under management and thousands of retirees relying on us for their income.

Contact