3

Hargreaves Lansdown
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Creating a secondary annuity market – call for evidence

Summary

A secondary annuity market may be beneficial for a minority of annuitants for whom a lump sum is more appropriate than an on-going income stream or for those who wish to change the 'shape' of an annuity due to a change in circumstances. However it should be recognised that this is not a silver bullet for those who have already purchased a poor value annuity, as any lump sum received in exchange for the income will reflect the existing value of that annuity.

To provide consumer protection and to ensure value for money it is essential that all prospective transactions go through an accredited annuity broker. These annuity brokers should be able to obtain bids from a number of potential annuity purchasers, provide a comparison showing the income stream the offered lump sum could currently purchase and provide appropriate information and risk warnings.

More details are provided in our responses to the specific questions below.

A new secondary market for annuities

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

It may be appropriate for an individual to assign their right to their annuity income if a lump sum would be more appropriate than a regular income payment or if a different 'shaped' annuity would be more appropriate.

A lump sum instead of an annuity income is unlikely to be appropriate unless the annuity holder would still have sufficient regular income. Subject to this requirement, the questioning of whether a lump is appropriate is comparable to questioning whether particular expenditure of 'spare' income is appropriate. The difficulty in assessing whether an assignment is appropriate is when an immediate lump sum need has to be balanced against the need for future income for example, paying off a maturing interest only mortgage by assigning an annuity which is the sole source of private pension income.

It could be appropriate to assign annuity income for a lump sum for the purpose of effectively changing the 'shape' of the annuity income, e.g. for purchasing an annuity with different death benefits due to a change in marital status or health.

Ultimately it should be up to the individual to determine what is appropriate, provided they are able to make an informed decision on the terms which they are being offered.

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?

We broadly agree that the purchase of individual annuity income streams would not be an appropriate investment for retail investors. This is because a retail investor is unlikely to be able to achieve sufficient diversity to mitigate mortality risk.

Although we agree that determining a fair price may be too complex for an unassisted retail investor, this is a determination which an annuity holder will be required to make when deciding whether to assign their annuity income. Any assistance which would be available for annuity holders could also be used by a retail investor.

We do not have any strong views on which entities should be permitted to purchase annuity income, however a sufficiently diversified portfolio of annuity income could be used by a pension scheme to offset existing mortality risk. Only allowing FCA authorised entities to purchase annuity income should make it easier for annuity providers to claim back any overpaid annuity income. Please also see our response to question 3.

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 think there is a significant risk that allowing direct annuity 'buy back' would lead to annuity providers being pressurised to offer it.

This risk can be clearly demonstrated by the introduction of Pension Freedoms in April 2015. There changes were wholly permissive, in that there was no legislative requirement for a pension provider to offer these new freedoms. Despite the fact that all pension providers could have chosen not to offer these freedoms, whether for commercial reasons or simply due to having insufficient time, those providers who haven't offered these freedoms have come under substantial pressure to do so. This pressure has not only been generated by the public and the press, but also from the government.

We also agree there is a risk that allowing annuity 'buy back' could lead to annuity holders opting for the easy option of terminating their annuity contract with their annuity provider and therefore being offered a price which is much lower than that which would have been available on the open market. This could be considered as being analogous to the open market option on annuity purchase, which is available for all but certainly not used by all.

However, despite these risks we think 'buy back' should be permitted provided it is via an accredited annuity broker as this should address both the above risks. In essence, this would be 'blind buy back' as the annuity provider would not know they are bidding on their own annuity and the annuity holder would not know whether their annuity provider will bid. It should not be possible for an annuity holder to directly agree with their existing annuity provider to terminate the annuity contract in return for a lump sum.

Even allowing 'direct buy back' where the capitalised value of the annuity income is below a minimum level such as £10,000 would not eliminate the above risks, although it would reduce the impact on a particular individual receiving poor value. It is also questionable as to whether there would be annuity providers who would wish to 'buy back' smaller annuities, as since 2006 it has been possible for smaller annuities to be cancelled in return for a lump sum under either the general triviality rules or under the de minimis rules. Very few annuity providers have made use of these rules.

Please see our response to question 10 for more details on the requirement to use an accredited annuity broker.

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?
We agree it would be disproportionate to set up a central 'death register' purely for the purpose of a second hand annuity market.

Allowing for partial assignment of annuity income would enable the annuity provider to be informed of the annuitant's death due to payment being returned. The greater the portion of income which remains payable to the original annuitant, the greater the incentive the annuitant has to ensure payments continue.

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 fees and charges imposed by the original annuity provider to enable assignment should be monitored to ensure they are not preventing competition.

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?
No. This measure should also include lifetime annuities which have bought in the name of the scheme.

There are occupational pension schemes which purchase lifetime annuities for the member in the name of the trustee rather than the name of the member. Other than this they are identical to lifetime annuities which have been bought in the name of the member, for example in both cases the annuity income will be paid directly from the annuity provider to the member. The annuity holder is unlikely to have had any say as to the name in which the annuity was written. They are even more unlikely to be aware of the name in which it was written and therefore whether they are able to assign their annuity. While there may be issues around whether an individual can assign an annuity which has not been written in their name this is an issue which can be left to market participants to resolve.

7. Are there any other types of products to which it would it be appropriate for the government to extend these reforms?
We have not responded to this question.

<u>Legislative changes</u>
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 that individuals should have the three proposed options.

It should be possible for those who have assigned their annuity to choose to have the proceeds paid into a flexi-access drawdown account. This would enable those who have received a large lump sum to either spread payments as smaller taxable lump sums or to provide for a flexible taxable income. Without this option there would be basic rate taxpayers and non-taxpayers who will end up paying 45% tax on the proceeds of their annuity assignment.

Where an individual does wish to receive the proceeds for immediate use it should be possible for the annuity purchaser to pay this amount directly to the individual's bank account after the deduction of emergency tax. The individual should then be responsible for reclaiming any overpaid tax from HMRC.

As well as being possible to purchase a flexible annuity it should be possible for the proceeds of the assignment to be used to purchase a lifetime annuity which is not a flexible annuity. This would allow for the re-broking of annuities to a more appropriately shaped annuity or potentially to an annuity paying a higher income. The same outcome could be achieved by the released funds being paid into flexi-access drawdown and then used to purchase a non-flexible annuity, however this adds a further party to the transaction leading to potentially unnecessary complication which could be avoided.

Based on current legislation it would be possible for an individual to receive employer pension contributions into their pension in lieu of salary, purchase a lifetime annuity and then assign the annuity income for a lump sum without triggering the money purchase annual allowance. This would save employee and employer national insurance as well as income tax. We therefore understand the need to prevent this unintended tax advantage.

However this complete series of transactions would only commence once it was possible to assign an annuity and is unlikely to be used by those who currently have an annuity in payment. It would therefore be disproportionate to apply this to all annuity assignments and so the money purchase annual allowance should only apply where the annuity being assigned was set up after a specified date. This could be 5 April 2016 or an earlier date, such as the date of any announcement confirming it will be possible to assign annuity income.

A payment from flexi-access drawdown or a flexible annuity will already trigger the money purchase annual allowance. If the above approach was accepted the only additional money purchase annual allowance trigger which would be required would be the assignment of an annuity set up after, e.g. 5 April 2016. The information requirements in relation to flexibly accessing benefits should follow the same process.

We agree that the tax treatment on death should depend on where any lump sum received for annuity assignment is held on death.

9. How should the government strike an appropriate balance between countering tax avoidance and allowing a market to develop?
If a secondary annuity market is created then it should be given as much freedom as possible to develop. There should however be provisions to protect against the risk of tax avoidance. The simplest way of achieving this would be to require that all prospective transactions go through an accredited annuity broker. This would ensure any assignment would be on arms-length terms and so avoid the complication of having to prevent assignments between connected persons or assignments involving registered pension schemes with fewer than a specified number of members.

Consumer protection

10. What consumer safeguards are appropriate – is guidance sufficient or is a requirement to seek advice necessary? Should the safeguards vary depending on the value of the annuity?
The main risk faced by annuitants wishing to assign their annuity income is that they are giving up a secure lifetime, the value of which they are likely to underestimate. Superficially, this is similar to the risks faced when transferring from a defined benefit pension scheme to a defined contribution pension scheme. The crucial difference is that the annuity income is already in payment and therefore much easier to value than a defined benefit pension scheme which is coming into payment at a future date.

There are already a number of on-line tools which could be used to assess whether the lump sum offered in return for an annuity assignment is good value. An annuitant could enter an offered lump sum into one of a number of on-line annuity search engines which would then provide income figures which could be compared to their current income. There are also annuity search engines which will specify the cost of providing a specified income. It is also possible for health and lifestyle to be taken into account within these figures. These existing search engines will not advise whether an annuitant should accept a particular offer; however they would provide a quasi-actuarial valuation of the existing income.

To provide consumer protection and to ensure value for money it is essential that all prospective transactions go through an accredited annuity broker. These annuity brokers should be able to obtain bids from a number of potential annuity purchasers, provide a comparison showing the income stream the offered lump sum could currently purchase and provide appropriate information and risk warnings.

As part of using the annuity broker, the individual would be required to complete an on-line questionnaire covering health and lifestyle in the same way as if they were applying for an enhanced or impaired life annuity. It is likely that the annuity purchaser will wish to verify the details of some or all of the annuities which they are purchasing.

If all annuity assignments take place through an accredited annuity broker providing appropriate information and warnings then the individual should be able to determine the value of any offered lump sum and so shouldn't be required to take financial advice before assigning their annuity. An individual would always be free to seek regulated financial advice and should be recommended to do so if they are at all unsure.

11. What is the best way to implement these safeguards? Should the safeguards include expansion of the remit of Pension Wise?
In conjunction with a requirement to use an accredited annuity broker, the scope of Pension Wise should be extended to cover the potential assignment of annuity income. This extension should not be a significant change in the nature of the Pension Wise service although it could increase the number of users.

Guidance offered by third parties is likely to have an explicit charge, while any guidance offered by an annuity purchaser could either have an explicit charge or be factored into the offered lump sum.

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 any guidance (other than through Pension Wise) or advice should be borne by the annuity holder.

If advice was to be made compulsory there is a risk that the annuitant will only be able to pay for advice if they choose to go ahead with the assignment. If the advice then resulted in the annuitant deciding they should not go ahead, they may still need to do so to pay for the advice they have received.

It is possible advisers will see this as a new market for simplified advice, however an adviser doing so would be taking on a liability similar to that incurred when advising on a defined benefit transfer. For this reason we would not expect many advisers to be able to offer this as a low cost service.

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?
All potential annuity assignments should take place through an accredited annuity broker obtaining quotes from a good range of providers on the open market. This would then promote effective competition to ensure consumers obtain a competitive price.

If it is decided that there should not be a requirement to use an accredited annuity broker then we agree that the government should strongly recommend an individual obtains a number of quotes, analogous to shopping around using the open market option. We do not agree that individuals should be required to obtain a minimum number of quotes. Were such a requirement to be introduced then it would be logical to extend the same logic to other products and services, including life insurance, mortgages, car insurance and phone contracts.

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?**

Where another party has a contingent right to receive pension benefits this will generally be in the form of a continuing income after the death of the annuitant. Where an annuity protection lump sum death benefit or the continuation of a guarantee period is available this will generally either be paid at the discretion of the trustees or to the estate of the annuitant.

Assuming annuity providers obtain the written consent of dependants prior to any assignment then this should, in most cases, provide sufficient protection to dependants. We have not commented on whether it is likely that annuity providers will obtain this consent.

It will be rare that a specified minor will have a potential right to annuity income on the death of the annuitant. Where this applies consent would need to be obtained from the legal guardian.

It also possible that the dependant will not be a specific individual at the point the annuity is assigned, for example an 'any spouse' annuity. Where this applies consent could only be obtained from the individual to whom the dependant's income would be paid if the annuitant died on the assignment date. Annuity providers would have to take a view as to whether someone who becomes a dependant after the assignment date could have a potential claim.

Any earmarking order currently applying to annuity income will have been drafted on the basis that an annuity cannot be assigned. Depending on the precise wording it is possible that an annuitant would be able to frustrate the purpose of the pension sharing order by assigning the annuity in return for a lump sum. It is also possible that if such an assignment is made an income will still continue to be due to the ex-spouse/civil partner. Where an annuity is subject to an earmarking order we would expect the annuity provider to satisfy themselves that any requested assignment is not prevented by the earmarking order.

Where an assignment is legally permitted on an earmarked annuity the annuity provider would have to consider whether the ex-spouse would be able to claim for any lost income. The simplest solution may be to prevent annuities subject to a pension sharing order from being assigned.

Those who have purchased an annuity with benefits for dependants on their death have already chosen to receive a lower lifetime income to provide these benefits. Allowing those who have purchased a single life annuity without considering dependants to assign their annuity while preventing those who considered dependents from assigning could cause more single life annuities to be set up, so reducing the overall protection for dependants.

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 decision should be left to the discretion of the parties to the transaction.

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?
In the same way as pensions providers are currently required to provide warnings for those flexibly accessing their pension, similar warnings should be provided by the accredited annuity broker. Although these warnings can highlight potential issues, detailed information must be freely available from the Department of Work and Pensions.

Some of the issues which should be explained are;

- How income and capital are taken into account when assessing eligibility for different means tested benefits and the impact of reducing income in exchange for a lump sum
- How the deliberate depravation rules would apply when the lump sum received should in theory be broadly actuarially equivalent to the income being given up
- How the actions of one partner could affect the other for jointly assessed benefits.

Generally, the impact on means tested benefits for annuity assignment should be more straightforward to assess than the impact due to pension freedoms. This is because there isn't the uncertainty of assessing whether drawdown payments would count as capital or income, nor the requirement to reassess notional income every time a capital payment is made.

The impact on bankruptcy would also need to be taken into account. Recent government guidance for insolvency practitioners and debt advisers[1] has made clear that an undrawn pension could be taken into account in deciding whether an individual can be made bankrupt. This could mean that an individual who has reached minimum pension age could be effectively forced to 'cash in' their pension to pay off debts. The same treatment is likely to apply to annuities once they can be assigned.

17. Should those on means-tested benefits be able to assign their annuity income?
Yes. Otherwise you would also need to exclude those who would potentially be on means tested benefits if they did assign their annuity income, effectively reintroducing a Minimum Income Requirement. If this restriction applied to assigning annuities then logically it should also apply to those exercising pension freedoms by not purchasing an annuity from money purchase pensions.

18. What are the likely impacts of the government's proposals on groups with protected characteristics? Please provide any examples, case studies, research or other types of evidence to support your views.
We have not responded to this question.

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[1] https://www.gov.uk/government/news/undrawn-pension-entitlements-summary-of-guidance-for-insolvency-practitioners-and-debt-advisors

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We have a diversified business with an established reputation for providing the best information, service and value for money investments and products to private and corporate investors.

The HL Vantage Service is the largest direct to consumer investment and pension supermarket in the UK.

We administer over £52.4 billion of client assets through the Vantage Service directly on behalf of over 707,000 investors. In total, we have £55.3 billion of assets under administration and management (30th April 2015) and are currently listed in the FTSE 100.

We were founded in Bristol by Peter Hargreaves and Stephen Lansdown in 1981 and the majority of our over 900 employees are still based here in Bristol.

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