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Canada Life Response to the HMT/DWP Consultation on the Creation of a Secondary Annuity Market

June 2015

Canada Life™

Executive Summary

Canada Life welcomes any initiative that creates freedom to allow individuals to make the most of their retirement. As a leading provider of annuities in the open market, we were one of the first providers to launch an all-new range of products to help consumers take advantage of the new pension freedoms. Our new range caters for all of the freedoms now available to individuals.

When reviewing the consultation document, it was evident that the industry faces significant challenges to build the basis of a sound and fully functional market.

More importantly we feel it is essential that there is agreement on what the success measures should look like. Throughout this consultation response, we have adopted the position that an effective market will be one that facilitates good customer outcomes by encouraging healthy competition, provides clarity to individuals around the risks associated with selling their lifetime income and how to recognise value.

We would also highlight that a successful market is one where a number of buyers compete for an individual's business. But equally it is recognised that an individual's assessment of what is fair value may be quite different to what a third party may be prepared to pay or even to a further extreme, no third party may be willing to purchase. We feel these are normal market risks.

The key concerns at Canada Life are as follows:

Death notification process – this is already an issue that often causes problems for providers where the death of an annuitant is not reported within a reasonable timeframe. For annuitants that live overseas, this issue becomes even more difficult to manage as there is no established method of tracing individuals, other than writing to check their continued existence. Where an income is assigned to a third party, we are very concerned that there will be no incentive for the annuitant to maintain any contact either with the annuity provider or the third party who has paid for their income. We believe that this problem can largely be solved by allowing use of existing public sector sources of information on notification of death.

Costs of underwriting – we believe that the only way an individual will be able to obtain a quotation will be to complete a medical questionnaire to allow the third party to assess their health and life expectancy. A life policy does not pay a benefit until after the underwriting checks have been carried out. For enhanced annuities, most providers adopt a post-issue sampling approach to ensure that the information provided in the Retirement Health Form was accurate. Where a sample highlights incorrect information, we are able to revise the income we pay. These processes will not work for a secondary annuity market as the benefit will be paid straight away and once paid, it would be difficult to reverse the transaction.

In addition, if the individual then decides not to proceed with a sale, the cost of underwriting is likely to be borne by the third party. We expect that this is likely to drive valuations down in order to recoup these extra costs.

Sales Process – we are already experiencing reluctance from advisers to engage with clients who have guaranteed or secure benefits and expect this to be the case for a secondary annuity market. It might be possible to allow individuals with small incomes to sell these without advice, provided that there are sufficient levels of warning to ensure they understand all the risks they might be exposed to. Even with such safeguards in place, we are concerned that this will not be adequate replacement for formal advice. We therefore would urge for the development of the sales process, within the bounds of regulation, so that it works smoothly for customers and encourages participation.

Furthermore, the various options available with annuities, such as Value Protection death benefits or second annuitant income will need to be considered when pricing an annuity. We would suggest that once an annuity income is assigned, it will not be possible to re-assign the income again and any death benefits that may have been payable will cease. This strengthens the value of seeking advice and having detailed risk warnings.

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?

(a) We believe that there will be circumstances where giving up a guaranteed lifetime income would be appropriate for an individual. The most obvious would be where the annuitant perhaps purchased an annuity prior to the announcement of the new pension freedom rules and would have opted for flexi-access drawdown instead.

(b) We believe that where an individual has a change in circumstances, for example they get married in later life and only hold a single life annuity, they may wish to move to an alternative arrangement.

(c) There is also the possibility that annuitants who have other income means, may want to sell their annuity income in order to be able to pass on funds in the event of death.

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?

(a) We believe that the pricing of such arrangements will be complex and involve a degree of underwriting in order to effectively value an annuity and assume a reasonable level of longevity risk. As a result, we agree that such a market would not be possible for a retail investor to partake in. We agree that corporate entities with the resources and ability to accurately manage longevity risk are best placed to enter such a market.

(b) This might include insurance companies as well as fund houses looking to develop a fund around annuity incomes, both based in the UK and from overseas.

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?

(a) We believe that adopting an 'Open Market' standard will help to drive better outcomes for individuals. In principle, there should be no reason why an existing annuity provider should not be able to 'bid' for annuity contracts they already provide. We would stress that our experience of the Open Market Option within Annuities highlights a significant degree of inertia. We believe that forcing customers to buy through a central 'Bureau' would help drive better outcomes but we would need a mechanism to demonstrate that the customer has shopped around. This could be achieved simply by obtaining a confirmation from the Adviser or alternatively by showing a summary from the 'Bureau'used, detailing the other valuations provided. This however would create a conflict with Office Fair Trading rules.

(b) If 'buy back' is permitted, both individuals and providers will need a clear framework to justify value and ensure fairness of the outcome.

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?

(a) No. The industry currently experiences significant issues with overpayment of annuities being made due to non-notification of death or later notification. Adding the complication of payments being made to a third party will only serve to complicate the matter further. The government could make things easier for providers by creating a central register of deaths that will be available for providers to refer to. Of course, this will not extend to individuals who reside overseas and this is a significant concern and source of complaint as the most common method of checking is to issue a request for the client to complete a 'Certificate of continued existence', which is often regarded negatively by customers (please see (e) below).

(b) We believe that a significant operational issue will be the management of the relationship between annuitant and annuity provider if the annuitant sells their income to a third party. There is a risk that the annuitant or their dependants will consider the relationship over when the income ceases to be paid to them and there is a strong possibility that providers could find themselves paying out an income for a considerable period after the death of the annuitant.

(c) Whilst there is no simple or fail-safe solution to mitigate this risk, we would urge consideration of an alternative to the annuity provider following up for death notification. We believe that it will be in the interest of the third party to provide confirmation of continued existence, where failure to provide such confirmation within a specified period, will result in annuity payments ceasing.

(d) One alternative might be to pay a lump sum based on guaranteed benefits only. This would be the simplest and easiest method to price and will mean that there is a clean cut-off of income, regardless of whether the annuitant lives beyond the guarantee.

(e) Overseas residents – Given the difficulty in identifying a death of an annuitant overseas, rules will need to be put in place to limit payments, either to the guaranteed payment period or an alternatively agreed basis.

5. Do you agree with the proposed approach of the government working with the FCA regarding the fees and charges imposed by annuity providers?

(a) Broadly agree. However there will need to be standard format for providing valuations of quotations in order to make it simpler for the customer to understand what they are comparing. All charges and fees need to be clearly signposted and where this is not possible, assumptions should be clearly explained.

(b) We also feel that the costs of calculating a valuation should be considered and who should cover this cost. Most providers approach underwriting in different ways and as a result, are likely to incur different costs when competing for business. As these costs will be incurred at the start of the relationship, the third party will have to price accordingly to compensate for the potential that customers might change their minds about selling their income.

(c) A simple alternative for covering medical underwriting costs will be for the individual to cover the cost of medical underwriting, the results of which can be shared with multiple third parties in order for them to provide an accurate valuation. There are however, DPA issues to resolve in doing this and also the possibility that an added cost might discourage individuals from this market altogether.

(d) With all the above, we will need clarity on the rules as quickly as possible.

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?**

   (a) We agree. It is also important that the government and FCA commit to making it clear to the market what will be in scope of the new rules and out of scope. We expect that providers will come under pressure from scheme members to 'cash in' the incomes and then be seen to be unhelpful when we explain this is not possible under the rules. It is important that government makes this clear to the wider market and media commentators.

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

   (a) We believe that the proposed changes represent a significant change to the industry, both in terms of the way the products are perceived by the public, how providers are perceived and how annuity products could be priced in future.
   (b) We believe it would be advisable to consider the merits of introducing such legislation and review the impact over a period of years before considering broadening the scope to include other products.

Legislative changes

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?

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

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?**

   (a) In order to remain consistent with our approach towards pension freedom, we believe that providing guidance and an overview of the associated risks is an absolute minimum requirement for individuals considering selling their income.
   (b) We believe that the safeguards and rules around risk warnings need to be clearly defined and communicated to give the industry sufficient time to prepare.
   (c) The process introduced a few weeks before pension freedom that providers should act as a 'second line of defence' created significant burden on providers and we strongly believe that intermediaries and advisers are best placed to ensure that the customer understands the risks they are exposed to.
   (d) We would prefer that providers should encourage individuals to always seek advice so that they understand the consequences of selling their income to a third party as well as understanding that this would not constitute a cessation of their contractual relationship with the annuity provider.
   (e) Of course we recognise that for individuals with smaller incomes, the cost of advice might outweigh the benefit of selling the income, so we believe that **pension wise** will also have a role to play in explaining these risk warnings and the consequences of selling income.

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

(a) Please see answers to 10 above.

(b) Yes, we believe that the remit of Pension Wise should be expanded to include this new market.

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?

(a) Yes. Whilst there may be public pressure to allow a free transaction, there will be a cost associated with informing the individual of the risks, completing the underwriting procedures and finding a suitable third party to sell to.

(b) We expect that the market could evolve where an Aggregator may offer a generic service to groups of consumers for a set fee.

13. Do you agree that the government should introduce a requirement on individuals to obtain a number of quotes? How else should the government best promote effective competition to ensure consumers obtain a competitive price?

(a) We believe that the government should make it compulsory to sell annuity income via the 'open market'. This way, the individual will be able to compare valuations and obtain a fair value. We need a mechanism to show the provider that the customer has obtained a few quotes or at least tried to obtain alternative quotations. Government and the FCA need to consider how best this aspect might be policed.

(b) We expect that the individual will be able to visit an intermediary who will then be able to search the market for the best rates (similar to the current annuity sales process) to give an indication.

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?

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?**

    (a) Whilst in principle we believe this could be the case, effectively we would be creating more administration and re-assignment. In order to keep the sales process simple and administration to a minimum, we would recommend that assignment of income includes all benefits derived from an annuity. This would include any death benefits payable or second annuitant / spouse income.

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?

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

    (a) Provided they are made fully aware of the impact that selling their income may have on their entitlement to benefits, we believe they should be able to assign their annuity income.

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.