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Submitted by Which?

Which? response to HM Treasury's 'Creating a secondary annuity market' consultation

About Which?

Which? is a not-for-profit social enterprise and the largest independent consumer body in the UK. We now have more than 1.2 million members and supporters; we understand consumers and what makes them tick. Our mission is to make individuals as powerful as the organisations they deal with in their daily lives.

We drive change in three ways: by providing information and advice to make complex markets easier to navigate; by campaigning for fundamental change in markets; and by developing products and services that put customers' needs first and are worth paying for.

We receive no government money, public donations, or other fundraising income. We are funded solely by our commercial ventures and we plough the money we make from these back into our campaigns and free advice for all. Over the last 10 years this has enabled our charitable arm to increase its spending almost six-fold.

Overview

Which? believes that consumers should be empowered to make decisions that reflect their particular needs and circumstances. The options created by recent reforms to the decumulation landscape are welcome in this context, but will only succeed if they benefit consumers sustainably over the long term. We welcome the opportunity to respond to this call for evidence and will continue to play an active role in discussions with the Treasury, Department for Work and Pensions (DWP), Financial Conduct Authority (FCA), and others to make reforms to the retirement landscape a success.

Overall, a secondary market in annuities has the potential to benefit some consumers. To be successful, any reforms must give consumers the opportunity to engage in a transaction which meets their needs and provides value for money. This will require a well-functioning market with a vibrant supply side and active demand side.

The Treasury's own view suggests that 'for most...existing annuity holders, continuing to hold the annuity and receiving a regular income will be the right decision'[1]. If only a minimal number of annuitants wish to reassign their future income, a market may not be efficient or viable. To ensure that longevity risk is sufficiently pooled, a large number of participants will also be needed to make the market work for buyers. Without more detailed analysis, this seeming contradiction between suitability for sellers and the

[1] HM Treasury, DWP, Creating a Secondary Annuity Market, March 2015, p.7

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requirements of buyers risks allowing a small group of consumers to bear heavy costs while, at the same time, exposing institutional buyers to huge uncertainties. Policymakers must not sacrifice consumer protections, for example by allowing non-FCA regulated purchasers to take part, in an attempt to make this market commercially viable.

There will be inevitable information asymmetries and weaknesses in this market, where consumers will be able to sell an asset which is valuable but difficult to value. Any new market will require appropriate regulation and safeguards to be in place before consumers are exposed to its effects. Strong consumer safeguards are essential, and they must not be sacrificed in an attempt to make this market viable.

It is therefore vital that policymakers take time to examine the evidence to ensure that a new secondary market for annuities does not undermine people's financial security in retirement. The Government should set out how it intends to provide sufficient analysis of the scale of the market, and gather evidence that gives grounds for confidence that two key conditions will be met:

i) Adequate protection at the point of sale; and
ii) Empowered consumers, armed with the information and advice they need.

The Which? response to this call for evidence sets out what we think is necessary to make this market work. In particular, the Government should undertake detailed analysis to test whether a market is viable on terms that are likely to offer consumers something approaching actuarially fair terms money. If this is not found to be the case, it should consider further steps. These might include ways of reducing transaction costs by matching up buyers and sellers through a centralised system. Proactive regulation will also be essential and the Government should consider:

- A requirement for regulated advice when significant annuity income is reassigned;
- An extension of Pension Wise to existing annuitants;
- Reformed disclosure regulations to counter known behavioural biases;
- Public guidance on value for money to consumers; and
- Communication of appropriate heuristics to guide consumer decisions.

In order to ensure that there is time to get this process right, the Government should also consider whether a staged approach, introducing this market to annuities paying a smaller income first (for example below £50 per month) would reduce implementation risks. Once reassignments have taken place successfully at this level, access to the market could then be staged in gradually for larger income streams.

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Responses to specific questions

<u>*A.1 In addition to addressing the specific questions set out in this annex, respondents are encouraged in their responses to add any additional information they feel is relevant to this consultation.*</u>

What do consumers expect and what will they receive?

What do consumers expect?

To gain an idea of possible supply in this market, Which? surveyed 542 of its members who have already purchased an annuity. Of course, this limited sample size cannot provide a reliable guide to how the 6 million annuity holders in the UK will behave. Nonetheless, in the absence of large scale surveys on this question, we believe that an indicative survey offers some useful, if broad, indications of consumers' intentions and expectations.

Just over a quarter (26%) said that they would want to give up their annuity in exchange for cash. Around two thirds (65%) of these potential sellers said that they would expect at least 90% of their pot back, minus any payments already made to them. Almost half of these potential sellers (45%) said that they would expect the entire annuity value back to be interested in resale. This means that around one in six of the annuitants we surveyed would be willing to sell their annuity if comparatively generous offers of over 90% of value are available. Of course, a payment of 90% overstates the returns that a market is likely to produce once buyers' costs and profit margins are factored in.

What might annuity holders receive?

The large uncertainties around how this market could operate make it impossible to work out an accurate picture of what consumers could be offered. In broad terms, it is fair to assume that consumers are unlikely to receive 90% or 100% of the value of their annuity. The price they are paid will be impacted by individual longevity risk and significant transaction costs. Rough estimates by Fidelity[2] suggest that a 75-year-old who bought an annuity for £100,000 ten years ago could now receive between 53% and 63% of its value when they sell it on to an insurer, if they remain in good health. This figure would be likely to reduce to around 40% if they were not in good health.

Which? has also undertaken research to understand the potential variations in value for money that a market like this might provide for consumers. This research assessed transfers from defined benefit (DB) schemes to examine whether these offer consumers value for money. From the consumer's perspective, this provides a useful illustration of the principles which will also underline how the re-sale of annuities could work.

Although there are some differences, a consumer selling their DB rights for cash is essentially selling a guaranteed income for life, much as an annuity holder would do. Our snapshot analysis showed that the level of cash payment a consumer could expect from giving up their defined benefit entitlement can vary very significantly according to the funding arrangements and situation of their current pension scheme and the assumptions

[2] Fidelity, Budget 2015: A second hand market in annuities?, March 2015

used by actuaries to calculate a Cash Equivalent Transfer Value (CETV). These variations emerge despite there being an established and regulated process in place for valuations, overseen by The Pensions Regulator. When a member requests a valuation before considering whether to transfer, legislation requires the originating scheme to create an 'Initial Cash Equivalent' (ICE) which is then adjusted as necessary in partnership with advising actuaries to provide a CETV. The ICE should be a 'best estimate' of the amount of money needed from the date of calculation to provide benefits to which the member is entitled, usually for the entirety of their retirement.

Despite this careful regulation, there is still no precise way to calculate the current cash value of an (often) inflation-proofed, guaranteed income for life, which must be paid irrespective of how the economy or scheme performs. The regulator therefore warns trustees that they should recognise a best estimate 'is not a precise concept and they will often need to be pragmatic and accept choices which seem to them reasonable'[3]. Clearly there is scope for consumer outcomes to vary significantly according to a wide range of factors.

To illustrate how these variations can affect an individual consumer we asked a researcher with two final salary pensions to request a transfer value. Both are for Mr Jones, aged 57, and eight years away from retirement:

	SCHEME 1	SCHEME 2
Pension benefits	Rises each year with inflation and pays 50% pension to a spouse after death	Rises each year with inflation and pays 50% pension to a spouse after death
When were benefits accrued	Between 1979 and 1985 - **6 years** in total	Between 2003 and 2015 - **12 years** in total
Final salary	**£7,700**	**£34,741**
Pension due at age 65 (2022)	**£3,044** in today's money	**£4,643** in today's money
Transfer value	The CETV offered by the scheme is **£51,694**	The CETV offered by the scheme is **£119,743**
Is it a good deal?	**£17** for every **£1** he gives up in pension income	**£20** for every **£1** he gives up in pension income

[3] http://www.thepensionsregulator.gov.uk/guidance/guidance-transfer-values.aspx#s1801

This demonstrates just how significant the differences between estimations can be for the same individual according to how generous the assumptions used by their pension scheme happen to be. While entitlement to a £30,000 pension income with one scheme would provide £600,000, the same entitlement with another scheme would secure £90,000 less (£510,000) for the same person in the same circumstances. These variations are not the result of competition between companies 'buying' the DB rights. Instead, the price can only be calculated by an originating scheme, and will be the same no matter which other scheme the consumer chooses to transfer to. An originating scheme is, by definition, the only possible source of a transfer for any single consumer.

It is likely that these kinds of significant variations (many of which are likely to be larger than the one we have discovered) will also apply to reassignment of annuity income. Whilst these variations might be justified in reference to economic assumptions and the funding requirements of individual defined benefit schemes for DB-DC transfers, they also underline how fraught the process of choosing to sell annuity income could be. In particular, the '...complexity and difficulty in determining a fair price'[4] of an annuity is likely to impede how far consumers can be expected to play their part in a competitive and efficient market. In our example, Mr Jones could well find it difficult to judge whether £600,000, £510,000, £300,000, or some other figure, is a fair price, just as many qualified actuaries do at the moment.

__A full consultation to ensure a market that works for consumers__

Which? believes that a functioning secondary market in annuities must benefit consumers over the course of their retirement. - The evidence highlighted above demonstrates potential divergences between consumers' expectations of this market and potential outcomes. It also shows the potentially arbitrary variations in value that different consumers may achieve, because they lack power and knowledge in this market. Further groundwork is needed to ensure that a secondary market for annuities will further consumers' interests.

Recommendation: The Government should undertake a full consultation on the basis of the existing information and insight it has gained from the call for information and set out how it intends to provide further evidence and analysis that ensures the market can be shown to meet two essential conditions:

i) Adequate protection at point of sale; and
ii) Empowered consumers, armed with the information and advice they need.

The Association of British Insurers (ABI) estimates that around six million annuities are currently paid. It is clear that some of these customers could benefit from re-sale. People who have significant defined benefit entitlements, just short of those necessary for being able to access drawdown before the 2014 Budget, for example, were effectively required to buy an annuity at a poor rate which may not contribute much to their quality of life. However, of this group, only retirees who are completely healthy are likely to get a reasonable deal from re-sale. Anyone who has developed any health condition since

[4] https://www.gov.uk/government/news/pension-freedoms-to-be-extended-to-people-with-annuities

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buying their original annuity is likely to receive only a minimal amount from selling it on because their individual longevity risk will have been impacted. This may dramatically reduce the numbers of consumers who would, or should, take up the flexibility. Overall, the smaller the scale, the harder it is to provide reliable income for institutions looking to purchase annuities and, therefore, reasonable value for individual consumers.

Condition 1: Adequate protection at the point of sale

The divergence between the value consumers expect from an annuity sale and the initial estimates from industry suggests that consumer appetite may be relatively low. Those who do choose to enter the market may be disappointed with the outcomes they secure. This demonstrates the need both to ensure a strong demand side to drive greater value and to put in place adequate protections for consumers who do enter the market.

This is particularly important because past experience of the retirement income market has shown that we cannot assume that there will be a competitive response to consumer demand. The prevalence of internal sales and consumers choosing inappropriate options (for instance single rather than dual life or standard rather than enhanced annuities) point towards a market that historically has not worked well for many consumers. With many of the same industry participants likely to be involved, and a potentially extremely complex transaction at stake, there is no reason to believe that a market for secondary annuities will be any different. For this reason, it is clear that strong protections at the point of sale will be essential.

We believe that at least two further measures will be needed:

- **Prescriptive disclosure regime:** We know that small differences in the framing of alternative products can make a large difference to consumer behaviour; this point is confirmed by the FCA's recent behavioural analysis of retirement product sales practices. It is therefore vital that the Government and the FCA prescribe detailed and behaviourally tested rules on how the costs and benefits of holding an annuity versus receiving a lump sum are communicated. Without a detailed set of communication standards in place, consumers will not have information they need to make the best choice for their individual circumstances. For instance, it may counter present bias and help consumers to make relevant comparisons if they are shown the guaranteed income that a lump sum on offer would buy them on the annuity market today.

- **Cooling-off period:** The FCA should explore how providers could be required to give customers looking to reassign a significant annuity income stream a cooling-off period. This requirement would ensure an opportunity for further signposting to available support, guidance and advice and the chance for the consumer to reconsider their decision in an unpressured environment.

Condition 2: Empowered consumers, armed with the information and advice they need

As well as sufficient scale and adequate protection, creating a market that works for consumers will require active, engaged and well informed consumers.

Establishing a clear value for money test to guide outcomes and consumer decisions

As the first step in ensuring that consumers have the power to engage fully in this market, Government must ensure that all consumers are armed with the right information before making a decision to sell their annuity income. We have already highlighted the complexity of assessing a fair price and that many consumers are likely to be unaware of the approximate value of their annuity income. For instance, many will undervalue what it is worth because they underestimate their life expectancy. Conversely, some are likely to overvalue the income stream, for instance if they have an illness or lifestyle which means their life expectancy is lower and have not fully accounted for this in their decision-making.

This situation reflects an asymmetry of information which could easily lead to consumers being offered (and accepting) poor value sales[5]. To tackle this, Government should look to inform consumers and help set their expectations of the potential value of their annuity income using a value for money framework to provide practical heuristics. Research shows that mental shortcuts of this kind play a vital role in complex financial decisions, even when consumers are already highly financially literate and familiar with the products in question[6].

Recommendation: Government should publish estimates of the value of annuity incomes for a set of individuals in different scenarios.

Public guidelines can never provide an accurate estimate of how much an individual could receive. They would, however, help consumers engage with the industry and seek clarification of why the offer(s) they receive are more or less than that published by Government. An example of how this might work is given in Box 1 below.

Box 1: Example of value-for-money estimates

A starting point for formulas which could be used for these purposes is provided by the framework for calculating Cash Equivalent Transfer Values, and equivalents used to work out levels of tax free pay out within defined benefit schemes (Pension Commencement Lump Sums (PCLS). As an example, PCLS is typically calculated as:

PCLS = Pension income ÷ [3/ 20 + 1/Commutation Factor]

Here, the commutation factor takes account of scheme investment, economic, and other assumptions which also feature in the CETV process. Which? encourages the Government to ensure that an equivalent framework is in place for annuity reassignment, and made public, before the reform takes effect, so that consumers can make informed plans for their future. This framework and information should then be used to create consumer-facing communications, and decision-guiding heuristics, to guide their choices.

[5] Note that we are also aware that information asymmetries also exist around the consumer's disclosure of lifestyle or medical conditions that the firm may be unaware of.

[6] See Choi, Laibson, Madrian and Metrick, 2006, 'Saving For Retirement on the Path of Least Resistance', in Behavioral Public Finance: Toward a New Agenda, McCaffrey and Slemrod, editors, 2006.

Providing robust guidance on how resale is communicated, so that present bias in consumer behaviour is not exploited

The FCA's disclosure rules are also important in ensuring that consumers have the right information. Well-documented biases in consumer behaviour favour the selection of lump sums up front against secured income in the future (present bias and hyperbolic discounting). The past decade of annuity sales, which are simpler to compare than lump sums versus annuities, demonstrates that we cannot rely on competition and consumer demand alone to assure good outcomes. Consumers also tend to under-estimate their life expectancy, meaning that we are all likely to underestimate the value of an existing annuity. This is likely to drive offers from providers which offer poor value (in actuarial terms).

Recommendation: Government must work with the FCA, consumer groups and behavioural insights specialists to create disclosure regulations in this market to ensure that consumers are provided with illustrations that they find useful rather than misleading. In the past, regulations in this area have not served consumers well, and it is vital that these lessons are learned. For instance, the linear growth projections underlying Statutory Money Purchase Illustrations (SMPI) of income from drawdown products make those products look disproportionately more attractive than alternatives like annuities. Current rules also allow firms to skew comparisons between different retirement options by using only their own annuity quotes, which might be substantially worse than those available elsewhere[7].

Beyond these significant existing issues, there will be a real challenge to develop and test ways of communicating which help consumers to understand the trade-offs at stake. Behavioural scientists and neurologists have documented for some time our predisposition to be uncomfortable with uncertainty[8], and this predisposition will have significant effects when consumers are asked to weigh up the costs and benefits of exchanging a guaranteed income for life for cash up front which can then be invested or spent.

The role of guidance and advice

The decision of whether to sell annuity income to a third party will be a difficult and complex one for many people. Alongside a value for money framework and a decision heuristic, Government should ensure that consumers have access to appropriate information, guidance and advice before making a decision to sell annuity income. Which? believes that the complexity and importance of this transaction means that taking regulated advice should be a requirement for pots above a specified threshold using a £30,000 threshold as a starting point.

There is precedent for this approach. Clauses 48-53 of the Pension Schemes Act 2015 create a requirement for individuals to take 'appropriate independent advice' before

[7] For example because the firm in question does not offer enhanced annuities, for which the customer is eligible; this would serve the commercial interests of a firm which relies heavily on drawdown sales.

[8] Colin Crammer. Neural systems responding to degrees of uncertainty in human decision-making. Science 9 December 2005: Vol. 310 no. 5754 pp. 1680-1683. Neurological research that found that the human brain fills in the gaps left by uncertainty with fear. This impacts our decision making as we naturally seek to avoid fear. Summary of key insights available at http://scienceblogs.com/cortex/2007/02/20/the-certainty-bias/

transferring their defined benefit pension to another provider in order to use the new freedoms[9]. Those regulations offer an exemption for smaller pots (below an equivalent value of £30,000). The same principle could apply to people who wish to sell an annuity. The FCA should also closely monitor the value of non-advised sales to guard against unintended consequences. For instance, if a very high number of sales took place just below the threshold for advice (£29,999), this would suggest that information asymmetries are preventing competition from working in consumers' interests. The regulator will need to act to address any indications that firms are deliberately valuing annuity rights just below the threshold for advice to promote inappropriate non-advised sales.

Recommendation: Access to Pension Wise should be extended to people who wish, or are considering their option, to sell their annuity income. This should apply regardless of the channel used to access Pension Wise, and when a consumer inquires about reassigning annuity rights they should be directed to the service in the same way as consumers wishing to access their pension savings for the first time are.

The Government should work with industry to introduce the infrastructure that would allow pension providers to book an appointment directly with Pension Wise for customers, or put them through (if communication is by phone) to the Pension Wise appointment booking service.

Recommendation: The requirement to take advice for DB transfers worth over £30,000 should be extended to cover annuity re-assignment, using the existing £30,000 threshold as a starting point for consultation.

What happens if consulting suggests that a viable market is unlikely?

Ultimately, it might prove impractical for a viable private sector option to be created. This is particularly true if scale is limited. Even without questions over viability, there are still real concerns about the potential for mis-selling. With this in mind:

Recommendation: Government should urgently consider whether a guaranteed value-for-money scheme might be set up through NS&I.

A.2 The government welcomes views on how it envisages the secondary annuities market working, and its proposed approach on the scope of these reforms.

Q1. In what circumstances do you think it would be appropriate to assign one's rights to their annuity income?

The decision to exchange guaranteed income for life for a lump sum will depend on personal circumstances. In general, we believe for a large majority, retaining the annuity they have purchased will likely make sense.

In principle, it may make sense to do so where an individual can derive greater value from a lump sum than they would do from the income they could expect from their annuity provider. This might be relevant where:

[9] Pension Schemes Bill, 2014-5

- Personal circumstances have changed radically since the annuity purchase, for example, where someone has contracted a terminal illness.
- There are significant individual/familial financial needs, like paying off debts, which can be met with a lump sum and make a material difference to the individual's quality of life which outweighs the benefits of a future income stream.
- The original purchase of an annuity was necessary because of regulation rather than beneficial to the consumer, for example meaning that:
    - the regular income from an annuity is too small to make a significant contribution to the consumer's standard of living. We would, of course caution against undervaluing the difference that relatively small amounts of regular income can make.
    - The saver already has a level of income from other sources, for example defined benefit entitlements, which meets their needs in retirement, meaning that annuity income plays an inessential and relatively modest role in meeting their financial needs.

Although it might be appropriate for consumers to assign annuity income in some of these circumstances, it is by no means certain that it will be possible to find a buyer. The annuity income of people who have developed a serious illness, for example, is unlikely to be in demand on an open market.

Q2. 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?

Which? agrees that re-assigned annuity income would not be a suitable investment vehicle for individual retail investors because it is difficult to value.

Past experience of re-sold life insurance products shows that this could cause very significant consumer detriment. The Government should also note that a difficulty in determining the fair price of an asset is just as much a problem for its seller as for a buyer. This entails that strong safeguards at the point of sale and measures to assure a competitive institutional demand-side will be critical.

The Government should also consider the practicalities of establishing a wide range of corporate buyers. Given the potentially limited supply of consumers wishing to sell annuity income there is a risk that, if spread too thinly across the market, firms will struggle to accumulate sufficient scale to manage longevity risk. This would impact on their ability to deliver value for money propositions and, in turn, the viability of the whole market. In these circumstances, it might be more appropriate to consider creating a guaranteed value-for-money scheme through a provider like NS&I.

Q3. 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?

In principle, Which? agrees that the termination of contracts would create a number of significant complications for the market and could undermine the way in which annuity provision in the UK is currently underwritten. It would, for example, mean that institutions would have to price the risk of early termination into their investments, and may not be able to make use of long term gilts and other fixed interest instruments to the same degree. At a time when consumers are being given more choice over how to use their pension pot, it would be a mistake to undermine one important product option.

That said, it is conceivable that the efficiencies realised through buy-back by an original institution could outweigh these concerns. The Government should therefore take a pragmatic approach and work with industry to model how significant the efficiencies of allowing buy-back from original providers (e.g. cost savings from companies already holding relevant data) might be.

Q4. 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 critical issue; it would be misguided to promote annuity reassignment to consumers without there being an adequate solution in place. As an essential first step, the Government should be able to show in detail that an efficient solution to this issue is feasible.

Since the sale of annuity income would have to be based on individual, rather than collective, longevity, purchasers of an annuity income will need certification of an individual's health before purchase. This will impose additional costs, and consumers will have no incentive to provide comprehensive and accurate disclosure on all conditions before sale. It is important that detailed analysis of this process is conducted by government and industry together before transactions take place.

There will also be an on-going certification challenge. The party which provided the historic annuity continue to pay out to the institution which bought the annuity on the secondary market so long as the individual whose life it was based on is still alive. With a conventional annuity, that person simply stops receiving income when they die. In the case of a re-sold annuity, the institution that initially sold the annuity (Institution A) will have to continue to check whether the individual is alive at regular intervals in order to know whether to continue paying the institution that bought the annuity rights (Institution B) on its investment. Neither Institution B, nor the individual, will have any incentive to inform Institution A of any changes - Institution B will want to continue to receive payments, while it will be irrelevant to the individual. We also know that many pension companies already struggle to remain in effective communication with their customers, and that many do not respond to communications. The FCA's retirement income market study confirms that extensive programmes of communications like wake-up packs have had a relatively small impact on consumer behaviour. Regularly checking on the status of often unresponsive consumers with no incentive to reply could be

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difficult and costly. In a competitive market, these costs would ultimately be borne by consumers.

Q5. 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 cooperation and monitoring between the Government and the FCA will be essential. This is not, however, a straightforward or conventional market. The complexity of the product being sold, the potential opacity of fees and pricing, and the likelihood of there being a limited number of institutional purchasers for reassigned income mean that we cannot rely on competition alone to determine a fair price.

Instead, the Government and the FCA should proactively research cost reflective levels of pricing with the industry and issue firm guidance on reasonable charge levels before the reform takes effect. In particular, they should explore whether the fee imposed by the annuity provider to cover the costs of reassignment should be capped because the firm imposing a fee will be operating from a monopolistic position thus be immune to competitive pressure to bear down on charges.

Q6. 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 believe that the proposed scope is a useful starting point. Annuities held within occupational schemes are already effectively bought and sold at scale by those schemes.

Q7. Are there any other types of products to which it would it be appropriate for the government to extend these reforms?

We have not yet researched this question, but we have not yet seen evidence that extending these freedoms to other products would benefit consumers.

A.3 The government welcomes views on how it proposes to change the tax rules relating to the assignment of annuity payments.

Which? does not comment on the Government's wider tax and benefits regime. From the consumer's perspective, it is essential that there is clear and definitive guidance available on the interaction between choices they make to buy or sell particular retirement products and their entitlement to means tested benefits.

Initial experiences of Pension Wise suggest that staff will not go into this question in a detailed, personalised way. We are concerned that there is not yet enough clarity to help consumers navigate this challenge. The Government needs to make sure that consumers fully understand, and can take account of, implications for benefits entitlements.

Q8. 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?

See above.

Q9. How should the government strike an appropriate balance between countering tax avoidance and allowing a market to develop?

No response.

A.4 The government welcomes views on how it proposes to ensure consumers are appropriately informed when making decisions relating to the assignment of their annuity income.

Access to the Pension Wise service should be opened up to consumers wishing to sell on annuity income and providers should work with the Government to develop the infrastructure that would allow pension and annuity providers to book customers an appointment directly with Pension Wise.

It is also important that that the FCA develops and amends disclosure regulations in line with findings from its own behavioural testing with consumers. In 2014, it produced an overview of existing evidence on consumer behaviour[10] during annuity purchase. The market study on retirement income products also considered how inertia and internal sales have impeded competition, concluding that:

> 'Consumers' tendency to buy from their existing pension provider weakens competitive discipline. Not only do incumbent providers feel less pressure to offer competitive vesting rates, but challengers find it difficult to attract a critical mass of consumers. As a result there has been limited new entry into the decumulation market in recent years.'[11]

The effects of factors such as present bias, inaccurate estimates of longevity risk, inertia and procrastination, aversion to planning, and overconfidence on the annuity purchases by consumers are relatively well-understood[12], but their likely implications for sales by consumers are not.

For instance, consumers also tend to under-estimate their life expectancy, meaning that they are likely to underestimate the value of an existing annuity. This is likely to drive offers from providers which offer poor value (in actuarial terms) unless specific remedies are developed for the point of sale. The FCA must learn from previous poor practice to identify how robust and proactive regulation can protect consumers against being pushed towards poor value products.

The Government and the FCA should require those selling a significant annuity income to take regulated advice. The threshold for this requirement should be consulted on, using the existing £30,000 equivalent for DB-DC transfers as a starting point.

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[10] FCA, Pension Annuities: A review of consumer behaviour, January 2014

[11] FCA, MS14/3.2, Retirement income market study: Interim Report, December 2014, p.6

[12] For a summary see Blake, and Boardman, Spend more today: Using behavioural economics to improve retirement expenditure decisions, 2010

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The Government could also help consumers to get an idea of how much they might expect their annuity income to be worth by publishing a set of realistic scenarios with what it judges to be actuarially fair values.

Q10. 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?

Advice should be required for annuities which provide levels of income above a specified threshold, using the £30,000 figure specified for DB-DC transfers and trivial commutation as a starting point for consultation.

Q11. What is the best way to implement these safeguards? Should the safeguards include expansion of the remit of Pension Wise?

It is essential that access to Pension Wise is extended to people considering whether to re-assign their annuity income. Access to guidance will be an essential first step for any consumer considering assigning their annuity income. In many ways, the decision to sell existing annuity income will be just as complex as a transfer from DB to DC provision.

Q12. 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?

Which? supports the principle that funding for Pension Wise should come through a broad-based levy on the financial services industry which does not impose a disproportionate cost on smaller pots. It would be appropriate for the costs of access to guidance from Pension Wise to be met through that service's arrangement.

Where regulated advice is taken by the consumer, it should be for that individual to cover its costs. Again, it is important that those with smaller pension entitlements are not forced to pay for advice that would impose a disproportionate cost. The Government should use regulations for defined benefit transfers as a starting point.

Q13. 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?

Although well-intentioned, this proposal could impose unnecessarily onerous requirements on consumers. Instead of creating a requirement for consumers to obtain multiple quotes, the Government should work with the FCA to research and create a more efficient way of matching consumers and their needs with the best offers available from financial institutions. A greater level of automation in this process would also have the significant benefit of lowering transaction costs and promoting better outcomes.

Q14. 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?

Women have historically been poorly served by the private pensions market. About three quarters of men and one half of women draw on private pension wealth during their lifetime. For men, the median level of private pension wealth in payment is more than double that of women, £126,500 versus £60,500[13].

As a result they are more likely to rely on spousal rights to annuity income. Some research suggests that this has also had an effect on consumers' expectations and behaviours. There is some international evidence that spousal rights can cause people to become aware that their long term welfare is a function of how long their partner will live, rather than their own financial planning[14].

Given this history, the Government must carefully consider how the rights of dependants can be safeguarded when individuals consider whether to reassign annuity income. Past experience of the annuities market suggests that consumers approach decisions of this sort with a confidence which is often misplaced. The Government should consider whether firms should be required to ensure that dependants are fully informed about this process before any reassignment takes place.

For instance, it is critically important that consumers understand the full implications of this transaction for all affected dependants before taking a decision. Deliberative research with consumers suggests that many approach retirement decisions with overconfidence and have not fully appreciated the implications for those who will depend on them in retirement.

Q15. 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 happening in principle, but believe that dependants' consent should be considered, as should the implications of greater costs which will result from the increased complexity of this multipartite transaction.

Q16. 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?

Implications for entitlements to means-tested benefits are critical to the utility of these transactions. It is essential that these are explained and considered during relevant guidance and advice sessions, including Pension Wise.

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[13] Source: Cox, P, 'Private pension wealth among 55-64 year olds in the UK', Policy commission on the distribution of wealth, University of Birmingham, 2013

[14] Friedberg L, Webb A, 2006, ``Determinants and consequences of bargaining power in households", WP 12367, National Bureau of Economic Research, Cambridge, MA

Q17. Should those on means-tested benefits be able to assign their annuity income?

Which? does not take a position on tax and benefits issues. From the consumer's perspective, it is essential that there is clear and definitive guidance available on the interaction between choices they make to buy or sell a particular retirement products and their entitlement to means-tested benefits.

Q18. 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.

No response.

For further information in relation to this submission please contact: