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LV=

LV= response to:

HM Treasury and DWP consultation: Creating a secondary annuity market

June 2015

1. About LV=

LV= is the UK's largest friendly society and a leading financial mutual. We serve 5.7 million customers with a range of financial products. We offer a wide range of financial services including general insurance, investment and retirement products. We offer our services direct to consumers and through IFAs and brokers, and through strategic partnerships with organisations such as ReAssure and Nationwide Building Society.

LV= offers retires a range of innovative "at retirement" solutions, including fixed term annuities, enhanced annuities, investment-linked annuities, income drawdown, SIPPs and equity release.

We sell the majority of our at retirement products through external IFAs but also have our own "in-house" telephone advice service, LV= Financial Advice Service, managed by a dedicated team of regulated financial advisers. This service makes recommendations to customers and then recommends a product(s) from a panel of providers, including LV=.

We pride ourselves on not only having one of the most comprehensive ranges of retirement solutions products in the market, but also being specialists in the retirement income market with a focus on delivering the best possible outcomes for customers. Our proposition is focused on offering consumers choice and a blend of products to best suit their circumstances, at both the point of retirement and throughout their retirement.

As a mutual, we are driven by values that support long-term member benefit and doing the right thing for customers. This has helped us to stand out as a leading innovative provider of retirement products in the UK.

2. Introduction and overview

LV = welcomes the opportunity to respond to this consultation on creating a secondary annuities market. We look forward to working with Government to help develop a suitable framework in this area that can support consumers to get the right outcome for their retirement.

Many of the significant decisions that individuals who want to sell their annuity will face mirror those of people who choose to take out an equity release product and also customers who choose to take up a break clause for a fixed term annuity. We have significant customer experience in both of these areas and would be happy to assist Government further in taking forward more detailed proposals.

Overall, we support the principle of allowing retirees who have already purchased an annuity the right to sell this for an alternative income and make the most of the choice and new freedoms now enjoyed by many. As with the new pension freedoms which came into effect in April 2015, we fully support consumer choice in retirement and embrace moves that allow individuals to make the most of their pension income.

We therefore believe individuals should also have the right to sell their annuity income (or part of their income) to their existing annuity provider through "buy back", should the annuity provider be willing to do so. By not extending this freedom, we believe it is unfair to the millions of individuals in this situation and not in the intended spirit of the reforms to allow individuals the freedom and choice as to how they take their retirement income. It is also something that lends itself easily to a live test, which we would be willing to support.

Given the potential detrimental risks involved for consumers, we fully advocate that consumers are obliged to take advice before making a decision as to whether they proceed with selling their right to an annuity. We accept that to avoid advice costs further damaging value, this requirement could be watered down for smaller annuities.

While it is right that costs for consumers for this market should be monitored by Government and the FCA, we also believe any policy framework needs to appreciate and be aware of extra costs for annuity providers, particularly if annuities are batched together and sold on to other investors. We do not, however, see this detail as a barrier to the proposal.

3. Our view on the potential for a secondary annuity market

From a consumer point of view, this proposal will appear similar to the break clause option available on most fixed term annuities. Judging from our experience, this should be a popular initiative that appeals to a number of people and offers a new option for those who locked into an annuity before the March 2014 pension reform announcement.

Unlike a fixed term annuity break-clause, it is proposed that the assignment value will be determined on the open market, rather than by the provider. Although this introduces competition, it also introduces a number of additional costs and increased underwriting requirements. In practice, these factors may work against those who could have most to gain from changing the shape of their retirement income – retirees assigning small incomes and/or holding poor value annuities due to not shopping around.

The offer prices will largely determine whether the market works in consumers' favour. Although this will primarily depend on cost and competition, there are a number of factors that we believe could help this proposal succeed:

- There is a large potential market, with most people shown to disproportionately value money today over money tomorrow. For a number of retirees, their default position will be to sell their rights, which should help create an efficient market. This underlines the need for appropriate consumer protection.
- Defined benefit schemes and insurers hold a high degree of longevity risk. Finding appropriate assets to match liabilities can be difficult and expensive. These bodies may be prepared to pay a premium for income streams that will (on paper) match the pension liabilities they hold.
- Common underwriting standards have already been developed. Initiatives such as the Common Quote Request Form and Tele-Underwriting could be re-deployed as ready-built solutions for this new market.
- In principle, the falls in annuity rates over the past 20 years should work in sellers' favour; annuities have become progressively more expensive, so when selling one you should get more for your money.
- On 3 July 2015, FSCS compensation limits will increase from 90% to 100% of the annuity value. If this protection is extended to buyers, it would remove any potential default risk, increasing assignment prices.
- Most annuitants are male and those who purchased before implementation of the gender directive (21 Dec 2012) will have benefitted from gender specific rates. The price they will be offered may be gender neutral, so this will work in their favour.

Key challenges: However, for a functional market to develop that works in the best interests of consumers, there are significant challenges to overcome. These include the following, some of which may prove to be insurmountable or at least barriers to an efficient market:

- Third party buyers are likely to demand full underwriting to determine the value of the investment, particularly for larger cases. Those who didn't shop around may have bought a poor value standard rate, but now receive an offer that has been fully underwritten and which could be significantly less than expected.
- Many annuities will originally have been purchased with smaller premiums. On top of the profit margin any buyer will demand, other substantial costs may make the amount offered for assignment unattractive. For instance:
    - If annuity providers can't 'buy back' the annuity, they will always have additional costs in redirecting payments and tracking the annuitant, which they need to pass on.
    - Buyers will want full underwriting to assess how long the annuitant may live. This will add cost and may include paying for a GP report.
    - A requirement for third party brokers to buy on an individual basis and sell on a bulk basis is expected and this will incur additional fees.
    - Annuitants may be required to pay for regulated advice before selling.
    - Taking the assignment value as a lump sum may push individuals into higher rate tax. Buying an alternative drawdown or annuity contract may therefore be more tax efficient, although any tax saving will be countered by the additional charges and costs incurred from purchasing the new retirement product.
- Advisers may not be prepared to offer advice in this market. The various costs may make this option very hard to recommend, with a potential on-going FOS liability if someone later suffers due to the loss of income.

4. <u>Answers to specific consultation questions</u>

<u>Question 1:</u> In what circumstances do you think it would be appropriate to assign one's rights to their annuity income?

We think it is difficult, and not necessarily appropriate, to prescribe a series of circumstances when it would be appropriate for someone to assign their rights to an annuity income. Ultimately it is an individual's choice as to whether they choose to do this.

Our experience with equity release shows that it is only right that individuals seek regulated advice before proceeding with any decision which will impact their future retirement income. We accept that to avoid advice costs further damaging value, this requirement could be watered down for smaller annuities.

<u>Question 2</u>: 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?

Yes, we agree with the proposed approach of allowing a wide range of corporate entities to purchase annuity income. A greater number of purchasers will lead to greater competition and ultimately better value pricing for consumers.

However, we would argue that corporate purchasers should be restricted to entities that are either regulated by the PRA and FCA or the Pensions Regulator, or a similar national regulator for non-UK firms to ensure appropriate consumer protection.

We agree there should be a restriction on retail investors due to the complexity of the product.

One potential concern we have with enabling greater corporate purchases is if there are multiple sales of annuities. Annuities that are re-sold to new entities could create potential excessive administrative costs for the original annuity provider. We do not consider it fair to charge something up front to the customer for the potential for this in future. We therefore favour a procedure whereby the subsequent corporate purchaser or seller covers future reassignment costs borne by the annuity provider.

<u>Question 3:</u> 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?

Annuity providers are able to support better customer outcomes through investing in illiquid assets such as infrastructure, social housing and equity release in a 'buy and hold' approach to generate higher income to customers. LV= agrees with Government that the cost of permitting 'buy back' – which might include less longer term illiquid investment by annuity funds and the potential for cashflow mismatching and capital challenges having to unwind illiquid assets on existing business - would act as a strong barrier. In addition, Solvency II's use of the matching adjustment would not cater for this, and this may mean 'buy back' is impractical.

Preventing the original provider from repurchasing the contract would also avoid concerns of poor consumer value being directed at the industry or firms being placed under public pressure to offer buy back when it is impractical to do so.

However, LV= disagrees that the Government should not allow "buy back" for existing annuity providers. We believe individuals should have the right to sell their annuity income to their existing annuity provider through "buy back", should the annuity provider be willing to do so. By not extending this freedom, we believe it is unfair to the millions of individuals in this situation and, not in the intended spirit of the reforms to allow individuals the freedom and choice as to how they take their retirement income.

Without allowing providers to 'buyback' an annuity, it feels unlikely that many consumers will receive good value. Those most likely to sell will not have benefitted from the underwritten rates at purchase that will now reduce their assignment value, or retain enough value in their annuity to absorb the costs advisors, brokers and providers will need to charge. Allowing 'buyback' would greatly reduce costs and may ensure that those who received poor deals originally now get better value in assignment. For example, an annuity provider who did not underwrite or offer an 'enhancement' at point of sale, would find it difficult to justify using a different basis when offering a commutation value. It would also be easier to administer partial buybacks, which could be an attractive option but would be messy if a secondary party were involved.

We appreciate the potential risks highlighted by Government, particularly in relation to consumer detriment, but believe these could be mitigated through a market approach. We would expect an auction market to develop for the re-purchasing of secondary annuities, allowing corporate entities to "bid" to purchase the annuities on that market. We would envisage a situation whereby an existing provider would be permitted to buy back an individual's annuity, but only after listing on the market to ensure competition.

One possible solution would be to only permit individuals with smaller annuities (paying £1,000 a year or less) to terminate their agreement and for their existing annuity provider to "buy back". This would ensure those on lower retirement incomes would not be unfairly disadvantaged and would mitigate any liquidity risks faced by the provider.

<u>Question 4:</u> 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?

We agree that resolving the issues of death notification is best delivered by the market. Death notifications will require some form of validation but there are already market solutions available, or that could be adapted, to resolve this issue.

Whilst a maximum age for payments may appear to be a neat way to avoid the challenge of identifying and ceasing payments on death, we believe the appeal of purchasing these contracts in the secondary market would be significantly diminished if this condition were added.

This is because the contract would fail to provide a hedge against longevity unless the maximum age was set artificially high. We would therefore not see this as an attractive feature given the additional administration it would incur. The original annuity policyholder would have no incentive or need to reply to the attempted contact, and our experience of existence checking suggests it is seen as somewhat intrusive even when policyholders are in receipt of the annuity income, and that therefore in these circumstances would be even worse.

We think the option of annuity providers paying a nominal amount to the original annuity holder on a semi-regular basis as a way to be informed of their death, is not realistic. This would add significant cost to the annuity provider, who would need to pay two parties. The payment may need to be at a level that was worthwhile to the annuitant, which would further reduce the assignment value.

The existing market solution using third parties to regularly interrogate the register of births, marriages and deaths would therefore be less intrusive and lower cost than the alternatives.

<u>Question 5:</u> Do you agree with the proposed approach of the government working with the FCA regarding the fees and charges imposed by annuity providers?

While it is disappointing that some providers would seek to charge excessive fees, we agree it is appropriate and necessary for Government and FCA to monitor the fees and charges imposed on individuals by annuity providers.

One further issue Government may want to consider is the fees and charges that annuity providers may choose to charge commercial buyers of the annuity. If an annuity purchase is sold to one buyer and subsequently re-sold to another provider, the original annuity provider will incur transactional and administrative costs of transferring payments to the new purchaser. We would suggest that any regulations permit annuity providers to charge a further administration fee to a buyer if a buyer wants to sell on to a third party at a later date. This would reduce fees for the consumer.

<u>Question 6:</u> 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?

No, we disagree and believe occupational pension scheme should be included within the scope of this measure so it is available for the largest possible number of consumers. We believe all pension schemes should be allowed full flexibilities under the new proposals and freedom and choice should be for all, though we appreciate the risks involved.

However, any new rules would need to be very clear which annuities can be assigned and which annuities cannot as it is potentially very difficult for providers to identify when an annuity can be assigned under this proposal.

Annuities from Occupational Schemes are purchased as both Lifetime Annuities and Scheme Pensions and it will depend on the ceding scheme as to whether they want the Scheme Pension or Lifetime Annuity written in the name of the Trustees or Annuitant.

Scheme Pensions are often initially written in the Trustees' name and, at a later date, the scheme will be wound up and the annuity assigned to the member via a deed of assignment. In addition, we have previously had Lifetime annuities from personal pension schemes, where the scheme insisted that the lifetime annuity is written in their name. For example, Legal & General used to insist that all annuities purchased via their personal pension scheme were written in their name, not the annuitants.

<u>Question 7:</u> Are there any other types of products to which it would it be appropriate for the government to extend these reforms?

We believe Government could potentially explore other areas.

Individuals trapped in Section 32 policies with Guaranteed Minimum Pensions (GMPs) – If the value of the fund does not cover the GMP an individual can't transfer their pension and has to take the GMP at age 65, with Limited price indexation (LPI) (and 50% for spouses), even if it is not right for them. Offering individuals in these schemes the opportunity to assign their rights would offer them greater freedom and choice.

Commutation values on final salary schemes – Our experience has shown that a majority of retirees want to commute and take tax free cash at retirement and use some of the final salary pension they have built up to do this. However, the commutation factors that permit someone to do this do not offer an individual good value.

For example, individuals typically give up £1 of pension income for £14 in tax free cash. However, to buy the index-linked pension they've given up would typically cost twice as much on the annuity market. If these individuals could sell the entitlement to the highest bidder, they'd potentially be able to achieve a much higher lump sum.

<u>Legislative changes</u>

<u>Question 8:</u> 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 design achieves parity in terms of the options potentially available. However, it doesn't necessarily provide parity in terms of ***<u>value</u>***.

For those who have annuitised and wish to change their choices, far more cost and complication is likely to be incurred than for those who originally accessed drawdown, with annuitants likely to have smaller pots and less able to absorb and understand these expenses and complications.

The proposal states that people will be able to use their assignment value to access flexi-access drawdown. Once annuitised, current legislation does not allow someone to re-join their pension scheme and transfer to another to access drawdown. In addition, the annuity provider is unlikely to be familiar with the rules of the originating pension scheme to understand what is allowed under the scheme rules. Will the assignment value therefore be treated as a pension contribution, which provides no tax relief and does not impact the former annuitant's annual or lifetime allowance (aside from triggering the MPAA rules)? If treated as a transfer from the original pension scheme, how will the rules of the originating pension scheme be accounted for?

The proposal states that people will be able to use their assignment value to access a flexible annuity. Currently, there is a number of existing lifetime annuity contracts (normally investment linked annuities) which utilise the ability to transfer a lifetime annuity in payment to a new annuity provider. For annuities that offer the possibility to transfer, the legislation states that where the original annuity commenced before 6 April 2015, they cannot be transferred to an annuity that meets the definition of a new flexible annuity. In addition, these annuities are unable to be transferred to a drawdown contract as the fund has been fully annuitised.

Consideration will therefore need to be given to annuities with the ability to transfer to a new annuity provider. These annuities have a readily available transfer value and the annuitants will often be interested in accessing flexi-access drawdown or a new flexible annuity. Could these annuities be notionally transferred to a new provider and then bought back by the original provider for a similar value to the transfer price, thereby circumventing rules around buyback. If not, what happens if the assignment value available on the open market is significantly different to the transfer value available to purchase a new annuity – this could give the perception of poor value on offer from the fund, or perhaps more likely, that the assignment market is giving poor value for consumers, thereby damaging its success.

<u>Question 9:</u> How should the government strike an appropriate balance between countering tax avoidance and allowing a market to develop?

We have already suggested only allowing assignment to organisations regulated by the PRA, FCA or TPR. In addition, restricting assignment to schemes with a minimum number of members would make it easier to monitor any new, unforeseen ways used to abuse the system. However, in order to allow a market to develop, there currently appears little incentive for annuity providers to allow assignment and a series of costs that will reduce assignment value for consumers and make regulated firms wary of giving advice in this area. One way of allowing the market to succeed would be to use the tax system to reduce the impact of these factors and incentivise interested parties to take part.

Consumer protection

Question 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?

As the consultation paper acknowledges, there is a strong case for requiring annuity holders to take financial advice from an appropriately qualified Financial Advisor. We agree with this and from our experience with selling equity release products, we would recommend that in most cases it would be sensible for individuals to seek advice before deciding whether to proceed. That said, we acknowledge the cost of financial advice is prohibitive for individuals with a lower annuity valuation and would estimate that advice would be of value for individuals who have an annuity paying £1,000 a year or greater.

The consultation paper has highlighted the FCA's clarification of rules around simplified advice which could help to facilitate new business models for online and telephone advice. LV= has launched a new, revolutionary direct to consumer online fully regulated retirement advice tool for those individuals who would not typically seek financial advice.

We believe we are therefore well placed to potentially contribute to this new model with regards to a secondary annuity market and would therefore welcome the opportunity to share our learnings with Government in this area further.

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

The consultation paper rightly references the role guidance could play to complement other safeguards and suggests one option would be for the annuity provider to offer guidance. We would strongly advise against any guidance being offered through the annuity provider.

As we referenced in our response to the "freedom and choice" consultation paper in June 2014, any involvement by pension providers in guidance would compromise the independence of any financial guidance given.

Focus group consumer research commissioned by LV = in 2014 showed that in relation to guidance, the overwhelming preference from consumer respondents was for this to be delivered by a Government or quasi-Government organisation. While there was an acknowledgement from respondents that providers are well qualified to do the job, there was a general mistrust of providers and perception that they have a vested interest.

We also believe there are practical issues around the limited information available to a provider which would prevent them from providing guidance. Any guidance must have an awareness of a customer's complete financial situation (such as assets, debts, mortgages, benefit entitlement and tax position) to provide guidance that is relevant and tailored to an individual's needs. This is not an area where product providers have experience or appropriately qualified skilled staff and we believe many consumers would not want to necessarily disclose this sort of information to their provider.

Should guidance be offered, we believe it should be delivered through the existing Pension Wise. However, given that guidance offers individuals options to understand their choices and does not make explicit recommendations on whether an annuity purchase from a second party offers value, we believe regulated advice is still preferable and, as stated in our response to Question 11, our preference would be for advice to mandatory for individuals holding an annuity worth £1,000 a year or more.

<u>Question 12:</u> 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, we believe it is fair and appropriate that the costs of any advice or guidance are borne by the annuity holder. In particular, ensuring advice costs are borne by the annuity holder will help to drive the online and telephony advice market for retirement advice.

<u>Question 13:</u> 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?

Yes, we support this idea and think it will help to drive competition in the market. We envisage that online marketplace portals could be developed which annuity providers could go to to sell the annuity and ensure the most effective price.

<u>Question 14:</u> Does the government's approach sufficiently protect the rights of dependants upon assignment? If not, what further steps should the government take?

We believe that the issue of protecting dependents is a fundamental reason why individuals should take advice so that they understand the consequences of their decisions. We expect that most annuity providers will want confirmation that any named dependant doesn't object before agreeing to the sale of the annuity.

<u>Question 15:</u> 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?

This option would be very costly and complicated for annuity providers to implement. If someone wishes to realise the value of their annuity now we believe they should be considering making appropriate provisions from that lump sum rather than trying to effectively rewrite the original annuity contract, which would be administratively costly and opens up risk and uncertainty. For example, which party would benefits go to if both first life and dependant died together within a guarantee period?

<u>Question 16:</u> 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?

As explained above we favour the involvement of a regulated financial adviser where practical – particularly where the annuity is worth £1,000 a year or more. They should be able to explore with the annuitant any impact on means-tested benefits. For smaller annuities we see the guidance provided by Pension Wise playing a key role.

<u>Question 17:</u> Should those on means-tested benefits be able to assign their annuity income?

Yes, but it must be made clear they may relinquish benefits should they do so. Any guidance or advice would help to address this issue and we believe a compulsory requirement should be placed on the annuity provider to inform them about the implications for means-tested benefits.

<u>Question 18:</u> 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.

As the consultation acknowledges, the likely demographics of annuities' consumers or their dependants may also include those of an older age, or with disabilities or those suffering from mental or other physical illness.

Because of the target demographic, the LV= lending criteria for equity release specifically provides resource and additional requirements for providing products to those in retirement that may be considered 'vulnerable', through either age, incapacity or for ensuring the adequate care of 'minors' or 'dependants'.

The proposition is designed from "front-to-back" to safeguard the customer in all aspects of the application process. Examples include (but are not limited to): the LV= dedication to adviser education in dealing with this customer demographic; independent solicitors for both borrower and lender; requiring a face-to-face meeting to confirm identities; identification and money laundering checks at application stage for both borrower and any potential attorneys; reason for loan analysis to ensure best practice responsible lending; and simple, clear customer literature and specific in-house training for successful communication with vulnerable customers.

We would advocate a similar process being implemented for this secondary annuity market to ensure these persons have adequate provision in place for any current or future concerns in regards to potential vulnerability through retirement.

5. Contact and Further Information

We would be happy to discuss the issues raised in this submission further. Further enquiries can be directed to