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Aon Hewitt
Consulting | Retirement

Consultation response

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Prepared for: HMT and DWP
Prepared by: Aon Hewitt

Creating a secondary annuity market

Introduction

Aon Hewitt is pleased to submit its response to the consultation on creating a secondary annuity market.

By way of background, Aon Hewitt is a global company providing human resource consulting and outsourcing solutions with more than 30,000 professionals in 90 countries. Our services include providing annuity broking to our clients.

Generally, we welcome the intention to widen the range of options for part of the retired population. Our main high level comments are:

- There are complex issues involved and advice is likely to be required. Costs of underwriting are also likely to be significant. Consideration of assignment would therefore appear to make most sense for those with significant annuities. Costs may otherwise be disproportionate.
- We support extending the concept of pension freedom to pensioners of defined benefit schemes. As a minimum, schemes should be able to allow such pensioners to surrender future pension increases (including statutory minimum increases) for a cash lump sum, a transfer value, or a higher pension within the scheme. Schemes should not be forced for offer these options to members but legislation should enable such flexibility.
- It is not clear why annuity providers would agree to allow assignment to a third party, particularly if they are not able to cover their additional costs in full. However, the possibility of allowing them to buy back the annuity as an option (effectively providing the policyholder with an option to surrender the annuity policy) could encourage the providers to agree to assignment as an alternative. The buy-back/surrender option would represent a simpler solution. Providers should not be forced to offer a buy-back/surrender option but legislation should enable such flexibility.

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Risk. Reinsurance. Human Resources.
Parkside House | Ashley Road | Epsom | KT18 5BS
t +44 (0) 1372 733 700 | f +44 (0) 1372 733 991 | aonhewitt.co.uk

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Introduction (continued)

- The risk of selection could mean that even a competitive price will be significantly lower than individuals might anticipate. Unless an elaborate system of underwriting is adopted the purchaser will have to make conservative assumptions, to protect against this selection risk, potentially making the lump sums on offer appear to be very poor value for money. For policyholders in good health, the value available may actually represent poor value for money, highlighting the need for specialist advice.
- We expect this option to be mainly of interest to those forced to purchase an annuity prior to 6 April 2015. If the facility were to be made available to members who opted to take an annuity after this date, when other options were available, the risk of selection seems particularly high.
- The Government should take steps to reduce the risk of "nuisance calls" encouraging pensioners to access their annuities, as a result of these new flexibilities. Consideration should also be given to any special measures required to address the possibility of new pensions scams resulting from the additional flexibilities.

We comment on the detailed aspects of the proposals 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?*

Generally, this decision should be left to the individual concerned, having taken suitable advice.

One option which is not mentioned is the possibility of assigning part of an individual's annuity. For an individual with a significant annuity, obtaining a cash lump sum for part of the annuity might be attractive, whilst retaining the security on an ongoing lower guaranteed income. Allowing this option will also solve some of the issues you have identified (such as notification of death). A variation on this theme would be to allow payments to be assigned for a period with future payments beyond a certain date reverting to the individual.

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A new secondary market for annuities (continued)

There are various circumstances in which it might be appropriate to limit the scope to assign. The following are mentioned in the consultation document and we comment further under the relevant questions below:

- Cases where means tested benefits are involved
- Cases where a contingent annuity would be paid to other beneficiaries after the death of the current annuitant

Some annuities pay an annuity to a legal spouse or civil partner on death. However other annuities have much more complicated rules on payments to other adult financial dependants, and to children, on death, and material investigation into the circumstances of a member can be required on death to work out who the correct beneficiaries of a dependant's pension are. Sometimes a judgement call is needed to assess the most appropriate dependant. This does not fit well with a situation where the real beneficiary of a dependant's pension award is no longer the dependant but another party (the annuity buyer). It could be stressful for a member's dependants to be asked to provide information on dependant benefit awards shortly after a death, and these dependants would have no financial interest in the outcome. There may also be less pressure on the annuity provider to identify a dependant when the dependants have nothing to gain. This may worsen the value of some dependants' benefits and create another issue for value assessment for the annuity.

Some annuities have other terms where payment is subject to conditions, for example a child's pension payable after the age of 18 if the child remains in full-time education or meets a definition of disability. This again points to monitoring that is made more difficult by breaking the relationship between the annuity provider and the beneficiaries. (Allowing the annuity provider to buy-back the annuity would help here, particularly if the legislation made it clear that only the policyholder was required to sign a form of discharge.)

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A new secondary market for annuities (continued)

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 agree with the proposed approach in principle. The market will naturally be tailored to those with substantial longevity and medical underwriting knowledge, as others will struggle to price annuities' true value accurately.

We anticipate that medical underwriting will be required for the individual and for any contingent beneficiary involved. We anticipate that the level of underwriting applied will depend on the value of the annuity.

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?*

Whilst we recognise the potential problems, we are not sure that the drawbacks of allowing existing providers to offer 'buy-back' terms outweigh the potential benefits of this option. We agree that there are significant issues if providers do offer this option, and we do not believe that it should be compulsory, but we do not believe there should be a legislative prohibition. It could simply be made clear that providers are not compelled to offer buy-back terms.

The consumer protection concerns could be addressed by a requirement to obtain multiple quotations and obtain advice, as you suggest in the consultation.

The buy-back option also solves some significant practical problems such as why the original provider should want to agree to the transaction and how the third party purchaser would be notified of a death.

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A new secondary market for annuities (continued)

4. *Do you agree that the solution to the death notification issue is best resolved by market participants? Is there more the government should be doing to help address this issue?*

This is a key issue. All the potential solutions set out in paragraph 2.21 have significant downsides:

- Instructions to the executor may not be carried out as requested (the executor may be acting several years after the original request) – for example the executor might be changed or might not agree to act.
- The maximum age approach is not an accurate solution and merely provides a limit
- The nominal payment approach will incur additional costs which may be disproportionate to the level of continued payment.

Allowing assignment of part of an annuity would help. Buy-back would solve the problem.

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 would expect annuity providers to be able to defend fees proposed as compliant with Treating Customers Fairly but that does not mean the fees will not be large and vary materially by firm to fit their own circumstances.

However, if fees are limited to costs incurred it is not clear why existing annuity providers would agree to an assignment arrangement. Presumably they would wish to devote their resources to profitable business, rather than business which, at best, only covers costs incurred.

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A new secondary market for annuities (continued)

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?*

It is possible that an annuity in the member's name may have originated from an occupational scheme and even a defined benefit scheme (for example if the annuity has been set up as part of a buy-out exercise). If the intention was to limit the new flexibility to benefits derived from money purchase funds, then it may not be possible to segregate these annuities to make this distinction.

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

We support extending the concept of pension freedom to pensioners of defined benefit schemes. As a minimum, schemes should be able to allow such pensioners to surrender future pension increases (including statutory minimum increases) for a cash lump sum, a transfer value, or a higher pension within the scheme. Schemes should not be forced for offer these options to members but legislation should enable such flexibility.

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?

We agree that the proposals achieve parity.

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

The comments in the consultation document on avoidance look reasonable.

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?

This will be a complex area. The advice required is likely to need specialist knowledge. It is not obvious how a member can be advised effectively on an annuity sale. The depth of knowledge in the IFA market has always varied materially to date, and this area appears to require material new knowledge which is not presently accessible to IFAs and may be difficult for them to fully understand without significant further training even if it was available. Specifically, to understand the fairness of the annuity sale price offered, the adviser would need to know if the member (and spouse if applicable) has health impairments, how these affect life expectancy, and how changes in the member's life expectancy impact on the spouse's benefit value and vice versa. He or she would also need to understand how changes in life expectancy affect the value of an income stream, which depends on market conditions, age and the specific benefit design secured and so is not something that can easily be summarised in industry wide "tables". There would appear to be a significant risk of mis-selling. (Even where the safeguards are robust, there may still be a perception that a quite reasonable lump sum represents very poor value for money. For policyholders in good health, the value available may actually represent poor value for money, highlighting the need for specialist advice.)

The advice needs to be "holistic" to take into account the individual's other assets and income streams, and short and long term liquidity needs. The individual's focus may be short term liquidity needs only – a US advisory website states that "*The yields on a secondary market annuity are often higher than the interest rates on an immediate annuity because the current owner of the secondary market annuity is willing to sell his income stream at a discount to receive quick cash today*".

Only requiring advice above a certain threshold would appear sensible from a cost perspective. However, it is difficult to see how policyholders with smaller annuities can make appropriate decisions without specialist advice – even though the cost of that advice could be disproportionately expensive.

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Consumer protection (continued)

A threshold would also introduce a risk of moral hazard in that offering the individual a lower value, below a set threshold, would enable assignment to take place without advice. It would seem very odd for advice to be required to accept assignment to company A offering £31,000 but not to company B offering £29,000. Requiring a benchmark price from the annuity provide could help but it is difficult to see why the provider should be forced to carry out additional work which would not have been priced into the original annuity cost so the cost would need to be met by the individual even if the assignment does not go ahead.

If the policyholder is obliged to obtain quotes from several providers, the highest quote could be used to assess whether the advice requirement is triggered.

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

Expansion of Pension Wise may be helpful, particularly for individuals with smaller annuities. However, the industry should not be asked to meet the additional costs involved. These products were priced on the basis of legislation in place at the time of sale and the industry should not have to meet the cost of retrospective changes.

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?

Yes. The annuity holder would be benefitting from the additional flexibility and should meet the costs.

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?

This is probably a necessity in order to ensure that individuals achieve adequate value for money. It will also be helpful in ensuring that advice is provided in appropriate cases, as noted above.

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Consumer protection (continued) (continued)

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?

Our view is that – unless an explicit exemption is introduced to legislation - spouses, or dependents who are named on the annuity policy as benefitting after death, should have to consent and, if they do not, their rights should not be assigned (only the single life annuity should be assigned). The process would work most efficiently if the legislation makes it clear that, unless there is a pension attachment, only the consent of the policyholder is required to assign benefits.

Where annuities are the subject of pension attachment, as a minimum the provider should be required to inform the ex-spouse of an assignment and it may be appropriate to restrict assignment in these cases.

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?

We do not think that legislation should prohibit this but annuity providers should certainly be able to refuse such an arrangement and ensure their additional costs are met if they do agree.

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Consumer protection (continued) (continued) (continued)

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?

This is a very difficult area and one that would need to be addressed in the guidance/advice before the new option is made available to relevant individuals. Advisers will need to be specifically authorised for this specialist market.

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

This is a question for Government, but when assessing members for means-tested benefits the treatment of assigned benefits should be consistent with that of pensions accessed flexibly. However, in our view the new option is best suited to individuals with significant annuities, for which the cost of obtaining appropriate advice will be proportionate to the value of benefits under consideration. In those circumstances it is less likely that annuity holders will be on means-tested benefits.

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.

No comments.