ILAG

Investment and Life Assurance Group
The Practitioner Voice

Annuity Consultation
Insurance and UK Regulatory Authorities Team
HM Treasury
Horse Guards Road
London
SW1A 2HQ

18 June 2015

Dear Sirs,

Consultation: Creating a secondary annuity market

ILAG is a trade body representing members from the Life Assurance and Wealth Management Industries.

ILAG members share and develop their practical experiences and expertise, applying this practitioner knowledge to the development of their businesses, both individually and collectively, for the benefit of members and their customers.

A list of ILAG members is at the end of this submission.

ILAG members are supportive of change that facilitates greater flexibility for those in later life. Although our members have not made specific comments about the viability of a secondary annuity market, it is widely acknowledged that this is likely to be niche. In answering the consultation questions our members have focused on the significant challenges and practical implications associated with the formation of such a market.

There are a number of fundamental matters to be considered if a market is to be created and operate effectively. It is important to build on, and learn from, what has worked well, and less well, in the lead up to the April 2015 pension freedoms. The Government should consider carefully whether a 2016 implementation deadline is realistic and be prepared to extend the timetable, if appropriate, to deliver better and more secure consumer outcomes.

The impact of a secondary annuity market on insurance firms' existing reinsurance arrangements needs clarification.

A further area requiring legal clarity is the management of assigned annuities in future Part VII transfers.

Consultation questions

A.2: A new secondary market for annuities

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

Our members believe that, for many, the continuation of benefits received from existing annuity rights is likely to be the most appropriate action. Attempting to categorise segments of the population or identify demographic characteristics for the purposes of appropriateness is not viable, as the decision should be based on an individual's personal circumstances, needs and financial situation. Providers will be unaware of each customer's individual circumstances as they will hold a variety of different products and may be based overseas.

It is, however, vital that anyone considering the reassignment of an annuity income receives appropriate guidance and, potentially, regulated financial advice before taking action that will affect their future financial position.

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?

Due to the complex nature of the product and the potential for adverse customer outcomes, our members strongly believe that only regulated organisations should be permitted to buy annuity rights and market related services. A specific authorisation to carry out such business would provide an appropriate degree of control and oversight of the process.

Authorisation requirements should not be overly onerous so enough organisations are encouraged to participate in the market. This will result in greater competition and better value for customers.

One practical point for clarification is the requirement for the purchaser to have appropriate PRA authorisations.

In considering the impact of future reassignments on the original annuity provider, it is important to establish the party responsible for bearing the costs of such further reassignment at a future date. It is not deemed appropriate to include the potential for these costs at the time of the original reassignment and the view is that any future sales of a reassigned annuity to a corporate entity should include a process for reimbursing the original annuity provider for the further work of reassignment.

Our members share the view that it is right to bar retail investors from the market.

If there is potential for the market to be opened to overseas entities it will be important to first review, understand and rectify issues with their taxation arrangements.

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?

It is understood by the industry that current legislation does not prevent provider commutation of small annuities (below the small pots limit) and this should not be affected by the outcome of this consultation. Flexibility should be retained for small annuities, as it is a solution for individuals who gain no real benefit from receiving a very small annuity.

If a market in 'buy back' annuities is to be pursued, it is vital that Government works with the PRA in the development of legislation, so that the impact on an insurance company's matching adjustment calculations for capital requirements is fully understood.

The potential implications must also be considered where the result of such annuity sales could be the unwinding of reinsurance arrangements. This will have a direct impact of the value an individual will receive from their annuity sale. If annuity sales are permitted, ensuring adequate advice is given to the customer is crucial. (This will help prevent future claims from customers who use up their lump sum and have no future income). Advisers should have specialist knowledge in this area and advice should be mandatory with an FCA requirement to provide comparative data.

In certain circumstances an annuity provider may offer more than is likely to be the 'open market' value for the annuity. For this reason 'buy–backs' should be permitted. However, to protect consumers (and avoid the apathy that causes individuals to accept offers lower than would be achievable by entering the open market) annuity providers should be able to present their bid on an anonymous basis, alongside offers from other parties, through a web-based service.

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?

The proposal for the annuity provider to maintain trivial payments to the original annuitant in order to retain an active relationship is both unrealistic and costly. The process would be better served by a central register holding data on deaths. The infrastructure must already exist, for example within DWP for the management of benefit and State pension payments. Such a system will ensure that the added costs associated with industry based solutions are not borne by customers.

When purchasing annuity rights it is key that the process for the recovery of overpayments, following a late notification of death, is clearly communicated.

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

In principle it appears prudent for the regulator to monitor and review the fees incurred in this market. Any regulatory approach should be proportionate and take account of the diseconomies of scale.

We ask that Government and the regulator consider the other legislative and regulatory changes impacting the industry in terms of costs, charges and disclosure regimes to ensure consistency of approach.

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?

In the spirit of providing flexibility to those in later life, there appears to be no sound reason for excluding pension income from occupational pension schemes from this measure. We understand and appreciate the risks involved, but believe that the freedom to choose should be available to all. If the Government has in mind a potential market size, extending the facility to occupational pension scheme members would be key to meeting that target.

It is vital, though, that the rules governing the assignment of annuity income are clear and detailed so that providers will be able to identify the types of annuity that can be assigned and those that cannot.

Considerations should include, but not be limited to, privately held annuities with protected rights or guaranteed minimum pensions and buy-in/buy-out arrangements.

Concerns have been raised in relation to this point as the reporting expectations, in terms of the continuing annuity payments, are not clear particularly, for example, on death.

A.3: Legislative changes

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?

The issue of parity should not just apply to the options available but to the value of exercising those options. There are likely to be higher costs, impact on benefits and greater complexity associated when an individual chooses to assign annuity income, already annuitised, than for those in drawdown.

PAYE challenges presented as a result of the introduction of the pension freedoms need to be incorporated into the development of the taxation policy for this market.

The impact of tax on the proceeds of annuity sales should be made abundantly clear in the sales material and possibly within quotations.

It seems most appropriate for the purchaser to be responsible both for the communication of and deduction of tax at source.

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

To be able to comment on the development of measures to counter tax avoidance, our members would like clarification on:

- how the income from an annuity sale will be taxed in the hands of the purchaser
- how offshore purchasers will be subject to tax
- how taxation will be affected by other measures, such as the rules surrounding inheritance tax.

A.4: Consumer protection

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 cost of regulated financial advice is comparatively high for many individuals relative to the size of their annuity.

Our members believe that the level of complexity and potential for adverse customer outcomes means that guidance in isolation is not likely to provide adequate information to help aid the decision making process.

The advice requirements should be consistent with the requirements for flexibility.

Determining the correct level of advice for customers will be key in this market. It should be delivered by regulated advisers who have relevant knowledge and it should be mandatory at the appropriate level.

Although Pension Wise may offer individuals a route to obtain information and guidance, it shouldn't be the only option available.

It would be worth exploring how the simplified advice process could be adapted to cater for the requirements of a secondary annuity market.

In terms of safeguarding individuals against the actions of fraudulent organisations, ensuring those operating in the market are authorised by the regulator is essential. The process itself could allow for further safeguards, such as the assignment of annuity income being confirmed only when there is proof that the lump sum payment has been made.

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

Expanding the remit of Pension Wise seems the most appropriate vehicle for the provision of guidance in this area. Both expertise and funding would need to be reviewed prior to implementation, to build on the infrastructure developed for the launch of pension freedoms.

As previously opined, Pension Wise should not be the only option available and the services provided by other parties should be considered.

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?

Guidance, if provided within the existing infrastructure, should continue to be free of charge to those making use of the service. For those accessing fully regulated financial advice, however, the cost should be borne by the annuity holder.

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?

It is essential that individuals are encouraged to shop around when considering the sale of their annuity and providers should help facilitate this activity.

It is not necessary for the number of quotations to be prescribed by Government but the process for comparison could be made simple and effective through the development of online portals that capture underwriting information once and display indicative prices from a number of purchasers. Consideration needs to be given as to how this would be monitored.

If responsibility falls on the annuity provider there will be an impact on administration costs.

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

In order to protect the rights of dependants, taking advice, or at least guidance, before deciding to sell an annuity is fundamental. Certification from dependants that the actions and consequences of the decision have been understood and accepted could be part of the process.

However, this does present issues if dependants are minors, or potentially vulnerable.

FCA could aid consideration by providing some case studies.

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?

Such a solution adds complication and administrative burden to an already complex transaction and may result in additional tax concerns.

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?

Determining the treatment of a lump sum payment resulting from the sale of annuity rights and how this impacts the payment of means-tested benefits is key to ensuring the implications are clearly communicated.

The guidance and advice provided to individuals considering selling annuity rights must include how this decision will impact eligibility for means-tested benefits. It should also be established whether it is the original annuity provider or the purchasing entity who should provide this information.

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

The measure should provide the potential freedom to choose how to fund later life for all individuals. Nevertheless, the consequences of assigning an annuity whilst receiving means-tested benefits should be clearly communicated. The annuitant could be required to confirm that they have discussed the implications with the DWP or Citizens Advice Bureau.

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.

Areas such as the gender directive and age/discrimination legislation are likely to be considerations in the assignment process.

The outcomes of FCA's work on retirement product communications and vulnerable customers will be helpful in guiding the process.

In terms of the gender directive, understanding how this will affect the calculation of purchase prices for annuity sales needs to be established and clarified.

Subject to our responses above ILAG is supportive of this initiative. We would be happy to discuss any of the points above in more detail.

Yours faithfully,

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