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HYMANS ROBERTSON

Second hand annuities

Response to HMT and DWP consultation

June 2015

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HYMANS ROBERTSON LLP

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Overview

Secondary annuity market faces significant hurdles to creation

Key points

- The idea remains attractive to both institutional investors and consumers. Today's low interest rates mean that insurers and pension funds are seeking bond-like investments which offer higher yields than conventional bonds. From the consumer's perspective, the drop in interest rates helps to reduce "depreciation" charges and some people could get more back from their annuity than they paid in.
- However, significant costs for buyers could limit the attractiveness of pricing offered to sellers, particularly for those looking to cash-in small annuities.
- A robust audit trail of documentation explaining the customer's reasons for trading-in is essential for maintaining confidence of investors and consumers. Requiring advice is the best way of delivering documentation and ensuring that someone is accountable for its quality.
- Permitting existing annuity providers to voluntarily offer surrender terms has the potential to offer better terms to consumers but could discourage other investors, making the availability of the trading-in option patchy. If existing insurers converge on the pricing level of third party insurers, there would be more market participants but the existing providers would have a source of windfall profits. Thoughtful implementation is essential.
- The creation of standardised health underwriting and auction-style marketplace would reduce processing costs and encourage competitive pricing.
- Extending the trading-in concept to pensioners of occupational pension schemes may provide further practical difficulties. However, defined benefit pension schemes would enjoy keener bulk annuity pricing if insurers were to be able to offer the trading-in option after a buy-out.

We welcome the development of a secondary annuity market. We think annuities are an important product for retirement planning. Clubbing together with other people to share your longevity risk by buying an annuity is effective for those who are concerned about running out of money. Equally, we appreciate that annuities are unpopular because of their compulsory nature and they are a one-off lifetime purchase. We believe that the potential to trade-in annuities, combined with a secondary market that is perceived to offer fair value, will help the future sales of lifetime annuities.

To achieve this, it is essential that the design is right from the start, and that potential sources of reputational risk are eliminated.

The case study in section 1 illustrates the dynamics of the decision process from the customer's perspective, and highlights the complexity of some the underlying issues.

Building a secondary market for annuities remains a good idea in theory, but significant hurdles could frustrate the running of a viable, large scale market:

Price setting issues

Setting an accurate, attractive and defensible price will prove tricky. This is due to the difficulties of estimating an individual's life expectancy, the costs of the underwriting process for the buyer and concerns over dispute resolution in the event of a seller's premature death. This asset class is only suitable for professional investors.

Market participants

Life insurers who manufacture annuities are best placed to offer attractive trade-in terms, having both the pricing skills and the investment appetite. And the existing providers should be able to offer better terms than third party insurers, because some duplication of cost would be removed. Realistically, most pension funds would only enter the market if the second hand annuities were bundled up and securitised into bonds, offering higher yields than other investments and there was confidence in the sales process. This introduces additional layer of cost than life insurers would not have.

In combination, these and other difficulties are likely to lead to buyers offering conservative prices, diluting the attractiveness of a deal.

For prospective sellers, this will likely combine with other barriers that could deter their appetite. These include the complexity of the market, which could lead to the need for further advice and its associated costs. In addition, sellers are likely to face an extensive qualifying process as buyers assess their life expectancy and other circumstances.

Finally, while cashing-in is likely to appeal especially to retirees with small annuities, the underwriting cost is likely to result in less competitive pricing for this group in particular compared to holders of larger annuities.

For both buyers and sellers, creating this market looks attractive on paper. It could be an opportunity to free-up cash for retirees and access to long-term, matching assets for insurers and pension schemes. What looks good on paper doesn't always translate to reality though – in this case, we find it difficult to see how the ingredients can make a cake with enough slices to go round.

Much of the problem is likely to stem from how to build an attractive price for both sides. Sellers will naturally compare the money they have invested with the payments they have received since the annuity started and the trade-in valuation. This difference is like the depreciation cost on trading in a new car, after running it for a few years.

The secondary buyers' ability to offer attractive prices will be constrained by the costs of underwriting (find out how rusty your biology is), prudence for potential premature deaths, ongoing administration, and of course the need to make a profit. They're also going to face difficulties in the event of a seller's premature death as they question the terms of the price they offered and the information they gathered.

For sellers, historically low bond yields mean that on the face of it they could receive more for their annuity than they paid in the first place. But that ignores all the variables buyers are likely going to have to factor in. Sellers are going to face a relatively high depreciation cost, in much the same way a car loses value as soon as it leaves the forecourt. Cashing in an annuity will still appeal to some retirees, but it will be a complex decision likely requiring significant further thought and potentially advice.

Ultimately, any successful market thrives on both parties believing the price is attractive enough to proceed. In this case there is the potential for neither side to feel that way, based on too many hurdles to a good deal. The last thing insurers, who are likely to be big buyers, will want is another mis-selling scandal. That too could lead to conservative pricing and efforts to dampen enthusiasm among sellers.

To make this market a reality is likely to require four things to happen. First, a standardised health underwriting process which will provide confidence to all buyers that a fair, open market can be created. Second, an open bidding process whereby all potential buyers can offer a price to sellers based on their assessment of the data provided. Third, consideration of how to offer guidance and advice for sellers and a set value at which this becomes mandated based on the annual value of the annuity. And finally, another major communication and education exercise by government, as just witnessed in the run-up to the pension freedoms earlier this year.

About Hymans Robertson LLP (www.hymans.co.uk)

Hymans Robertson helps people manage their money at all points in the life cycle, by applying our skills in actuarial science, investment, risk management, communications and technology. Founded in 1921 as an actuarial consultancy, we have diversified in recent years whilst remaining owned by our working partners. In 2008, we founded Club Vita, as a centre of excellence in understanding longevity. Club Vita now tracks the survival patterns in 2.5m UK pensioners, around 1 in 7 of the retired population. Our services also include Guided Outcomes (GO), a market-leading savings guidance tool to help people. We employ around 750 people across four UK sites.

1 How much depreciation? - a case study

April 2012
Consider Joe, a healthy 65 year old man who bought an annuity with a pot of £38,000. He used the Money Advice Service to get the best annuity on the market, giving an annual income of £2,400, before tax. Joe and his wife also have company final salary pensions and state pensions giving them regular income.

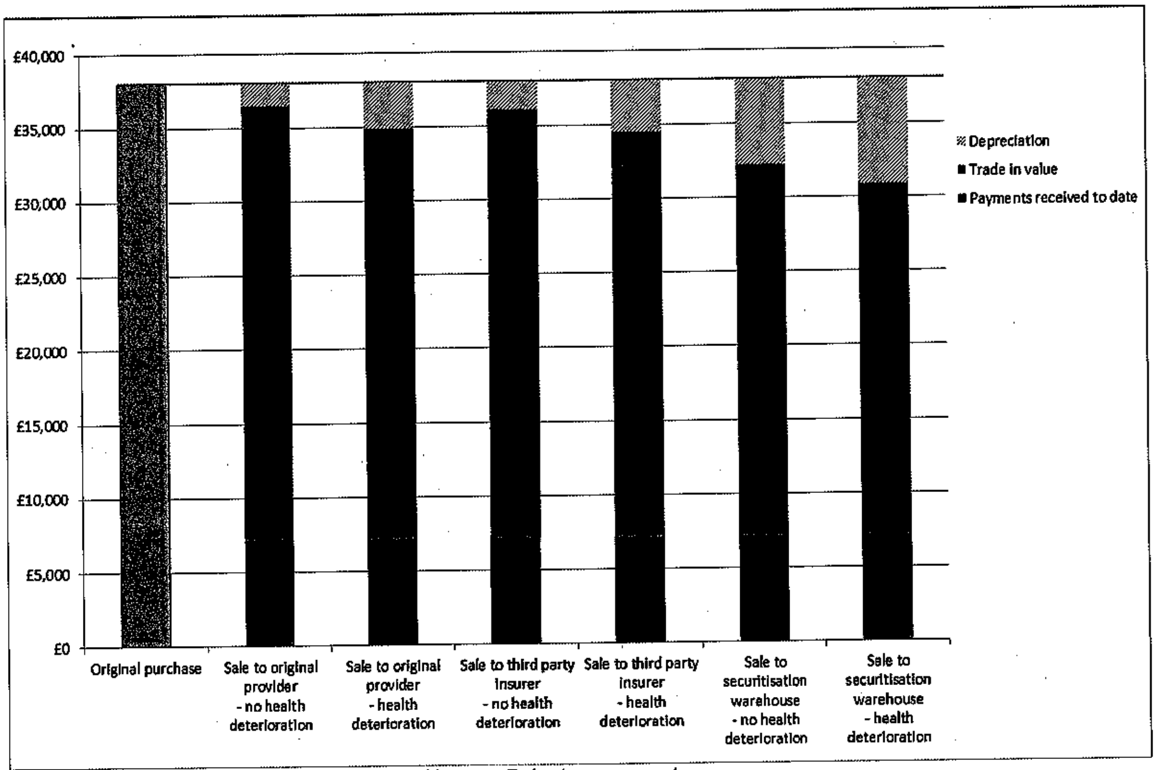
June 2015
Today, a healthy 65 year old with £38,000 would get around 10% less (£2,200 a year), because the bond investments that insurers buy to back annuities have become more expensive. This effect is often called the fall in interest rates, because the returns from investing in bonds can be expressed as annual interest – and as prices rise for bonds, so the interest rates fall.

The recent fall in interest rates means that those trading in would get better terms than if bond prices had fallen (interest rates had risen). But they are not guaranteed to get all their money back.

So what about Joe, now 68 years old? Dry root has been diagnosed in the roof timbers of the family home, costing an unexpected £30,000 to repair. Joe needs a lump sum and borrowing the money would be tricky. As his income exceeds his regular spending (although not by enough to repair the roof), Joe is interested in trading-in his annuity. But how much might he expect?

The answer depends on how Joe's health has progressed in the last three years – has his biology "rusted" faster or slower than the assumptions made at outset - and whether his existing annuity provider is permitted to buy-back (surrender) the existing policy and has the appetite to beat the price of other insurers.

The chart provides some estimates of trade-in values. These values are shown before any income tax is deducted.



Source: Money Advice Service and Hymans Robertson research

The money that Joe has got back comes from both the payments he has received over the last three years (shown in orange), and the trade in value (shown in green). The depreciation charge can the thought of as difference between the original investment and the trade-in value, plus the annual income payments received.

The analysis shows:

- the scale of deprecation – ranging from 4% to 19% of the original purchase price – may be surprisingly small. If Joe is in good health and his existing insurer prices as competitively as third parties then he could get back what he paid in.
- whilst the current annuity provider would be well placed to offer the best price, they could make an extra windfall profit if they priced at same level as another life insurer. In practice, it is likely that an equilibrium level between existing insurers and other insurers could be delivered through a competitive auction process.
- The reduction from becoming unhealthy is relatively modest. We have assumed that Joe has put on weight, developed a new thirst for alcohol and is on drugs for high blood pressure. The modest difference is partly because the original calculations assume that health declines with age.

Please note that long-term interest rates have fallen by almost 0.5% a year since 2012. If, instead interest rates had fallen less, or even increased, then the depreciation charges could be significantly higher, by around 10% for each 1% change in interest rate. Similarly, if secondary investors require yields above levels assumed in current annuity pricing this would lead to further depreciation, again by around 10% for each 1% p.a. additional yield required.

Older people who annuitized earlier would benefit more from the greater fall in interest rates pre 2012, increasing the chances of trading-in looking attractive.

Of course, there are alternative strategies for Joe including downsizing or taking out an equity release mortgage to pay for the roof repairs.

Notes:

- The original purchase price of £38,000 was quoted by the best provider on the Money Advice Service's annuity comparison tool in April 2012. This is for a level, single-life annuity with a five year guarantee period purchased by a healthy male aged 65 years old at the time.
- The estimated trade-in values are based on the price quoted in June 2015 for a 68 year old to purchase a level, single-life annuity with no guarantee period. The quote was provided by the best provider on the Money Advice Service's annuity comparison tool.
- Separate quotes were obtained for a healthy individual and for an individual classified as "obese" based on their BMI score, who consumes alcohol and who take medication for high blood pressure, high cholesterol and other medical conditions.
- The trade-in values have been adjusted in the following manner:
    (i) A reduction of 15% if the annuity is purchased by an insurer and 25% if it is purchased by a securitisation warehouse. This is to allow for profit margins and the cost of capital needed to support the securitisation asset.
    (ii) A further reduction of 5% to allow for the fact that the provider who sells annuities at the cheapest rate may not enter the second hand market as a purchaser.
    (iii) A reduction of £1,000 to reflect the cost of underwriting.
    (iv) A reduction of £500 to reflect the cost of financial advice.
    (v) A reduction of £400 to allow for the purchaser's future costs of maintaining the contract. This is assumed not to apply if the contract is purchased, and effectively cancelled, by the original provider.
- In April 2012 insurers were permitted to charge men and women different prices to reflect their different life expectancies. The original purchase price would have been higher than £38,000 if the purchaser had been female. Gender-specific pricing is no longer permitted and we presume that the trade-in value would be the same for both men and women.

2 A new secondary market for annuities

A.2 The government welcomes views on how it envisages the secondary annuities market working, and its proposed approach on the scope of these reforms.

Q1. In what circumstances do you think it would be appropriate to assign one's rights to their annuity income?

We believe it is appropriate for all in-payment annuitants to be eligible to sell their annuity income rights to a third party investor. We would include pensioners who have transferred from a DB pension scheme under an annuity buy out policy (not a buy-in policy), but understand that the legislation may need carefully worded to extend this offer to these particular annuitants due to the current specific tax treatment that may still treat them as DB scheme pensioners. We would exclude pensioners of occupational DB schemes from a secondary market offer for the reasons cited in question 6, but suggest there is further consultation to possibly include DB pensioners in payment should the scheme be able to offer a cash-in value akin to a cash equivalent transfer value.

It is essential that there are strong customer protections in place to ensure that annuitants make an informed choice (see question 10), appreciating the trade-off that they are accepting, and that their reasons as documented in a verifiable audit trail. This will inevitably incur additional cost, but we think it is a price worth paying to sustain the confidence of consumers and increase the appetite of a wider pool of investors to buy the income streams, without the threat of the sort of mis-selling problems that have dogged the US life settlements market.

Q2. 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 that to develop a wide market then there is a need to allow a wide range of professional investors to purchase annuity incomes. We also agree that purchasing individual annuity incomes would not be a suitable investment for retail investors.

Life insurers that manufacture annuities – either for individual or bulk deals – are the natural buyers. They would be attracted to the matching shape of the income profile, as an asset to back new business. They also have the people with the skills to place a fair price on the cash flows. The pricing that the insurer can offer to new customers will be enhanced if the prospective return on investing in second hand annuities is higher than available on corporate bonds. The longevity-link to the cash flows makes them a natural matching asset.

DB pension funds should, in theory, be similarly attracted to the shape of the income stream, but individual deals are too small to make them attractive and the overheads involved in running a pricing function would be disproportionate. DB pension funds may buy from an intermediary who priced the offers and bundled up the deals into securitised bond. This role may be provided by a specialist asset manager or investment bank.

Pension funds – buying via a securitised bond - may have to accept lower returns than the insurers because of the extra processing costs. This puts insurers in pole position to successfully bid, but the pension funds would provide an important back stop to ensure insurers offered a good deal.

It is therefore important to encourage investors other than UK life insurers to buy these second hand policies to deliver competitive pricing. A regulatory environment that encouraged securitisation to flourish would be welcome.

Q3. 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?

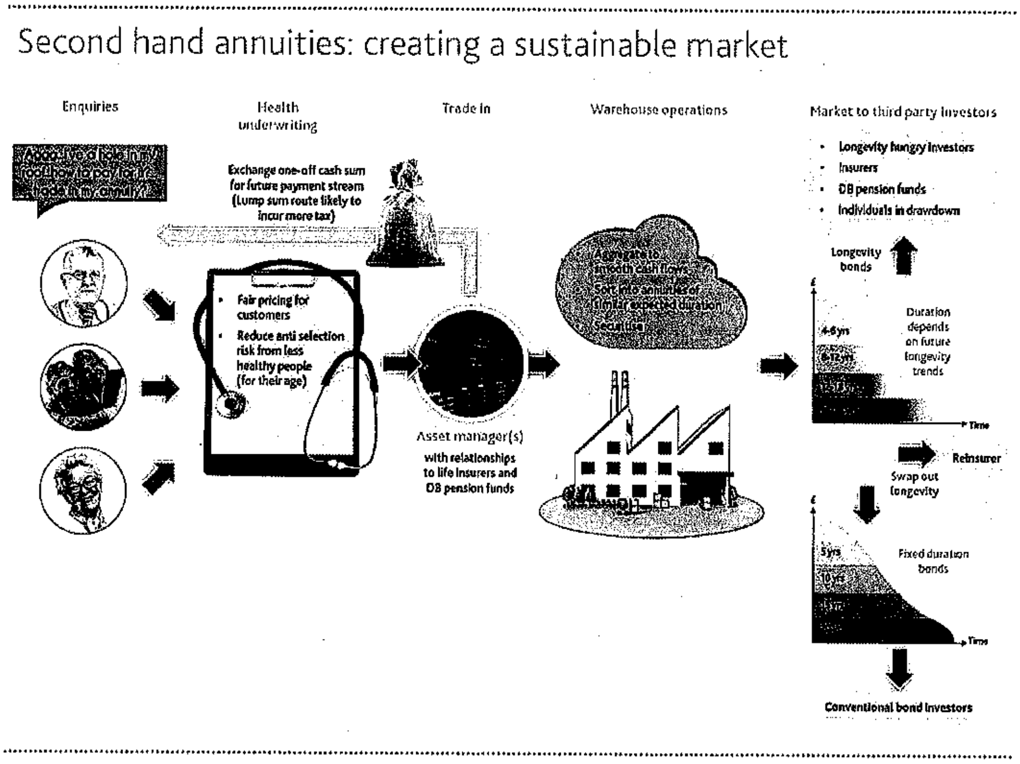
No. There is a tricky balance to strike between offering customers best value and fostering an active and competitive market, but we think there is more to be gained from existing providers being able to offer surrender terms.

Our analysis in the case study in section 1 shows that existing annuity providers should be able to offer better terms than third party investors because of the removal of two sets of ongoing administration costs and the removal of the cost of servicing risk capital allocated to the annuity.

The competitive advantage that existing annuity providers have could discourage non insurers from participating in the market. We would expect the trade-in price that insurers were able to offer to be higher on surrender than for an identical annuity on the same life with another insurer. This sounds great from the consumer's perspective but the uneven playing field could create the reputational risk of windfall profits for annuity manufacturers. We would expect other insurers to compete, but without the competition of non-insurer investors, we fear that the trade in values offered for the surrender option and other insurers could converge.

It is therefore important that third party investors do actively participate to ensure that there is a pricing floor. Regulators should monitor who the successful bidders are – if they are dominated by existing annuity providers surrendering policies, further reassurance that the prices offered are reasonable ought to be sought.

Managing the consequences of offering buy back:



- **Sale of illiquid assets at short notice:** We believe this risk is manageable for most annuity manufacturers, particularly those that write new business – creating positive cash flows - and those that do not invest in equity release mortgages. The key point is that the insurer has the discretion, but not the obligation, to offer surrender terms. As the provider will have the say on offering a buy back they will control the timing, they should be able to structure their asset portfolio in a way to reduce the risk of a forced sale.
- **Capital requirements:** Under Solvency II many annuity providers are applying to be allowed to take credit for the extra yield available on illiquid assets when discounting the value of their future liabilities. This "matching adjustment" can only be applied to long dated liabilities where the cash flows are well known and are at no risk of customer triggering a surrender. The matching adjustment results in lower capital requirements for the insurer which in turn should reduce new annuity prices. We believe that maintaining the optionality of buyback with the insurer would allow the continued existence of the matching adjustment under Solvency II. Any move to compel insurers to buy back annuities would severely jeopardise the ability to apply the matching adjustment which would have a detrimental impact on future annuity prices.
- **Customer Protection:** We believe that competitive pricing is best delivered through an auction process, after a standardised health underwriting process. To be most cost-effective, this would ideally be managed in an online marketplace. We recognise that fewer older people are digitally savvy, so they make need the help of a financial advisor, rather than dealing direct.

Q4. 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?

No. We don't think the death notification issue is best left to market participants.

Only the original annuity provider has an interest in the death being reported accurately; the family of the deceased annuitant has no requirement to report to the provider and the annuity purchaser has an interest in the income stream being paid as long as possible. The incentives are asymmetric.

In our view this is an excellent opportunity to extend the existing "tell us once" service to the private sector. The "tell us once" service currently allows people to inform a range of government agencies of a death through a single point of contact. Extending this to the private sector would reduce the likelihood of an annuity provider continuing to provide payments after a death and may help to improve the attractiveness of the secondary annuity market.

In addition to this the wider benefits available to the financial services industry of a centralised electronic death register should not be underestimated. For example the benefits to pension schemes and the wider actuarial profession could be huge. We think that such a database may help reduce instances of fraudulent claims and could help pension schemes identify where they hold an unnecessary reserve. We think that the life insurance and pensions industry may be willing to pay a fee for access to such a database which may help to meet some of the set up costs.

Q5. Do you agree with the proposed approach of the government working with the FCA regarding the fees and charges imposed by annuity providers?

We think it is appropriate that the government monitors the terms offered by annuity providers. Naturally, the FCA will need to reflect the additional costs or additional risks taken by different parties and the need to be compensated for these.

If existing annuity providers are able to offer surrender terms (Q3), the FCA should monitor the volumes of business won by different types of bidder (existing insurer, other insurer, non-insurer investor).

This point also ties in with our proposal above in Q4 where we suggest extending the "tell us once" service to the private sector. By extending this service the risk that a death is not reported in a timely fashion is reduced which will, in part, reduce the need for annuity providers to levy additional charges upon a sold income stream.

Q6. 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?

Yes, for a secondary market we do not think it is practical to extend the policy of transferring the income stream for DB pensioners in payment.

- investors would have to form a view on the strength of the sponsor covenant, and reflect the credit risk of default and the possibility of a hair cut on falling into the PPF. Valuations would be lower – and more complex - than for annuities from insurers, and
- pensioners may have an information advantage over third party investors (eg knowledge of company in difficulty).

In addition there could be issues for unfunded public sector pension schemes (Civil Service, NHS, Teachers etc) who would suffer a cash flow hit, which would make balancing the budget more difficult. However, as in freedom and choice, we understand there could be specific exemptions made for these schemes.

To deliver a further level of consistency we do however believe it worthy to consider a further consultation to include DB pensioners in payment should the scheme be able to offer a cash-in value akin to a cash equivalent transfer value.

Q7. Are there any other types of products to which it would it be appropriate for the government to extend these reforms?

We note that the government has not yet made any distinction between Compulsory Purchase Annuities and Purchased Life Annuities; we assume that both are eligible for the secondary annuity market.

We do not think there is any need to extend the reforms to other product types. As stated above we expect the secondary annuity market to remain a niche market and other products this concept could be extended to will be even smaller making the cost of any reform outweigh any potential benefits.

3 Legislative changes

A.3 The government welcomes views on how it proposes to change the tax rules relating to the assignment of annuity payments.

Q8. 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?

Q9. How should the government strike an appropriate balance between countering tax avoidance and allowing a market to develop?

We do not consider ourselves sufficiently qualified to comment on these issues.

4 Consumer protection

A.4 The government welcomes views on how it proposes to ensure consumers are appropriately informed when making decisions relating to the assignment of their annuity income.

Q10. 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?

It is essential that the reasons for sales of existing lifetime annuities are robustly documented. We believe that this is best achieved by requiring regulating advice. There is a case for excluding sales of annuities sold after April 2016 from this requirement as they would be bought in the knowledge that they could be traded-in later.

Additionally, creditors should not be able to force individuals to sell their annuity income to meet debts.

Our reasons are as follows:

- The suitability of exercising the trade-in option from the customer's perspective is a potentially complex and confusing process. The attractiveness depends on several factors including other income streams, attitudes towards risk of outliving savings, value placed on flexibility, current health and even the difference in interest rates between time of purchase and sale.
- There is strong evidence that pensioners under-estimate their life expectancy, and may be tempted to take a short-term decision to pay for some home repairs that they later regret. Older people are less confident users of digital support making it more difficult to deliver effective guidance tools to help people understand the trade-offs.
- The reputation and efficiency of this new niche market could easily be wrecked by the risk of future mis-selling claims. Prospective investors would discount their offer prices for the risk of future compensation claims – even though the new owner would not necessarily be liable. It's not clear who would be accountable for the sales process if advice is not required.
- We accept that the up-front paying for advice in a RDR-compliant way could be a significant turn off to cash strapped pensioners, who may well be looking to cash in their annuity to pay off an unwelcome bill. It is unlikely that many would go through this process without first having a pretty strong feeling that they want to cash in their annuity. Some may question why they need to pay up front for advice. The true benefit of the advice stage is really about getting an audit trail to document the sales process, which then helps investors offer larger amounts because the risk of future misselling claims is reduced.
- There is an argument that people with smaller annuities (or older people with shorter life expectancies) might be excused from the requirement for guidance, to broaden the appeal of the measure. We think that would be dangerous as it threatens the reputation of this new niche market, which would contaminate it for other annuitants.
- We would expect new purchasers of annuities to be told that trading-in was an option, and we hope that this would encourage more retirees to embrace annuities, as they would no longer be a lifetime decision.
- In addition to requiring advice for individuals we believe a "cooling off period" would be suitable to provide further consumer protection. We recommend a minimum 30 day cooling off period for all secondary annuity sales; regardless whether they have received advice or not. This would bring secondary annuities into line with other insurance products.

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Q11. What is the best way to implement these safeguards? Should the safeguards include expansion of the remit of Pension Wise?

Pension Wise seems an obvious area to expand, with an additional session tailored to annuity sales offering a simple solution. This decision should be made after looking at how successful Pension Wise has been in providing guidance since the introduction of the freedom and choice regime. If Pension Wise has been shown to be successfully providing suitable guidance then we would welcome the expansion to include guidance on secondary annuities.

Q12. 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?

We believe it appropriate that the annuity holder pays the cost of advice as they are instigating the sale. We would hope that low cost mass advice solutions may become available to allow those with low annuity values to retain as large a proportion of their value as possible.

We appreciate that the requirement to take, and pay for, advice may limit the size of the market as it may throw up a barrier for some individuals. However we believe that in order to actively participate in the market individuals need to be as informed as possible; this is the basis for our requirement that individuals receive advice when they are selling a significant income stream.

Q13. 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?

We agree that the requirement for a minimum number of quotes would increase competition; however this requirement would not be in line with rules around purchasing other financial products. The requirement for independent regulated advice, at a minimum level, should ensure that the customer is correctly advised to sell their income stream at the most competitive price. For example the intermediated protection and mortgage markets see a good level of price competition as advisers are able to use their knowledge of the market to obtain low prices for their clients.

The government could promote effective competition in the non-advised market by publishing best buy tables, for example through Pension Wise if this was the forum being used for guidance.

If the market reaches a sufficient size then aggregators may enter and enable individuals to obtain a number of quotes at once. We would expect this to drive competition in the market. As a step in the meantime the government may wish to create a comparison tool, similar to that seen on the Money Advice Service website for annuities, to allow individuals to compare secondary annuity quotes. By having the market start with such a tool available may prevent early misselling of annuity incomes.

Q14. 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 if the dependant's income is being assigned then both original holder and dependant should provide consent for the transaction, as the annuity will be held in both names. This will afford an effective veto to the dependant should they be concerned about the potential loss of future income.

Further to this as part of our proposed cooling off period we would allow either of the first or second lives to terminate the agreement to reassign the annuity income during the cooling off period.

a. Should the government or FCA issue guidance to annuity providers about protection for dependants?

   We believe that requiring written agreement from both the original holder and named dependant will ensure sufficient protection for dependants. However we would recommend that the FCA ensures that this requirement is met and regularly reviews providers' procedures to ensure dependants are not having their rights removed without consent.

b. Are there particular classes of beneficiary which require special consideration, for example minors or following a divorce or dissolution of a civil partnership?

We do not consider ourselves sufficiently qualified to comment on this issue.

c. Are there specific equality impacts that should be considered in this context?

We do not consider ourselves sufficiently qualified to comment on this issue.

Q15. 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 seems an additional complexity, to what is already a complex area. We do not believe it would be sensible, or practical, to split an annuity income in such a way. As such we do not think that pieces of annuity income should be assignable in this manner.

Q16. 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?

Any impact on means tested entitlements is a key area where we believe regulated financial advice may be especially valuable for individuals looking to sell their annuity incomes. The consideration of wider areas, such as means testing, which an individual may not consider whilst making the decision to sell an annuity income stream is a key part of the service we would expect a regulated financial advisor to provide.

The government needs to consider carefully how means testing will be applied alongside the new freedom and choice regime. Traditionally the income stream from an annuity has formed part of the assessment of an individual's wealth for the purpose of means testing. However any capital value of the annuity has been excluded. If an individual chooses to assign their income stream to a third party at which point does the capital they receive form part of their assets for the purposes of means testing?

In light of the freedom and choice regime we think the government needs to carefully consider how they will assess individual's pension savings; in particular any capital values that are moved into registered pension vehicles. Below we have set out three potential scenarios where individuals opting to sell their income stream may have implications for the benefits system.

Scenario 1: An individual with a total income stream which puts them above the means test threshold assigns an annuity income to a third party in exchange for a capital value. They place the capital value in an alternative pension arrangement with the intention to leave the capital value as a small inheritance for their family. Their income level now places them below the means test threshold.

Should this individual now qualify for means tested benefits? If not are there any criteria under which they would regain their eligibility for means tested benefits? For example if the threshold rose to a level above their previous income level would they then become eligible?

Scenario 2: An individual whose income is below the means test threshold converts an annuity into a capital value, withdraws this value as income, and pays marginal tax on the income drawn. The additional income drawn takes them above the means test threshold for the year they sold the annuity, but their residual income will be below the means test threshold in future years.

Under the current system this individual would not be eligible for their benefits in the year they sold their income stream but, provided they spent the capital drawn down, would become eligible again the following year.

Scenario 3: An individual whose income is below the means test threshold converts an annuity into a capital value, and places this value into a pension vehicle with the intention of drawing it down in future. Their residual income continues to be below the means test threshold.

This individual has accessed the freedom and choice regime but has had no impact on their means test eligibility under current rules. They are free to continue to receive means tested benefits. Should this individual require to drawdown an unusually large portion of their fund, for example to carry out repairs to their home, then they may inadvertently impact their eligibility to future means tested benefits.

As our scenarios illustrate the interaction between the pensions freedom and choice regime and means tested benefits (and indeed the wider tax system) is very complicated. The government may consider how the system as a whole may be simplified in order for individuals to better understand how their benefit entitlements may be affected.

Q17. Should those on means-tested benefits be able to assign their annuity income?

We see no reason for those already below a means test threshold to be excluded from the freedom and choice regime. As laid out above we think the government needs to carefully consider how the complex benefits system will interact with the freedom and choice regime.

Q18. 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

We do not consider ourselves sufficiently qualified to comment on this issue.