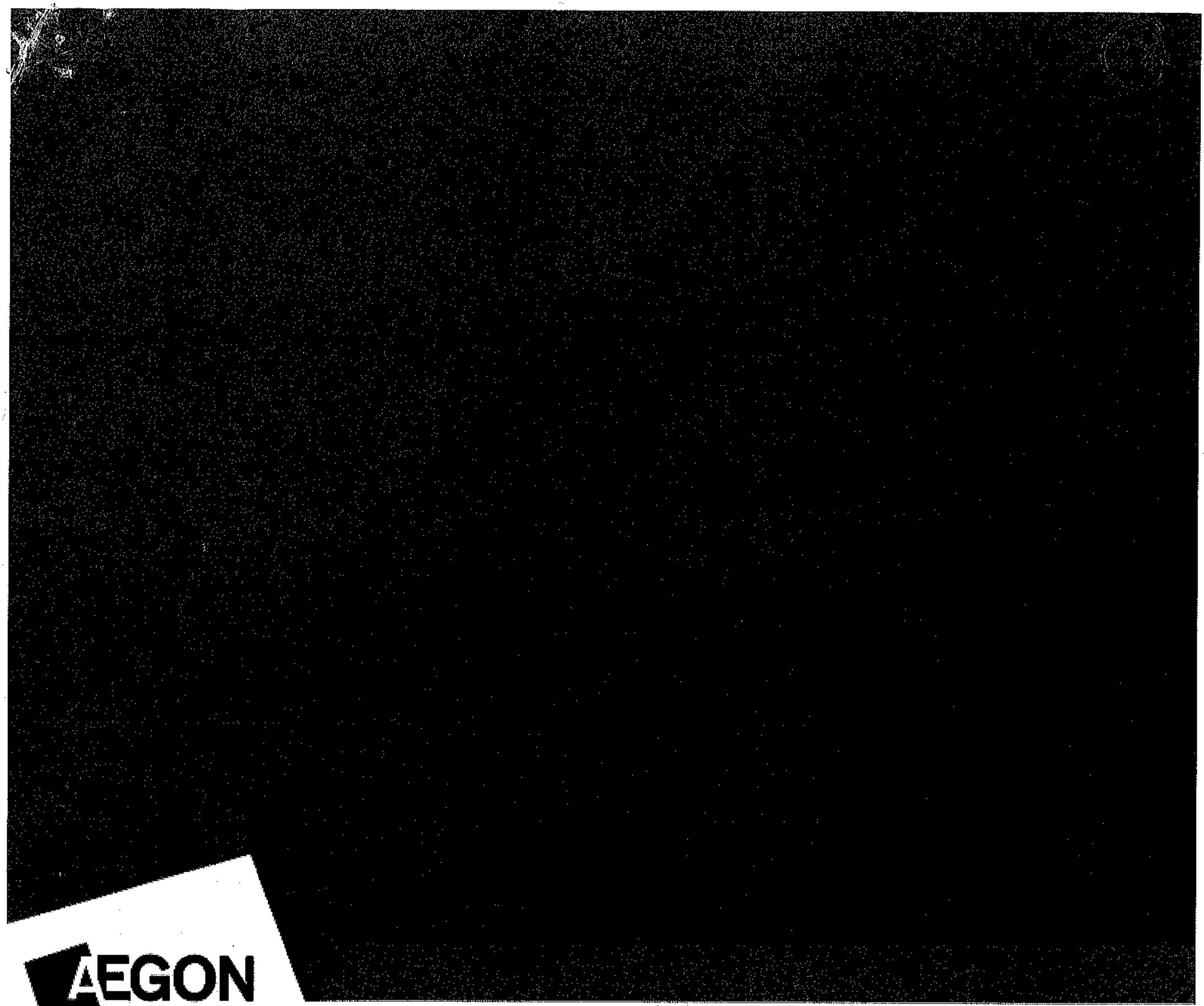

AEGON

Transform Tomorrow

Aegon's response to

HM Treasury and Department for Work and Pensions Consultation

Creating a secondary annuity market

18 June 2015

Introduction and high level comments

Aegon is pleased to have the opportunity to contribute to the debate around the development of a secondary annuity market. We support the pension freedoms introduced in April 2015 and can understand why some individuals who have already purchased an annuity may be attracted to this option to obtain equivalent freedoms.

We support the principles behind the development of this market. However, in practice, there are a number of key challenges and considerations. We note the Government believes continuing with existing annuities will be the right choice for the vast majority. We agree and are keen that this is highlighted to all those who might consider assigning their annuity and to those currently considering their retirement choices under pensions freedoms.

Our key interest in responding is to support the development of a market which can truly ensure consumer protection. This is essential to avoid damaging the broader trust in pensions. Our key points are as follows:

Consumer protection

- The industry and Government need to ensure consumers generally are not presented with an imbalanced perception that annuities are inherently bad and that the sensible thing to do is to assign future instalments (or "sell" in their eyes).
- Consumers need to be provided with a basic understanding of this market and ahead of implementation, the Government and FCA need to be fully confident that adequate consumer protections can be designed, including from scams, bearing in mind there will be a disproportionate number of vulnerable people who might consider, perhaps with encouragement, selling their annuity.
- The risks of consumer detriment under the 2015 freedoms apply to the secondary annuity market too, with some risks, such as the interaction with means tested benefits, having greater significance. There are also additional risks around understanding fair value and incurring personal costs before concluding whether proceeding with the selling on of their annuity is the right course of action.
- Consumers should be given access to an initial high level estimate of broadly how much their annuity might attract if sold on the second-hand market, after all costs, and allowing for a broad assessment of health.
- Many of these risks would be addressed if customers seek advice, which is why we support compulsory advice as the default position.
- We support the creation of a 'hub' through which annuitants, ideally with the support of an adviser, can offer up their annuity for assignment, rather than approaching third party purchasers individually. The contract would still be with the third party, not the hub. This would create the most competitive and transparent market experience and help to reduce the risk of third parties taking advantage of vulnerable customers.

Market participants

- Rather than having an objective of creating a wide market, the Government should only permit entities to be annuity purchasers if they meet both conduct and prudential standards so consumers can be protected.
- All purchasing entities should be FCA regulated. We agree that individual retail investors should not be permitted to be purchasers. This will protect customers; ensure tax is properly accounted for; reduce annuity provider concerns regarding assigning to unregulated parties; and help reduce the risk of money laundering.
- We support the Government's original intention, as stated in the consultation document, not to allow existing annuity providers to buy back future instalments. Allowing this would further complicate the market and introduce additional risks of consumer detriment through default behaviours. It would be wrong to assume that the existing provider could or would offer the best terms. Allowing 'buy back' would also create additional pressures on providers, potentially creating significant liquidity and/or solvency challenges including jeopardising any matching adjustment approval under Solvency II.

- If the Government ultimately permits buy-back, it should be entirely voluntary and facilitated through a central hub, with direct approaches to or from the annuity provider prohibited.
- It is likely that the demand for assigning annuities will reduce quite rapidly after an initial period of interest. This needs to be taken into account when considering the commercial viability of developing capabilities and infrastructure.

Advice and guidance

- Our starting point is that anyone considering selling on their annuity should be required to seek advice. Any exemptions from this need careful justification. We believe selling future annuity instalments is at least as risky as transferring from a defined benefit to a defined contribution scheme. It could also be considered as similar to arranging equity release on a home.
- The development of the secondary market must take into account adviser needs. This includes mechanisms to ensure they can cover their costs and FCA clarity of adviser obligations to protect against widespread retrospective 'mis-selling' claims.
- If, as we believe is appropriate, advice is compulsory, we see limited benefit in extending the scope of Pension Wise. It will be difficult for Pension Wise to support customers in what will often be a binary decision without straying into offering a personal recommendation.
- If the Government does believe that for those who are not compelled to seek advice, a Pension Wise style guidance facility is required, rather than being free at the point of use, we recommend it should be self-funded through charging annuitant users for the service or paid for by third party purchasers.

Other points

- It will be particularly important to have a central Government-supported mechanism for notifying the original annuity provider of the death of the annuitant.
- There would be significant benefit in the development of 'independent' underwriting facilities to produce an assessment of the annuitant's health which could then be used by all potential purchasers of future annuity instalments when bidding for assignments. This would avoid a customer needing to complete multiple health questionnaires or even assessments.
- The Government needs to provide greater support to customers so they fully understand how their choices at and in retirement will affect their entitlement to means tested benefits. The approach for secondary annuities must be consistent with implications for 'at retirement' choices and for social care.
- Implications of the Gender Directive need to be clarified, including explaining when purchasers must not take gender into account when determining a purchase price. Consideration needs to be given to any additional aspects which apply where the annuity was bought in the UK but the annuitant is now resident overseas.

We would be very happy to discuss further with you any aspect of our response.

Responses to consultation questions

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

We agree with the Government that for the vast majority of individuals, retaining their annuity income will be the right choice. We also agree that for some individuals, assignment may be appropriate. The development of a secondary annuity market represents a further major extension of the freedoms that came in from April 2015. While existing freedoms will deliver benefits for many individuals, they also present significant risks of consumer detriment, as would annuity assignment. This needs considered very carefully so the market can be made safe for consumers and we avoid any possibility of broader trust in pensions being damaged.

The circumstances where assignment might be appropriate will vary from individual to individual – it is a very personal consideration which will depend on a number of factors. Such circumstances will also depend on whether the individual wishes to assign future instalments in return for a cash lump sum or for a payment / transfer into an alternative form of pension product, such as flexi-access drawdown.

The factors will include:

- The individual's health / life expectancy
- Any change in personal circumstances since the annuity was purchased
- Other regular income the individual has, for example from state and occupational pensions
- The price a third party is prepared to pay after allowing for their, and any intermediary, costs
- The extent of costs borne directly by the individual – for example, to pay for advice and medical underwriting
- Whether the annuity is joint life and the income needs of a beneficiary or dependant
- If taking as a lump sum, the benefit to the individual of having this after the tax which will be deducted
- If transferring the proceeds into flexi-access drawdown, the benefits to the individual of being able to leave funds invested tax-efficiently; take income flexibly; and leave any remaining proceeds to a beneficiary on death compared to the guaranteed income offered by an annuity.

Once the market becomes clearer, it may be possible to identify certain segments for whom assignment would not be appropriate. For example, the size of any 'fixed overheads' or costs borne by the individual directly may place a *de minimis* on viable annuity size that can be sold on. Another example may be that there is a maximum age above which it is too difficult to medically underwrite with sufficient accuracy as to have confidence that the price offered is a reasonable reflection of future life expectancy. To avoid any suggestion of age discrimination, any maximum age will require objective justification. Similarly, those who are in very poor health and have a short life expectancy might also be considered as not appropriate for this, as the costs incurred may not make the transaction viable in view of short expected lifespan. Another category which the call for evidence highlights is those who are already in receipt of means tested benefits. Here the considerations are less about value for money for the individual and more about fairness to taxpayers more generally if such individuals can 'play' the benefits system. We expand on this in our response to Questions 16 and 17.

In terms of potential consumer detriment, the proposal to allow future annuity instalments to be assigned has all the risks of detriment from the April 2015 changes.

- The risk of paying **more tax** unnecessarily
- The potential to spend proceeds and then **not have enough to live on**
- **Spouses,** financially dependent partners and beneficiaries could also lose out – particularly if not part of the advice process. This is likely to be a big issue for women who are far less likely to have built up an adequate private pension or be entitled to the full state pension in their own right.

Some of the areas of potential detriment would have greater significance, such as interactions with **means tested benefit entitlements**.

New pensioners reaching State Pension Age after the single tier state pension commences

- The Government said this April's flexibilities were possible because the new state pension from April 2016 would take people above means tested benefits. This is not the case for everyone as entitlement to the £148 per week is dependent on having paid sufficient NI contributions. Those who have been contracted out will also receive less (they will have a replacement private pension, but it may be the annuity from this that they are assigning). Over time, we accept that more new retirees will be above the means tested benefits threshold.

Those whose state pension commenced before April 2016

- Allowing an individual to effectively cash in existing annuities brings many existing pensioners into means testing considerations. Many more of this group won't have a state pension above the means tested benefit threshold. If these individuals sell all of their private pension, and then spend it, they may not have enough to live on. We support measures the Government is now taking to explain the future treatment of individuals who voluntarily reduce their income. However, this is not currently widely understood and needs to be given much higher profile if we are to avoid large numbers of individuals ending up in this position.

We strongly urge the Government to develop a consistent and clear approach to this issue and communicate to all those potentially affected.

There are also some new areas to consider:

- Customers may **not appreciate what represents fair value** of their future annuity instalments to a third party. We'd need some generic education on this to avoid people having false expectations or accepting poor value without recognising it as such. We do not support the existing provider providing a benchmark figure, as this would increase their costs and potentially put them in conflict with the purchasing party. Instead we believe it should be possible to develop a central facility or 'hub' to allow individuals to input their current annuity income, an indication of their health and to obtain a very high level indicator of possible assignment value. It would not be reasonable to require the annuity provider to take any responsibility for the value agreed between the annuitant and the third party, not least because they will not be aware of the individual's current life expectancy.
- **Incurring costs before concluding selling their annuity isn't for them.** Firms entering this market as buyers are likely to want customers to pay up front for advice and underwriting, as there may be an expectation of significant numbers who don't end up selling their annuity due to the actual or (perceived) low values on offer. This could be expensive, with unsuited customers incurring unnecessary costs. An early broad indication of assignment value, net of all transactional costs including underwriting and arrangement, might discourage 'unsuitable' customers from incurring such costs.

A further group requiring specific protection comprises those in debt. Some may see annuity assignment as an 'easy' option for repaying that debt, and pay little attention to the amount offered on assignment or the potential tax implications. There may be alternative ways of repaying the debt which are more suitable.

Those with existing annuities will also tend to be older or in poorer health and may as a group be more vulnerable. It may be this group needs additional protection through regulation or some form of industry Code of Good Practice for those operating in this market. The FCA Occasional Paper No. 8 (February 2015) on Consumer Vulnerability is relevant here. Again, there is a limit on what the annuity provider can reasonably do.

There are parallels with equity release. Assigning an annuity in return for a lump sum could be considered as a loan against an asset, with the loan repayments being annuity instalments until death. It may be helpful to consider the consumer protections introduced to protect consumers considering equity release, which can also be considered as a loan, in this case repayable on death.

Although the consultation refers to annuity providers implementing consumer protection measures, there is a limit to what they can do beyond simple guidance or information especially as they are unlikely to be actively involved in the sale process itself.

2. ***Do you agree with the government's proposed approach of allowing a wide range of corporate entities to purchase annuity income in order to allow a wide market to develop, whilst restricting retail investment due to the complexity of the product? What entities should be permitted and not permitted to purchase annuity income and why?***

We believe the range of entities allowed to be purchasers should be set based on consumer protection and security of the overall system, and not to meet an objective of allowing a wide market to develop. We agree that this market is too complex and risky for retail investors to purchase future flows of annuity income from other individuals.

It's vital that any secondary annuity market is safe for consumers. We believe anyone in this market in any capacity needs to be regulated by the FCA to ensure appropriate standards of conduct. This will include:

- marketing practices
- ensuring communications are clear, fair and include appropriate risk warnings
- treating customers fairly and
- operating a cooling off period before concluding the assignment

If the purchasing entity is transferring the agreed 'purchase price' direct to a flexi-access provider, then it's also important that this transaction is fully regulated to avoid scams and to ensure anti tax-avoidance measures are in place.

The purchaser is also assuming mortality risk and the PRA might have an interest in whether it is managing its affairs in a financially sound manner in addition to any solvency requirements. There will be circumstances where notification of death does not happen in a timely manner and the annuity provider will then need to reclaim overpayments from the third party. This creates a further requirement that third parties are subject to appropriate regulation and are operated on a financially sound basis, possibly with some minimum capital requirement.

Legislation will also need to set rules around the ability for the third party purchaser to sell on assigned instalments, either individually or in bulk, to which entities. This will have a bearing on the original annuity provider's costs including redirection of annuity instalments. Any re-selling would have to be without medical underwriting of the annuitants.

There are also money laundering considerations whenever an annuity is assigned or re-assigned. For example, there is a real money laundering risk if an unregulated third party can 'purchase' an annuity and then immediately reassign it to another third party. Placing responsibility for anti-money laundering checks on initial and subsequent assignments on the original annuity provider will add to costs and discourage providers from agreeing to assign.

3. ***Do you agree that the government should not allow annuity holders to access the value of their annuity by agreeing to terminate their annuity contract with their existing annuity provider ('buy back')? If you think 'buy back' should be permitted, how should the risks set out in Chapter 2 be managed?***

We strongly agree that the Government should not allow this.

Allowing (or in a more extreme scenario requiring) providers to buy back their own annuity contracts would be a substantially bigger change with wider consequences than the current assignment proposal. It brings additional considerations for both consumers and providers.

Provider considerations

For providers, an annuity contract is a long term guarantee to pay income throughout life. The regulators rightly require stringent reserving to make sure this guarantee can be honoured. Most providers will be holding matched assets. There was no past need for liquidity once an annuity was set up, so many underlying investments will be in illiquid assets, with the resulting yield uplift used to enhance annuity rates for the benefit of customers. The terms available for cashing in these assets may be poor, particularly where there is a heightened pressure to sell (for example in the months following the facility becoming available), and this would need to be passed on to consumers. Where the annuity provider invested in illiquid assets to offer a more competitive price, their buy-back price will typically be relatively 'poorer' as a result. Clearly, buy-back considerations are also likely to impact annuity purchase rates going forward as providers will have to recognise the shift to more liquid asset holdings.

Providers may also have reinsurance contracts to manage their longevity risk. These are likely to be set up based on a book of business with, for example, providers paying agreed payments to a reinsurer in return for the reinsurer paying out amounts due across the full annuity book covered by the longevity swap. These will not typically have any surrender clauses written into them and in any case would be highly complex to amend in reflection of individuals having undertaken buy-back. Again, this complexity and cost would need reflected in the buy-back price offered.

Some providers also reinsure annuities on a 'quota' basis, in some cases reinsuring 100%. Under such an arrangement, it is the reinsurer who holds the full liability and it would be for them, not the annuity provider, to decide if they were prepared to buy back and if so, at what price. If a reinsurer refused to allow buy back, it would be hard to explain to customers that the terms available to them were dependent on a third party that they were unaware existed.

There would also be important implications under Solvency II which would need worked through in detail ahead of any legal change. We would ask the PRA to clarify the terms under which an annuity provider who offered to buy back could still be eligible for a matching adjustment. There is a second order risk to matching adjustment eligibility if a provider found they had to sell the liquid assets in its backing portfolio, leaving it with a disproportionate exposure to illiquid assets, making it difficult to rebalance the matching in a timely and cost effective manner.

There would also be complex implications for the annuity provider's, or in some cases the reinsurer's. reserving. In its reserving, an annuity provider will make an assumption about future longevity experience based on its knowledge of its full annuity book. If individuals can buy back, the provider will need to review on an ongoing basis the extent to which its assumptions about the longevity of its remaining annuitants need changed to allow for any self-selection (healthy or less healthy lives) among customers buying back the annuities.

For all of the above reasons, the buy-back price from an existing provider could be very different from, and certainly not necessarily higher than, the value a third party would place on the payments. We appreciate there is no current suggestion that providers would be forced to buy back annuities. However, even permitting them to do this would generate significant added consumer pressure on providers to do so. As we see significant risks in this, we do not support it. We are also concerned that while the pension freedoms introduced in April 2015 are permissive, some providers who have chosen not to offer the full freedoms are facing public criticism.

Customer considerations

From the customer's perspective, asking your existing provider to surrender your annuity might seem like the 'easy option'. Customers might approach their own provider first, 'insist' on a surrender value and reject the need to shop around. This is similar to the issue now emerging with customers aged 55 and above asking for all their money in cash, and the consumer detriment risks would also be similar.
While perhaps contrary to the broader policy of freedom and choice, it could be argued that annuity assignment could be made 'too easy' if customers can approach their provider directly to request buy-back, creating future problems. In the past, it was very easy for customers to have the freedom to take out a large mortgage, and this caused widespread detriment to both individuals and the wider economy.

We are in favour of compulsory advice, to make sure consumers get the best price from across purchasers in the market. We believe the extra consumer risks and market complexities with allowing buy-back would significantly outweigh any potential benefits to customers.

Consequences

If the Government does ultimately decide to permit buy-back, we would urge it to put appropriate controls and assurances around this. First, it should make it very clear to customers that providers are not required to buy-back and may have very good reasons for not doing so. We also recommend annuitants are prohibited from approaching their provider directly. Instead, we favour the purchase process to be facilitated through some central hub, ideally with support from an adviser. This would allow the annuitant / their adviser to offer his or her annuity to potential purchasers who could all submit their 'bid'. The original provider could participate in this if they chose to. The actual assignment would be with the purchaser, not the hub.

The mechanics of buy-back will be different from assignment. The original provider will be cancelling the contract, rather than buying the future flow of income it would otherwise be paying to itself as purchaser (the latter approach would be cumbersome).

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

We do not believe the proposals around 'market' solutions are workable.

The majority of individuals do not have an executor, so this solution is limited in reach.

Stopping payments at some maximum age provides a 'backstop' protection, but making it too young will discourage purchasers, and making it too old limits the protection offered to the original annuity provider. Paying a nominal amount to the original annuity-holder would substantially complicate the overall transaction and add to costs.

If the Government wants this market to develop, we believe it needs to play a more supportive role. We note the 'Tell us once' facility which the Government operates for notifying Government agencies of death. We believe this, or methods used to identify when state pensions should cease, might be built upon for use by annuity providers.

The lack of a central solution to death notification will discourage providers agreeing to assign and could also represent a barrier to those who might otherwise enter this market as a purchaser.

The lack of a reliable death notification service will mean providers agreeing to an assignment incur additional costs in monitoring the annuitant's survival and in avoiding potential overpayments from the third party receiving payments when not due. Electronic verification processes providers have adopted to make their business more efficient will be undermined by no longer having regular contact with the annuitant and no longer being able to rely on closure of a bank account to indicate death. Furthermore, it will be more difficult to obtain positive confirmation that an annuitant is alive as there will no longer be a financial incentive for the annuitant to provide this information or indeed to keep us advised of changes of address. But if annuity providers are able to take lack of response to indicate death, and stop payments, then third party providers will need to build 'premature cessation' into the purchase price they offer, meaning the annuitant will also get a worse deal.

In the absence of a central Government solution, costs will increase for new annuity business (where assignable) as well as for inforce assigned business. Annuity providers should be entitled to pass on additional legitimate costs, either by way of a deduction from future annuity instalments or as a one-off charge to the annuitant at the point of assignment.

If the annuity provider is not notified of the annuitant's death, and instalments continue to be paid to the third party for a period, these will need to be reclaimed once the provider becomes aware of the annuitant's death. This increases the need for the third party to be regulated and to be operated on a financially sound basis with a minimum capital requirement.

It will be important to clarify that there are no data protection issues with the annuity provider continuing to hold data on the annuitant and any beneficiary, even though these parties have no contractual rights to any benefits.

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

We support this approach. Initially, we agree that monitoring is appropriate. It will take some time for this market to establish itself and legitimate costs will need to be covered.

There will be media interest in what annuity providers are charging for assignment and we'd expect this in itself to put downward pressure on costs and charges.

A more challenging (and in our view more important) issue will be how the Government or regulator might assess whether general (as opposed to individual) resale prices offered by third parties are reasonable. We cover this in our response to Q13.

6. ***Do you agree that the scope of this measure should be annuities in the name of the annuity holder and held outside an occupational pension scheme?***

Yes. We do not support extending the scope to cover 'scheme pensions' where the pension is being paid out of wider scheme assets without an annuity contract, or indeed to pensions from (funded or unfunded) public sector schemes. However, whenever the annuitant has a contract in their own name with an annuity provider, whether this was purchased from the proceeds of a personal or occupational scheme, they should be in scope. We see no reason to differentiate between annuity contracts purchased with funds representing safeguarded and flexible benefits.

There is a risk that if the secondary market takes off, those with scheme benefits will request similar flexibilities. They may put pressure on trustees to buy out their benefits through annuity contracts in their name which, for safeguarded benefits, could impact on the funding of other scheme benefits. The Government may wish to introduce measures to protect against this outcome, possibly through asking the Pensions Regulator to cover this specifically in its guidance to trustees.

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

Under some newer pension legislation, it can be difficult to determine how some types of contract, such as Section 32 Buyouts and section 226 policies are to be treated. We believe annuities purchased by such contracts should be included (permissively) in any future annuity assignment rules and would ask that any resulting legislation makes this unambiguous.

Legislative changes

8. ***Do you agree that the design of the system outlined in Chapter 3 achieves parity between those who will be able to access their pension flexibly and those who will be able to access their annuity flexibly? Are there any other tax rules which the Government would need to apply to individuals who had assigned their annuity income?***

We agree that the proposals create parity between those groups. In one regard, they go further than is needed for this, and in doing so create more complexity for those making 'at retirement' choices in future.

We interpret the call for evidence as meaning those who purchase an annuity after 6 April 2015 will also have the flexibility to assign future instalments, even though they had access to the full range of flexibilities when choosing to purchase an annuity.

We accept that it might be difficult to rationalise why flexibility offered to pre April 2015 annuitants wouldn't be extended to post April 2015 annuitants. However, from a customer perspective, it adds complexities for those weighing up their future retirement options. At present, annuities and flexi-access drawdown contracts have certain unique features. Purchasing an annuity is currently 'irreversible'. The proposals change that and some individuals may believe annuities will become more flexible than they will be in practice – again highlighting the need to educate customers to make sure they have realistic expectations. This may make comparison with drawdown less clear cut.

The provision that an annuity can only be assigned with the annuity provider's permission is also consistent with the 2015 pension freedoms. We note that the Government is threatening to 'name and shame' providers who are not offering the freedoms to all customers. This raises concerns over whether the freedoms and the proposed assignment provisions are truly permissive.

If the ability to assign continues to require the provider's permission, this might allow providers to insert clauses into future annuity contracts forbidding their future assignment. However, unless this leads to the provider being able to offer a more competitive rate (for example by allowing continued investment in higher yielding illiquid assets), it is likely that these would be considered inferior to those without such a clause, so their marketability would suffer.

If the annuity provider were compelled to agree to assign, there would be a greater need for legislation to specify and restrict who is allowed to purchase future instalments.

Regarding tax rules, one key consideration will be who is responsible for either deducting tax due or on reporting assignment to the tax authorities. We expand on this in Q9 below.

We agree that there should be a consistent approach to the April 2015 freedoms regarding when an individual becomes subject to a lower Annual Allowance. We assume the £30k exemption will apply and that it will be based on the payment made by the third party. The annuity provider will not have this information. They will also not know the precise date on which the payment was made, or if transferred to drawdown, when the first income withdrawal is taken. This makes it difficult to make the original annuity provider responsible for notifying of a reduced Annual Allowance.

There may be additional considerations where an individual purchased a UK annuity but is now resident overseas. The FCA rules prohibit a UK insurer from any transaction which amounts to a new contract or a material change or variation to an existing contract with an overseas individual. We are not clear if agreeing to assignment would constitute such a change.

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

At present, those offering annuities are regulated by the FCA. They deduct tax before paying an annuity and account for this to HMRC. In future, after assignment, our understanding is the annuity provider will no longer deduct tax and that it will be up to the third party to deal with their own tax on receipt of the ongoing income.

The greatest risk of tax avoidance will arise if there is no mechanism for HMRC to be aware of the assignment, and in particular if it resulted in a cash lump sum from a third party to the previous annuitant. While the ceding annuity provider could notify HMRC of an assignment, as there is the option of the third party paying a transfer into flexi-access drawdown or a flexible annuity contract, the only parties who will know the details are the individual and the third party. We question how feasible it will be for HMRC to ask for the third party purchaser to collect tax at source on lump sums paid to annuitants on assignment. While the rate could be set at emergency code level, some third parties would not at present have the necessary functionality. The alternative is that HMRC considers how to interface with the third party purchasing institutions to require notification of such payments.

Where proceeds are paid by the third party into a flexi-access drawdown contract, the new provider will need notification of the nature of the transfer to ensure appropriate tax treatment on receipt (such as no new tax free cash). We comment elsewhere on the significant benefits of all parties being FCA regulated.

There are many existing notifications and verification processes providers use around transfers and instructions from advisers and we would encourage HMT and DWP to consider how these may be extended to preserve anti-avoidance measures.

Consumer protection

10. What consumer safeguards are appropriate – is guidance sufficient or is a requirement to seek advice necessary? Should the safeguards vary depending on the value of the annuity?

The decision to sell a guaranteed lifelong flow of income, possibly extending to a beneficiary, is a very serious decision involving considerable risk of consumer detriment. The difficulty, particularly for the individual, to assess whether an offered on-sell price is fair value increases this risk. Furthermore, the individual's personal health and other circumstances will often have even greater bearing on whether this action is suitable than is the case for those considering pensions freedom options 'at retirement'.

For these reasons, we do not believe guidance will be sufficient to protect consumers. We believe the starting default position should be that advice should be compulsory for all. Any exemptions from that should be thought through very carefully.

The need to seek advice could be highlighted within risk warnings annuity providers give to their annuitants who approach them to ask for assignment. However, if the annuitant has already 'agreed' to assign their annuity, possibly after being approached by a purchasing organisation, they may be highly resistant to then seeking advice. This makes it more important that the need for advice is made clear to all at an early stage and that any third party purchaser must be prohibited from approaching an annuitant or 'agreeing' to an assignment unless that annuitant has received regulated advice. There is a significant scamming risk here.

Clearly, advice comes at a cost and the impact of this will be more significant the smaller the value of the annuity. The 'gross' value of the annuity (before transactional costs and margins) is not a simple function of the amount of regular payment and there is no recognised valuation method, so setting a *de minimis* valuation level is more complex than in areas such as defined benefit transfers.

The value which the customer actually receives on assignment will be 'net' of the fixed overhead of underwriting (unless paid for separately by the annuitant), the annuity provider's transaction charges and the purchaser's margin. The costs of advice, where taken, will also have to be met. We believe this means there will be a 'gross' value level below which the net (of all charges) resale value will be zero or close thereto. This needs to be communicated to annuitants.

We appreciate there will be some circumstances where it is clearer that an annuitant would benefit from assigning their annuity – for example, the scenario mentioned in the paper where the individual has a large defined benefit pension and a very small annuity purchased from a defined contribution scheme. If a *de minimis* level before advice is required is introduced, it should be based on considerations including whether the likely age and hence vulnerability of those considering assigning an annuity might lead to a *de minimis* of lower than the £30,000 used elsewhere for safeguarded benefits.

If a *de minimis* were set based on annuity income level, a fund of £30,000 could be deemed to be equivalent to £1,500 per annum of annuity, or an age-related conversion factor could be used. Alternatively, if services are developed to offer an initial benchmark price, this could be used to determine if advice is then required.

If the Government decides to set a *de minimis* level below which advice is not required, this creates more pressure to find a solution to support / provide guidance to those below the level. We comment further on this in our response to Q11.

The FCA will also need to consider if it will require specialist permissions to advise in this market. While this also has cost (and advice supply) consequences, we believe the starting point should be that advice on annuity assignment is equivalent to advice on the transfer of safeguarded benefits such as defined benefit to defined contribution transfers. Parallels could also be drawn with equity release.

We appreciate that many annuities have been taken out on a single life basis without inflation protection, whereas defined benefit schemes tend to have these extra benefits. It could be argued that this means consumers need less protection or have less need for advice than when considering a transfer from a defined benefit scheme. However, some annuities *do* have spouse's benefits and inflation protection so unless the rules are different in these circumstances, the only safe approach is to treat all annuity assignments in line with transfers of safeguarded benefits.

Furthermore, a defined benefit to defined contribution transfer does not equate immediately to giving up future income – it is about replacing a guaranteed and set flow of income with new flexible investment and income options. Selling even a small annuity for a lump sum does equate to future income ceasing and might take remaining regular income below the means tested benefits threshold. Even when the person has then spent that money, they won't get a means tested top-up so it can potentially have a very significant impact and most individuals are currently unaware of these consequences.

One possible approach would be for DWP and Treasury, or the FCA, to conclude that the market can only work for annuities above a certain amount per annum. This is particularly relevant if, as we suggest, advice should be required in all cases without a *de minimis.*

Another approach would be to require the individual to have a guaranteed income of say £150 per week (including state pension) before being allowed to encash an existing annuity. This latter approach is similar to the minimum income requirement that used to apply to flexible drawdown – but with a much lower income level requirement. It would mitigate the risks associated with existing pensioners with low state pensions falling below means tested benefits.

Whether or not advice is made compulsory, consideration is also needed on whether there will be a supply of advice within the market. There will be at least 2 concerns for advisers considering advising in this market:

- future regulatory liability if there is a retrospective review of 'failings'; and
- ability to cover their costs.

In terms of covering costs, it is likely that many individuals who consider assignment and seek advice will then decide not to proceed. This means there may be a case for requiring advice to be paid for upfront and not out of the proceeds of an assignment. This avoids creating customer bias towards assigning even if against advice. Similarly, there is a case for requiring the customer to pay separately for medical underwriting. This is the most transparent approach and would help customers truly appreciate what costs they'll incur and what they are for.

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

We do not believe guidance will be sufficient to protect customers. Pension Wise might offer a service in this area, but we see this as of limited value and not as an alternative to professional, regulated advice with a personal recommendation.

If advice is compulsory, there is much less of a role for Pension Wise or providers, although we believe providers will have a role to play in delivering risk warnings and potentially enforcing the requirement to seek advice by refusing to assign if advice has not been taken.

For annuitants considering assigning, Pension Wise might offer some initial insight into the considerations. Under the existing pension options, Pension Wise sets out general options with some limited tailoring of the pros and cons to the individual's circumstances. It never recommends a specific product. If an individual approaches Pension Wise considering assignment, it will be harder to keep the guidance generic as the annuitant's choices are binary – keep or assign.

However, it might be feasible to develop a separate service – not necessarily linked to Pension Wise - specifically for guidance on annuity assignment and possibly targeted at those below any advice *de minimis*. Unlike Pension Wise, it is very unlikely that either providers or advisers will benefit from the annuity assignment and therefore it is difficult to justify their funding the guidance. Instead, it might be more fitting for individuals who use the guidance to pay to cover the costs. If the service stays focussed, it might be substantially cheaper than regulated advice. Another approach would be for third party purchasers to fund the service.

Both Pension Wise and providers will need to amend their explanation of options to those considering retiring. Some annuities will now be assignable although this will be at the provider's discretion. This may complicate the customer's consideration of their options – see our response to Question 8.

12.Should the costs of any advice or guidance be borne by the annuity holder (mirroring the arrangements for conversion from a defined benefit scheme)? If not, what arrangements are appropriate?

Yes. Not everyone who considers assignment will proceed after having received advice. Therefore, it is only fair to levy the cost of advice on those who receive it. This is also transparent and consistent with the RDR.

13.Do you agree that the government should introduce a requirement on individuals to obtain a number of quotes? How else should the government best promote effective competition to ensure consumers obtain a competitive price?

We agree it is important to find ways of protecting consumers from being offered or accepting unjustifiably low lump sums in return for their annuity instalments. Because the price will be based on (at least) two variables – investment yields and longevity – both of which involve subjectivity, it would be very difficult to impose any form of 'charge cap'.

At present, an individual can access the MAS website to work out how much annuity they might get for a £100k fund. An informed and numerate consumer could work backwards from this to assess a reasonable 'value' on assignment. However, we believe it would be more helpful to introduce a new facility which would allow an individual to input their current annuity income and their assessment of their health status to get a broad indication of what they might receive on assigning their annuity, taking into account likely underwriting and other costs. We see this as a far better solution than expecting the current annuity provider to provide a benchmark.

We do not think requiring multiple quotes would be workable. There is no precedent for requiring an individual to obtain multiple quotes and doing so in this market has unique difficulties and costs. It is also not yet clear how many market 'purchasers' there will be.

To provide a firm quote, a potential purchaser will need to obtain medical information, which is likely to require individual underwriting. The purchase price is likely to be very dependent on the results of this, so any pre-underwriting figure will be no more than an early indication.

It is very likely that providers will pass the cost of underwriting to the customer. And any need for attending a medical examination will take time. For joint life annuities, both partners will need underwritten.

One solution we favour here would be to create a facility for an individual to be underwritten once, and from an authorised source. The individual could then present that to potential purchasers ideally through some form of central 'hub'. Interested purchasers could then bid through the hub.

For this to work, purchasers would have to be prepared to operate on the basis of 'standardised' underwriting. There would also need to limit the time period over which the medical assessment could be used. Health, particularly at older ages, can change quite rapidly. But the key benefit is it avoids the customer having to pay more than once for standard underwriting. Purchasers should, however, be able to ask for further medical evidence through exams or specialist tests to refine the standard underwriting.

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

- ***Should the government or FCA issue guidance to annuity providers about protection for dependants?***
- ***Are there particular classes of beneficiary which require special consideration, for example minors or following a divorce or dissolution of a civil partnership?***
- ***Are there specific equality impacts that should be considered in this context?***

We agree that it will be essential to obtain the written agreement to both parties before assigning a joint life annuity. We believe the legislation should extend to cover all permitted beneficiaries rather than simply referring to 'dependants'.

Where the annuity is subject to an earmarking order, or is in the process of being shared on divorce, this needs to be allowed for as part of the processes around assignment, to protect the spouse.

It will be important to explain clearly to a dependant what they are agreeing to. This would ideally be part of regulated financial advice.

Some annuities have provisions to continue to any spouse, not just to an existing spouse at the point of purchase. There is no feasible way of protecting future spouses from loss of benefit – only those with a known entitlement at the date of assignment can be party to the assignment. However, where an annuity does provide for second and subsequent spouses, it should continue to be paid at the relevant level to the third party for the lifespan of such other spouses.

15. Should the government permit the principal annuity holder's income to be assigned while dependants retain their own income stream? Should the decision on whether to do so be left to the discretion of the parties to the transaction?

We do not believe it would be practical to assign only the primary annuitant's rights. We agree there would be considerable costs and contract complexities.

16. How can the proposed consumer protections for the assignment of annuities ensure that any impact on means-tested entitlement is understood by those deciding whether to assign their annuity income?

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

We are responding to questions 16 and 17 together.

The interaction with means tested benefits needs careful consideration.

We believe it is essential that the Government makes it much clearer to individuals how their choices at and in retirement will affect their entitlement to claim means tested benefits both initially and in the longer term. Ideally, the Government should provide a central source of information on this which providers could signpost customers to.

We agree that the Government rightly should avoid creating a situation where an individual can cash in their annuity, spend it, notify the authorities they now have less income and ask for (more) means tested support. This would have to be funded by other taxpayers and is not likely to be seen as fair by people generally. However, this is easier said than done.

The approach taken here needs to be consistent with that adopted in other situations. An individual approaching retirement has a choice between drawing a periodic income, taking a lump sum, or a combination. If they take a large lump sum, it is not clear to us if, when assessed for means tested benefits, they will be deemed to be receiving the regular income they would otherwise have been able to secure. This is the only approach which removes the potential to 'game' the benefits system. But if this is the approach taken, the lump sum should be disregarded from the savings element of the means tested benefits assessment.

If a 'deemed' rather than 'actual' income approach is taken, there will be a growing number of people who spend their lump sum and in later life have an income below the means tested threshold but who are unable to claim. We are not convinced this is a politically tenable situation.

The approach taken under a secondary annuity market must be consistent with the approach taken for those approaching retirement. So if an individual who takes a lump sum at retirement is deemed to have the income he or she could otherwise have generated, then someone who sells on their annuity should be similarly treated as continuing to have that income.

We recommend that the Government considers this at cross-departmental level, alongside rules around qualification for long term care support, including deprivation of income and assets. The rules here should also be considered alongside the tax treatment of the individual under each scenario, to again ensure cohesiveness of policy. For example, is it reasonable to tax someone on actual income in a year but to assess their entitlement to means tested benefits on a deemed income?

There is a broader question around whether it is right for organisations such as Pension Wise and the Citizens Advice Bureau to help individuals maximise their entitlement to means tested benefits by drawing income from their pension fund in a particular way.

18. What are the likely impacts of the government's proposals on groups with protected characteristics? Please provide any examples, case studies, research or other types of evidence to support your views.

There are a greater number of women who receive a 'dependant's' annuity on the death of their husband than men inheriting a deceased wife's annuity.

One other point that needs considered is whether the purchaser of future annuity instalments can take gender into account. The gender directive prohibits annuity rates taking into account gender. We believe this means it will also be prohibited for gender to be considered within the calculation of the resale value, and assume this would apply whether the annuity was purchased before or after the Gender Directive came into force.