

THE ASSOCIATION OF POLICY MARKET MAKERS

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**RESPONSE TO HM TREASURY CONSULTATIVE PAPER ON
'CREATING A SECONDARY ANNUITY MARKET'**

Any market needs products, providers and purchasers. Unless the interests of the latter, investors in a financial services market, are taken into account, the market will fail to meet the needs of those supplying the products.

The Association of Policy Market Makers (APMM) was incorporated in 1992. Its founding members were companies trading in the then rapidly-growing secondary market in with-profit endowment policies (TEPs). The founding firms wished to ensure that the market developed in an open and orderly manner that served the interests of investors and individual policyholders, as well as those trading in the market.

It soon became apparent that although there were willing investors the market was being constrained in size as information about its opportunities was not reaching many policyholders; they were therefore surrendering policies they no longer wished to hold to the originating life office, rather than offering them for sale on the open market. Therefore the Association took on a high-profile role, engaging directly with government, life offices, regulators and the press to correct this deficit. A centralised electronic information distribution system was also developed to ensure that policyholders could obtain quick, competitive quotes from a number of independent market makers / auctioneers for their policies, at no cost to the policyholder.

The Association believes that there are many similarities between the market in traded endowment policies and that proposed for annuities. Our comments that follow are derived from the Association's experience in developing a similar market in TEPs over more than 20 years. As the secondary market in annuities is established and develops, participants and those responsible for the market may wish to utilise the considerable experience already gained in the secondary market for endowment policies by APMM and its member companies. We look forward to hearing what the next steps are and to contributing to the development of a framework for the market.

Summary of Conclusions

- The owner of an annuity should be fully entitled to dispose of the annuity should he or she so wish; it must not be up to an annuity provider to decide who can or who cannot access the market. All providers must participate in the market.
- Annuity providers must be required to provide owners with information about the market and how to access it in a clear, pro-active way to ensure that annuity holders are not penalised in the way that some policyholders were by the unwillingness of their life office to engage with the TEP market. This will require the equivalent regulatory provision to COB R16.6 in the FCA Handbook, which requires policyholders to be given the necessary information. However, even now, some life offices work to the letter, rather than the spirit, of this requirement.
- Once the decision to sell has been made, the market's operation to value and then assign the annuity should be as simple, cost-effective and swift as possible:
 - The annuity provider must provide accurate and timely information on the annuity to the owner (and the owner's agent, where appropriate) for distribution to prospective purchasers. The content of this information will be determined by what the market needs to know to value the policy. Ideally, the provider will enter this information directly into a clearing system so that potential purchasers know that the information is accurate and up-to-date, as well as allowing for its swift dissemination.
 - There should be a clearing system (electronic and web-driven) for obtaining competitive quotes from prospective purchasers or their agents for each annuity in a short time-frame. This clearing system should be provided by a third party that is regulated in both financial conduct and data-protection terms. This 'clearing-house' must be wholly independent of both providers and prospective purchasers, and thus have no commercial interest in the level of offers made for any annuity, to ensure that all holders are treated fairly (TCF).
 - The FCA should be able to set standards for the administrative work required; undue delays and poor quality services could prejudice the viability of the market.
- The consultative paper proposes that only corporate entities be allowed to purchase annuities. While there are risks associated with these investments, experience of the TEP market has shown that individuals are responsible and knowledgeable investors; there should be no reason why High Net-Worth Individuals (HNWI) should not be permitted to participate as direct investors or through a retail specific fund should they so wish. Over the years they have proved themselves be astute and knowledgeable investors, well capable of understanding valuations and risk

- Allowing annuity providers to buy-in a contract from the holder is tantamount to surrendering a with-profits policy, allowing the provider to set an arbitrary price without regard to the price that might be obtained in the open market; there would be a clear conflict of interest. We do not believe that this should be allowed unless the annuity has been offered for sale in the open market. Nor do we believe that providers should be allowed to cancel contracts. With their access to privileged information, such as health, there is clear potential for abuse. An open and competitive market is vital if this project is to succeed.
- The FCA should have responsibility for monitoring the charges raised by annuity providers; these might be capped as a percentage value of the transaction, with a nominal threshold being set to protect the larger annuity holders. The scope of charges must be linked to enforceable standards of service.
- The Association believes that the market will be capable of finding a solution to the 'death-notification' issue.
- Will the tertiary trading of annuities be permitted? The Association firmly believes that this will be vital to provide liquidity in the secondary market and that it must be understood that there will be a need for providers to make available updated information throughout the life of an annuity and in particular under these circumstances.

The Association's views on the questions posed in the summary of questions in the consultative paper are as follows:

A new secondary market for annuities

1. All annuity holders should be entitled to assign their rights to their annuity income. The annuity provider should **not** have the right to veto any sale, either directly or by the imposition of excessive charges. All annuity providers must be required to allow the trading of their annuities in the market so that all annuity holders are treated equally and fairly (TCF). The appropriateness for an individual will depend on their personal circumstances. Safeguards should be in place to ensure that the interests of all those entitled to income from the annuity and public funds are safeguarded.
2. While the Association supports the proposal to allow a wide range of corporate entities to invest in this new market, experience in the traded endowment market shows that individuals can be responsible and knowledgeable investors; therefore High Net-Worth Individuals (HNWI) should be permitted to participate either as direct investors or through a retail specific fund to ensure diversification, should they so wish. Over the years such individuals have proved themselves be astute investors, well capable of understanding valuations and risk. Furthermore, it is perhaps illogical to suggest that annuity holders, who by definition fall within the 'retail' ambit, are capable of making what may be a life-changing decision to sell an annuity, while retail investors who may be knowledgeable and sophisticated investors are not allowed to participate.
3. We do not believe that it is in the interest of annuity holders to allow providers to cancel contracts, nor should they be allowed to buy in their own annuities unless the offer is made in open competition with other potential purchasers. The lack of this safeguard would lead to a closed market and experience in the TEP market has shown that some providers can offer poor value, justifying their valuations on the lines of 'the unilateral cancellation of a contract for which it is reasonable to make a charge'. There is no doubt that over the years many with-profit endowment policyholders have missed out on significant sums of money, both individually and in aggregate, through accepting the surrender value for a policy offered by their life office when unaware of the opportunities offered by the trading option, through a lack of information about the market. It is important that this flaw is corrected in the development of this new market.
4. The market should be able to determine a method for the notification of deaths. The options suggested in the consultative paper (paragraph 2.21) are all viable options. Other than perhaps flagging the issue as one to be resolved during the assignment process, the government has no role to play – establishing a death register may not be a proportionate response, although the register of bankruptcies has played an important role in speeding up the assignment process in the TEP market.

5. Annuity providers will incur unplanned costs in servicing this market and it is reasonable to expect that these be reimbursed. This money will inevitably come from the annuity holder and in turn it is reasonable to expect that they be shown the charges at the outset, what they cover and the service standards that are to be provided in return for the fees. Provision should be made for the FCA to monitor and if necessary regulate fees as these will be unilaterally set by the providers. However due regard must be given to the provisions of the competitions authorities - APMM had the experience of court action originated by the Competition and Markets Authorities many years ago when the Association proposed including a maximum fee level within the Association's Practice Guidelines!
6. It is sensible to establish a new market by limiting its scope. However, restricting access to annuities in the name of the annuity holders discriminates against those who by accident of employment (many years ago) are part of an occupational pension scheme. The Association believes that all those in receipt of pensions, in whatever form excepting the state pension, should have access to the market and therefore proposes that the market be expanded as soon as possible.
7. Rather than propose other products to which the market could be extended, the Association believes it essential that a tertiary market in annuities be allowed to develop, to provide liquidity. Tertiary markets exist in almost all financial products (equities, bonds, and TEPs to name but three) and so this provision must be allowed for in the legislative changes.
8. The consultative paper has been written largely from the perspective of ensuring that annuity holders are given a fair deal and we understand why this is so. But a market is only as successful as its investors allow it to be – without investors being willing to purchase the annuities at a fair price, there will be no market for the holders to access. Such investors will be looking for long-term investments and their information and servicing requirements must be considered at every stage. Annuity providers must understand that investors in both secondary and tertiary markets will have an on-going need for updated information on annuities that have been traded.
9. The statements in paragraphs 2.3 and 2.4 on page 7 of the consultative paper suggest that research into the potential market been carried out. It would be interesting to know the government's estimate of the size of the expected secondary market for annuities.

Legislative Changes

8 & 9. Legislative changes to allow the establishment of the market and regulatory provisions to allow its operation must be as simple, to encourage wide participation in the market, not confining it to large corporations with extensive legal and financial resources at their disposal.

Consumer Protection.

10 & 11. It will be appropriate to ensure that consumers (annuity holders) are given advice before agreeing to sell an income stream. The figure of £30,000 suggested in the consultation paper would provide a sensible cut-off level. Appropriately trained financial advisers are likely to be able to provide this service; the only danger is that the net benefits of sale to the annuity holder will be reduced significantly if a high level of fees are charged for this service. Pension Wise is easily accessible to all and should be expanded to incorporate annuities.

12. The costs of advice and guidance should be born by the annuity holders.

13. We can see no benefits and several pitfalls in requiring annuity providers to offer a benchmark selling price. The surrender value of a with-profit policy is the price that a life office will pay to buy the policy in; a benchmark price for an annuity would not provide that certainty and so lead to disappointment and a loss of confidence in the annuity market by consumers and even could be potentially misleading if not met or exceeded.

There should be a requirement for any annuity to be offered to at least three potential purchasers. With the willing and timely provision of the required valuation information by the provider, and an automated distribution system, this should not be onerous. As well as being a trade association APMM is a regulated company which enables it to process data and information about policyholders and their policies. The Association has developed and uses a web-based clearing system in the TEP market to distribute policy information to potential investors. Access to the system can be given to providers and some life offices have chosen to input policy information directly, as a service to their policyholders. Such a system is secure and flexible, meeting the requirements of the Data Protection Act and the regulatory authorities and could be adapted to meet the requirements of the secondary annuities market.

14. With-profit policies in joint names are traded in the TEP and there is no reason why annuities in joint names should not be traded also. Each party should take appropriate advice and all must agree to the proposed sale.

15. Splitting the income from an annuity may be complicated but if technically possible, there is no reason why the market could not cope with such a possibility.

16, 17 & 18. In a free-market there is no reason why those on means-tested benefits should not be allowed to sell their annuity income. However, they must not become an additional burden on the state at any time as a result of so doing.