



**Creating a secondary annuity market:  
Aviva response to HM Treasury's call for evidence  
18 June 2015**

**Executive summary**

Aviva is very supportive of pension flexibility and choice for customers. The proposal to create a secondary annuity market would extend these choices further. The proposal is a complicated one and the fundamental challenges (of market efficiency, consumer protection and advice and guidance) need careful consideration and to be fully addressed. If they are fully addressed we believe a market should develop that serves to meet the needs of and protect customers. However we are concerned that the proposed timelines may not give sufficient time for the market infrastructure to be delivered, for potential buyers to be operationally ready and for consumers to be adequately protected.

*Blind-bid portal system*

We firmly believe the best way to protect consumers, whilst delivering an effective and simple to use market would be to develop a blind-bid portal. It would serve to establish the open market best value for the consumer. The consumer would complete one standard questionnaire (including medical questions) that would form the basis of indicative bids for the annuity by potential buyers. The portal should be available both direct to consumers and via intermediaries. Competitive pressure could also be brought to bear by making the buyer responsible for paying the original providers fee.

*Advice and Guidance*

The issue of advice and guidance for customers is a critical element of consumer protection. Whether to sell an annuity is a complicated decision and will not be the correct decision for many consumers, for whom it will continue to be appropriate to enjoy the security and assurance that a guaranteed income from an annuity provides in retirement. Accordingly, consumers will need access to advice and guidance.

The rules on advice should be aligned to those that exist for a similar issue (the transfer of Defined Benefit ("DB") entitlement). In particular, the assignment of annuities worth more than £30,000 should be advised. For those individuals with annuities of less than £30,000 (who are unlikely to receive a net-benefit from financial advice), the blind-bid portal system, would ensure they get value for money for their annuity. Pension Wise should provide guidance on the implications.

*Buy back*

Buy back by the original provider should be permitted at the discretion of that provider in conjunction with the blind bid portal. This is because it may often be the original provider who is able to purchase the annuity at the best price, particularly for smaller value annuities. The PRA should confirm there are no Solvency II matching adjustment issues that prevent such an outcome.

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

Assigning one's annuity will not be the correct decision for many consumers, for whom it will continue to be appropriate to enjoy the security and assurance that a guaranteed income from an annuity provides in retirement. However, we agree there are reasonable circumstances where someone might now want a lump sum rather than an income for life. For example:

- They already have enough income from other sources like the state pension, a defined benefit pension, income drawdown or other annuities, and did not have the option of taking their savings as a lump sum when they previously reached retirement.
- The new inheritance rules allow them to pass pension savings onto the next generation, tax efficiently. This could be more appealing than continuing to receive a retirement income.
- Death benefit options available from products currently on the market might be better than those offered by their current annuity.
- They receive a relatively small pension that does not make much difference to their standard of living, but receiving a lump sum could make a much bigger difference to their life.

**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?**

The nature and complexity of annuities should limit the type of market players allowed to participate. Only insurers, reinsurers, buyout specialists, actuarial firms and pension schemes have the knowledge with which to price the product and only insurers and reinsurers the ability to underwrite them. Given this we agree that retail investors should be excluded but they should be able to invest in a subsequent pooled vehicle provided they understood the implicit risks, as with any investment. Beyond this we believe all market participants should be FCA regulated entities. By restricting market participants in this way an additional safeguard is provided to protect consumers from the risk of scams and ensure the market operates in an orderly way.

**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 be managed?**

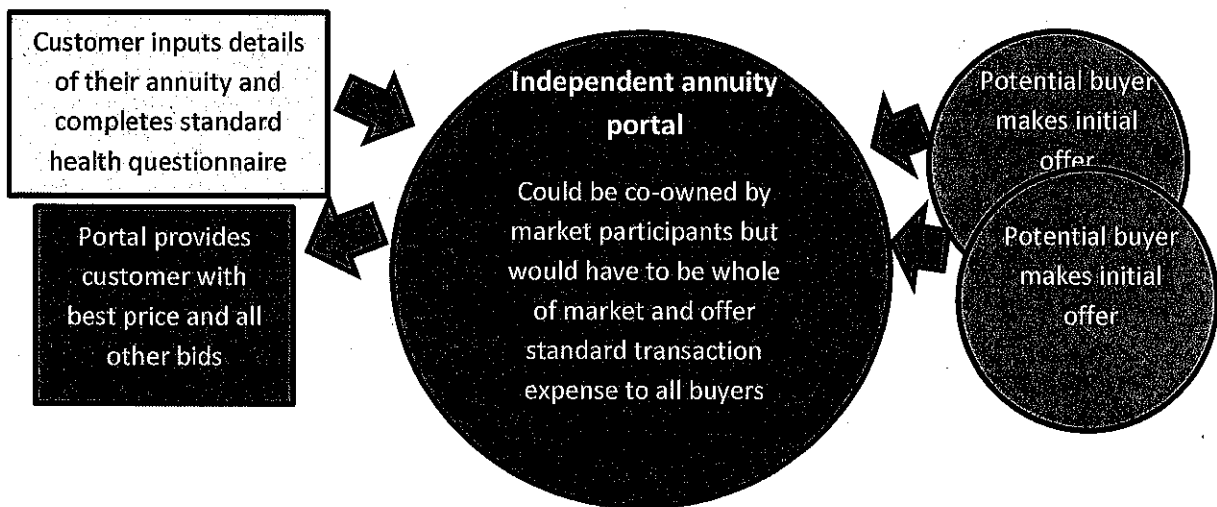
There is a good case to support buy back to be allowed as it may often be the original provider who is able to purchase the annuity at the best price. This is because the original provider would be able to remove the expenses and capital associated with managing the annuity and reflect that in their pricing.

If it is to be allowed it **must** be at the discretion of the original provider (rather than a right of the annuitant) who should have freedom over what they pay. A provider should also have the choice to only bid for their own annuities rather than acquire new income streams. This may suit some providers best and would help drive competition.

The consultation document states in 2.14 that there may be scope for FSCS protection “to continue following assignment within the existing rules”. We believe this is essential to ensure that a bid is based on the value of the annuity rather than the identity of the original provider or concerns over their solvency.

The consumer protection risks should be managed by having a central portal for providers (including the original provider if they choose) to bid for the annuity. The only way to transact in the market should be via the portal or a whole of market adviser. The portal should be a blind-bid system which serves to establish the open market best value for the consumer (along with the other bids made).

The following diagram shows how the portal could work:



Please note the following key points about the proposed blind-bid portal structure:

- The customer would not include their name to receive the indicative bids, which would be based on age, postcode, existing annuity details and responses to the (medical and other) questions posed.
- Where a customer has a fund less than £30k and does not use an adviser portal should include additional yes/no questions for the customer to answer, to check they have fully understood the implications of the transaction and as protection for the provider of the portal.
- Providers should not be allowed to see other providers' bids or iteratively bid for the same annuity income.
- The customer should not know who is bidding until all bids are collected and presented to them by the portal.
- The questionnaire should be compliant with the existing Origo 3.7 question set and use existing infrastructure to the extent already available and fit for purpose

The portal would require regulation to ensure that providers are penalised if they might repeatedly offer prices which subsequently reduce in an unjustified fashion once full underwriting is carried out. The FCA should be responsible for monitoring this and issuing a sanction such as an escalating ban from bidding if a provider is found to repeatedly submit false prices to the portal.

In addition the PRA should be asked to confirm there is no matching adjustment issue under Solvency II (if buy back by the original provider is permitted) due to disturbing the close cash-flow matching of such business. Clarity from the PRA on this issue is critical if buy back by the original provider is to be viable. If an independent portal is not used an authorised whole of market bureau could provide the same blind bid mechanism, but this may be a higher cost service.

**Q4: Do you agree that the solution to the death notification issue is best resolved by market participants? Is there more that government should do to help address this issue?**

Aviva uses a tracing service to establish whether a customer has passed away and would continue to use this service if the annuity income is assigned to a third party. Most annuity providers would have an equivalent service.

However we do see merit in other options being explored including understanding the parallels with death notification and the cessation of state pension payments, particularly linking with the Tell Us Once initiative to improve information sharing

In practice the original provider may benefit from including additional conditions in the terms of assignment as envisaged under option 1 but this should be at their discretion. Options 2-3 are likely to be too costly and impractical.

**Q5: Do you agree with the proposed approach of the government working with the FCA regarding the fees and charges proposed by annuity providers?**

The government should work with the FCA and in the industry in developing the framework for fees and charges. This work should go beyond what is proposed in the consultation document and set a regulated maximum fee for the original provider. We would assume the original providers' fee or charges would be related to the additional administration costs incurred by re-directing the annuity payments. And providers should also be required to justify the fee they do charge to the FCA (at their request) to ensure their fee is justified.

We believe the fee should be paid by the **buyer** to the original provider. This would provide for more effective market pressure on existing provider fees. It would also lead to a more efficient market as the buyer could release the funds to the annuitant without the delay caused by first the annuitant having to pay the existing provider.

The costs incurred by the buyer would be reflected in the purchase price, which would be the basis for market competition.

In setting the regulated maximum for the fees chargeable by the original provider, it should be noted costs will vary and depend on the providers system and processes. Some providers, for example, have outsourced the administration of their back book of business. This may mean they have higher fixed costs, as the terms of that administration did not envisage a secondary market.

Also, commission should not be allowed in the secondary annuity market. This clarity would avoid the distortion observed in the primary annuity market where non-advised intermediaries can receive commission.

By using a combination of a commission ban, the blind-bid portal system described in the answer to question 3 and whole of market regulated intermediaries, the failures of the primary market (noted elsewhere by the FCA) would be avoided.

**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**

Yes and the prescriptive definition should be analogous with that used for pension flexibility.

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

No.

**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 pensions flexibly and those that will be able to access their annuity flexibly? Are there any other tax rules that the government will need to apply to individuals who had assigned their annuity income?**

Yes the changes are logical and should provide parity with the pension flexibility rules.

The buyer is required to operate PAYE. Not all buyers will have the existing systems or processes to do this. We would recommend the final guidance makes clear the ability of a buyer to meet its PAYE obligations by arrangement with a third party provider (i.e. a SIPP provider). It is likely to be easier for certain buyers to release all funds into a SIPP deposit account and the SIPP provider operate PAYE on funds that are withdrawn.

However lessons should be learnt from the operational issues that were experienced with pension flexibility, particularly in relation to PAYE administration and guidance. New operational guidance was published on 6 April 2015 (the date pension flexibility rules went live) which left insufficient time to implement the guidance on time. Accordingly, with the secondary market, any new operational guidance should be published at the same time as amending the primary legislation or at least well in advance of those amendments taking effect.

The tax treatment of the annuity in the hands of the buyer should also be clarified early to ensure potential barriers to the creation of a viable market are removed. If the buyer is an insurer or a pension scheme, then the annuity income would be tax free. Regardless of this there should be no operational requirements on the original provider other than to pay the annuity gross to the new recipient (or there would be a cost implication that would reduce the viability of the market).

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

The key tax avoidance risk is that a third party buyer of annuity income would not be required to withhold PAYE on a lump sum paid to the original annuity holder if the buyer has no presence in the UK for PAYE purposes. This would mean that the customer would need to report the lump sum under self-assessment.

**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?**

We agree that there must be a variety of consumer protection safeguards in place in any secondary market. The FCA should use the outcome and lessons from its planned assessment of the effectiveness of current safeguards to inform the development of safeguards for the secondary annuity market.

Consumers will need access to advice and guidance. The rules should be aligned to those that govern the transfer of Defined Benefit ("DB") entitlement. In particular, the assignment of annuities worth more than £30,000 should be advised. This approach would use existing regulations designed to protect customers in a similar situation i.e. those who will lose their entitlement to a guaranteed income for life by transferring from DB to DC.

Advice should be provided by whole of market regulated rather than restricted advisers. The advice requirement should be kept under review and depending how the market develops amended based on experience.

For those individuals with annuities of less than £30,000 in value, the blind-bid portal system, described earlier in this response, would ensure the customer gets value for money for their annuity. The de-minimis is important to ensure that those who would not receive a net benefit from financial advice still get value for money. They along with all other individuals considering cashing in their annuity should be able to access Pension Wise in order to receive guidance on the potential generic implications (i.e. the interaction with tax, means tested benefits etc).

Standardised risk warnings should also be used, however the lessons from the late introduction of the second line of defence (the standardised risk warnings introduced for pension flexibility) should be learned in this regard to ensure they are an immediate success.

There should be specific safeguards in place to protect those without the capacity to contract. Limiting the potential buyers of annuities to regulated entities (see our response to question 2) would also serve to protect the consumer from the risk of potential fraud and scams. It would also reduce the potential costs to the original provider (in completing due diligence on the buyer) and therefore limit the fees chargeable to the consumer.

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

Yes Pension Wise should be expanded in scope to enable it to provide guidance on the secondary annuity market. However it should be noted at outset that the guidance, and therefore staff training required, will be complex and therefore time intensive. Any expansion of the service should not come at the cost of diluting the service which is already provided in relation to pension flexibility.

**Q12: Should the costs for any advice or guidance be borne by the annuity holder? If not, what arrangements are appropriate?**

Yes the annuity holder should pay for the cost of advice. Guidance should continue be free at the point of delivery for the consumer.

**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?**

If there was a requirement to use the blind-bid portal system (described earlier in our response) or to seek advice from a whole of market regulated adviser, there would be no need to obtain a minimum number of quotes.

If a blind-bid portal is not used then the rules should mirror those to be introduced by the FCA on buying an annuity, with the onus on the purchaser to follow the prescribed process. For example, if a firm is required to tell an annuitant what the best income per annum they can achieve is when sold an annuity (FCA paper MS14/3.3) and promote shopping around, the purchaser of an annuity in the secondary market should have to tell the annuitant what the best cash sum they could get for that annuity is, and promote shopping around in the same way.

**Q14: Does the government's approach sufficiently protect the rights of dependents upon assignment? If not, what further steps should the government take?**

We agree that the written consent of a dependent (who has a contractual right to future annuity income) should be required before the annuity income is assigned. If consent is withheld no assignment should be allowed.

However dependents are unlikely to have an explicit contractual right. Such rights are usually only acquired upon death of the annuity holder.

Accordingly FCA guidance would be useful to establish clear standards over what permissions should be required by the original provider absent the dependent having a current contractual right to future annuity income.

We are supportive of a permissions regime being developed. This is a very complex area and will need to take into account pensions sharing and earmarking orders, whether the annuity originates from a

scheme that required a widow's pension to be provided and exactly what is, and isn't, a contractual right. Certain scenarios will be more complex to accommodate within such a regime than others, for example those without the capacity to contract, minors etc. Given this complexity, considered guidance from the FCA would help to ensure consistency of approach and consumer protection.

**Q15: Should the government permit the principal annuity holder's income to be assigned while dependents retain their own income stream? Should the decision to do so be left to the discretion of the parties to the transaction?**

In practice the procedures to assign part of the annuity income stream would be complicated and import risk into the process for all parties to the transaction. This is likely to increase the costs and therefore reduce the attractiveness of such a transaction. Rather than develop a market where certain transactions are not likely to be practically viable (and therefore the source of consumer frustration) we believe it would be better to provide clarity by not allowing it in the rules which will govern the secondary market.

**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?**

Any advice provided should be required to explain the impact the sale of an annuity might have on means tested benefits. The guidance provided by Pension Wise should also set out the potential impact and provide new Department of Work and Pensions (DWP) advice on this subject.

DWP advice on the deprivation of assets would need to be updated to reflect a secondary market in annuities and such advice should be signposted by any advice or guidance that is provided to consumers.

As set out in our answer to question 10 we also support the use of retirement risk warnings to ensure the impact on means tested benefits are appropriately highlighted.

**Q17: Should those on means tested benefits be able to assign their annuity income**

The secondary market should be open to all consumers who have access to pension flexibility, otherwise it will be inconsistent from a policy perspective and those who may stand to gain most from the secondary market may be excluded from participation.

If those on means-tested benefits were not permitted to reassign, there is an implied duty for either the buyer or the annuity provider to check whether the seller is in receipt of such benefits. This would be a prohibitively arduous addition to the customer journey, and the additional costs of it would reduce the value of bids especially for the smallest annuities where benefit claims are more likely.

Capital received through assigning annuity income could be treated the same as any other capital with regard to means testing levels and deprivation of assets rules. HMRC will receive details of the sellers



of annuities and the new recipient of the income stream under RTI. They should share this information with the DWP so they can police deliberate deprivation of assets, if this is their concern.

**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**

We agree that gender, age and disability will be significant considerations relevant to those who wish to assign their annuity.

There may be customers who bought a gender-priced annuity who would assign its income under gender-neutral pricing but that reflects the regulatory reality of today's market. Gender-neutral pricing must be enforced for the secondary market or the market would become distorted.

*If you wish to discuss any of the issues raised in the consultation please contact us on [public.policy@aviva.com](mailto:public.policy@aviva.com).*

