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By email: Annuity.Consultation2015@hmtreasury.gsi.gov.uk

Dear Sir/ Madam

Creating a secondary annuity market

Legal & General welcomes the proposal in principle for a secondary annuity market. We believe it is important to ensure that the market operates in the best interests of customers, and have outlined our thoughts in our response to this consultation, setting out the matters that we believe need to be considered before you finalise your proposals.

As you may know, Legal & General, established in 1836, is one of the UK's leading financial services groups. At 31 March 2015, we had £737 billion in total assets. We've over nine million UK customers and look after the investments of over 3,000 pension schemes. We've made a commitment to investing in UK infrastructure, including housing, student accommodation, care homes, hospitals and urban regeneration, and we've already made over £6.3 billion in these types of direct investments.

We agree with the statement in the consultation that "there is no reason why the government should impose barriers that prevent individuals from being free to make their own choice about what to do with their annuity rights, purchased with money they have saved throughout their working life". The principle behind this is no different from the new pension freedoms and should apply equally, regardless of whether annuity purchase has already taken place or not.

We would like to see an open market created that will achieve the best possible outcomes for individual consumers and therefore for government, regulators, insurers and annuity income buyers. To achieve this we believe that the Government should firstly ensure effective consumer protection and secondly ensure effective market mechanisms are in place to enable customers to receive the best possible price.

Ensuring effective consumer protection

The secondary annuity market presents freedom and opportunity for the individual customer, but also creates risks. Therefore, we believe it is essential that there is a market mechanism that provides the customer suitable protection and the ability to be paid the best possible price. This can be achieved by:

- Ensuring all parties involved are regulated and recognised by FCA and HMRC;
- Advice being mandatory if the cash sum exceeds £30,000 (recognising the need to provide consistency with wider reforms, but crucially to ensure that customers make an informed decision);

- The annuity insurer ensuring the customer is given the appropriate information and risk warnings if the sale is on an execution only basis;
- Applying service standards for all annuity insurers and buyers to ensure customers are not unreasonably delayed or impacted throughout the income assignment process;
- All fees and charges being made clear and transparent to the customer, and buyer.

Ensuring an effective market mechanism to enable customers to obtain the best possible price
Consumer protection and an effective market mechanism will lead to confidence for both the customer and the annuity insurer market, enabling the customer to achieve the best possible price, which should be the customers' primary interest.

To ensure this can be achieved we would also propose the following measures are put in place:

- Maintaining FSCS protection is essential to ensure an effective secondary market, so that any financial compensation is also assigned to the annuity income buyer;
- Offers to purchase an annuity income can only be obtained via an FCA regulated online auction facility, enabling the widest range of potential buyers (with permissions) to bid within an open, regulated, market environment, and therefore ensure that 'shopping around' for the best price is mandatory;
- Restricting final bids to 'Guaranteed Bids' only based on common and complete information available to all potential buyers, ensuring the customer is not attracted toward the highest indicative bid that may be reduced by the 'winning' bidder later in the purchase process;
- Enabling the original annuity insurer to participate in the auction and the opportunity to 'buy back' annuity income. The original annuity insurer should be in a position to offer the best price for the annuity and restriction on it bidding could result in a detrimental outcome for the customer and a lower final price being achieved.

We recognise there are a number of challenges and areas to be considered further to create a successful secondary annuity market that all parties can participate in with confidence, and would be delighted to continue working with you to deliver a successful secondary annuity market.

In the attached annex we have set out our responses to the specific questions raised in the consultation paper. Please feel free to contact me if you would like to discuss any aspect of our response or if you have any other questions.

Yours sincerely

Responses to individual questions

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

There are a number of instances in which an individual may deem it appropriate to sell their annuity and the paper already sets out an extensive list.

In addition to those scenarios, we believe that the ability to sell might also be particularly appealing to individuals coming up to retirement with a Guaranteed Annuity Option – the individual could obtain a good outcome by taking the GAO and selling the resulting annuity policy, rather than taking the cash straight from their pension under pension freedoms.

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 agree that institutional investors such as pension funds and insurance companies would be attracted to this market and that this would not be a suitable market for retail investors. We would expect underwriting to be a key element to the market – this is both to ensure the purchaser knows what they are buying and, crucially, to ensure the customer can get the best possible price for their annuity. As a result, it is likely that the key players in this market will be the annuity providers themselves, since they will naturally have the best understanding of risk in this market.

By using an annuity auction site, such as the one described in our response to question 13, it would allow for the easy collection of all necessary data which would be shared amongst all potential buyers, each participant having full information available to them. This already happens in the primary market where all data, including medical underwriting data, is gathered online on a portal and each annuity provider returns a quote instantaneously.

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 believe the primary objective is to creating an open and fair market in which consumers obtain the best possible price is paramount. Therefore, the widest possible range of buyers should have the opportunity to quote for the annuity and we believe this should include the original issuer of the annuity.

The original issuer of the annuity should be in a position to offer the best price for the annuity. To prevent providers from quoting for their own annuities may cause detriment to the individual by not allowing them to sell to the company who could potentially offer the best price. The issuing annuity provider has the following advantages in terms of being able to offer a higher price:

- once bought the ongoing liability can be extinguished;
- the capital backing the annuity can be released;
- there would be no need to make a charge for the cost of transferring ownership of the policy;
- the ongoing cost of administration of the policy would no longer apply, including the costs associated with existence checks.

What is crucial is not obliging the existing annuity provider to participate in the secondary market – for very good reasons (financial, commercial, operational) they may decide not to, but banning them from doing so does not support the creation of a secondary market that works in the best interests of the consumer.

We believe the two risks identified in Chapter 2 are fully mitigated by mandating that annuity incomes can be sold via a regulated online auction as described in our answer to question 13. This approach would remove pressure on any individual company as it will not be possible to approach any company directly, and will also ensure shopping around in an open market always happens, addressing the second risk identified.

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 believe that the government has a key role to play in supporting the market.

The government has records of who is being paid the state pension and this must be the best source of data to verify whether an individual has died. There is currently a paper based, time consuming and prohibitively expensive (currently £4.26 per check) process in place to check this government data. Making this data available in a simple, secure, low cost electronic format would benefit both the market participants and the customer. Without a robust death notification process there will be uncertainty for the buyer which may directly impact the price they would be willing to pay, to the detriment of the customer.

Alternatively, a code of conduct could be necessary where the onus is on the annuity provider to provide evidence of death of the original policyholder. This would require positive evidence of death of the customer, rather than evidence of failed attempts to contact the customer as proof of death.

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 agree that the fees and charges by the selling annuity provider should be monitored closely. Fees should be transparent and publicised on company websites.

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?

In the same way that DC scheme trustees have the ability to offer pension freedoms to their members coming up to retirement, they should also have the ability to offer the freedom to their retired members to sell their annuity should they so wish.

If the trustee is able to assign the annuity to the member within the rules of the scheme, then the trustee should be responsible for notifying its members of their right to opt out. Equally the trustees should be clear when members are not eligible, for example when the annuity is owned by the trustees as an asset of the scheme. In such cases we agree a sale should not be possible.

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

We suggest that initially the market is established and developed with basic, single and named joint life, products before considering extending the market further. This could include annuities that originated from a

DB scheme where the annuitant is already the policyholder and the scheme trustees have discharged their liability to the annuity provider.

The more complicated the annuity the more difficult it becomes for the consumer, and for the market participants to play in the market with confidence.

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?

Yes, we believe that the proposals do achieve parity as far as reasonably possible.

With regards to further tax rules, we would propose that no further lifetime allowance test would be required for these funds, since the test would have already been carried out when the fund was originally crystallised. The chance of the proceeds from the secondary annuity sale being more than the original purchase price is very low and, therefore, it could be disproportionate to require a second lifetime allowance test at this time.

As section 3.9 rightly points out, for DC members the reporting requirement regarding Money Purchase Annual Allowance (MPAA) reporting will need to be revised. In the case of a flexible pension contract being purchased with the proceeds, the MPAA should be issued by the new pension provider since the current legislation states that trigger for the MPAA is the first payment of flexible benefits and we see no reason why this legislation should change. In the event of the proceeds being paid as a cash lump sum, it should be the purchaser's responsibility to pay the amount, less tax, and carry out the necessary MPAA reporting.

Assuming that sales would be limited to institutional investors, then we agree that the ongoing annuity payments should be made without deduction of tax.

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

We agree that restrictions should be placed on transactions between connected parties, and believe there should be procedures in place to ensure that proceeds are being paid on to genuine pension schemes, and that the appropriate amount of tax is being deducted when paid out as a lump sum.

A further consideration for this new market is the additional risk of financial crime and money laundering, which has previously been limited within the lifetime annuity market. The new market may enable an annuity to be purchased and then sold shortly afterwards to release 'clean' money. Therefore, it may be necessary of the annuity holder to apply anti-money laundering checks around suspicious transactions, such as a short timeframe between an annuity being bought and sold.

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?

We believe that there should be a threshold above which advice should be mandatory. Care needs to be taken to ensure recent issues with 'false' advice in the DB pensions market are not replicated in this market.

Enabling a customer to access an initial indicative valuation for their annuity before they commit to any fees or advice related to the sale, could act as a trigger based on the valuation, to inform the customer whether advice is required.

Below the threshold, annuity providers must ensure that individuals are aware of the risks of selling their annuity by taking them through the appropriate risk warnings in accordance with FCA Additional Protection. We understand that the FCA plan to revisit the Additional Protection requirements in the summer. We would urge the FCA to consider the secondary annuity market as part of that work.

We would also recommend that the FCA create rules regarding the disclosure on an annuity sale, so that individuals will find it easy to compare like with like, supporting the findings of the Retirement Market Study. Many people that fall below the mandatory advice threshold will not choose to take advice, so it's imperative that the quotations are easy to understand.

If the proceeds of the sale are to be placed into a new flexible contract, the existing disclosure regime should apply to the key features of the new product.

We believe the central mechanism for the sale of annuities in this market outlined in our response to question 13 will help the market apply suitable safeguards for the consumer, and participants.

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

We agree that the remit of Pension Wise should be extended to those wishing to sell their annuity.

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?

We believe that the remit of Pension Wise should be extended to provide guidance to those wishing to sell their annuity. The service has to remain free at the point of access.

The individual should have the freedom to choose their own financial adviser - some may already have an existing relationship with one. The cost of that advice should be down to the individual and the adviser to agree upon and the cost borne by the individual. The quotations would have to reflect this cost of advice if it is facilitated from the sale proceeds.

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 believe this is one of the most crucial elements for HMT to focus on.

To ensure that the customer gets the best possible price we would urge the Government to require that offers to purchase annuity income can only be obtained by an FCA regulated online auction service. Customers would submit details of their annuity and their medical conditions and this information, with other medical information confidentially obtained by the auction service provider, would be circulated to a wide range of potential income buyers with the necessary permissions. This would make the process easy for customers, provide confidence they were not dealing with a fraudulent market participant, and create an efficient place for providers to participate in the market. We would suggest the online auction service has the following characteristics:

- Auction service provider must make all reasonable efforts to ensure the customer achieves the **best possible price**.
- Auction must be **open to all** annuity income buyers with permissions to bid. It must be easy to bid with no upfront charges to place a bid, seeking to ensure the widest possible range of potential bidders make a bid and the individual customer receives a number of quotes.
- A simple underwriting question set for an **initial indicative quotation / valuation** prior to commitment to proceed, which could trigger a notification to the customer that advice is necessary.
- If the customer commits to proceed further, **Guaranteed bids only** – if indicative prices are offered throughout there is a risk that a buyer bids high enough to "win" then finds reasons to justify reducing the price after the auction, to the detriment of the customer. The auction service provider will need to collect all medical evidence and information and then ensure the information meets a sufficient quality standard so that buyers are confident to make guaranteed bids for the income. Making the process as efficient as possible for all involved will ensure that customers achieve the highest price and in the most straightforward way.
- All potential bidders receive the same, **complete information** from the auction service provider.
- If the auction service provider makes an auction fee charge to the seller prior to the auction to pay for the collection of medical information and running the auction then this needs to be a **fair and transparent charge** published on the auction website.
- Auction charges payable by the buyer who makes the highest bid to the auction service provider must be **published online and be common** to all buyers.
- FCA regulated.

We believe it is essential that the FSCS protection provided to the original policyholder is also assigned to the purchaser of the annuity. If this does not happen the financial security of the annuity provider will become a factor in the price that a purchaser will be willing to pay for an annuity.

Without the benefit of FSCS protection the lump sums offered by the market for annuities issued by some providers, for example some unrated monoline annuity writers, are likely to be very low as it will be very hard to price the long term credit risk of the income. The original issuer is likely to be the only company interested in buying the income and so could offer a low amount leaving the customer with a poor value offer – if they go ahead the issuing annuity writer could make a windfall gain at the customers' expense. This is likely to undermine the credibility of the market and lead to complaints from customers.

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?**

It is going to be challenging in some instances to track down dependants. We believe that the proposed government-backed death notification register is the key to resolving these issues.

It is very common that death benefits such as a balance of a guarantee or an annuity protection lump sum death benefit (value protection) are payable at the trustee or provider's discretion. While the individual may nominate a beneficiary, the person to which the benefit will be awarded will only be established at the time of death. It therefore will not always be possible to establish up front who the beneficiary would be in those circumstances.

In the event that a couple become separated but are still legally married, the second life could refuse to give their consent, or claim a share of the proceeds.

The same issues will exist when considering medical underwriting, as the second life would also need to be underwritten.

It's clear that these issues relating to joint life policies are complex, but must be resolved before the market goes live in April 2016, otherwise potential buyers will offer a sub-optimal price for them or avoid them completely.

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?

No, we do not believe that this should be possible. It would be challenging for consumers to fully understand how the offer price has been arrived at, especially if it was much lower than expected.

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?

While we will do our best as a product provider to ensure that our customers are aware that there could be an impact on the means-tested benefits they are receiving (or intend to receive in the future), we cannot determine how an individuals' benefits will be affected.

We note that DWP recently published a leaflet at www.gov.uk/government/publications/pension-flexibilities-and-dwp-benefits which you may decide would also be useful for this market. Guidance on this area could also be a key part of the service provided by Pension Wise.

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

Yes, if the government's aim is to mirror pension freedoms.

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.

We recognise the need for 'due regard' for the groups with protected characteristics identified in Chapter 4. We believe that carefully considered regulation regarding the treatment of dependants and joint lives, alongside the safeguards and controls provided by a central auction mechanism and the requirements for advice, will ensure these groups are considered throughout the development of the market.