The Guardian Financial Services Group ("Guardian") – Response to the Government's consultation paper on "Creating a secondary annuity market" ("Consultation Paper")

The Guardian Financial Services Group ("Guardian") welcomes the opportunity to respond to the Government's consultation paper. Guardian is a closed-fund consolidator, managing pensions, savings and protection policies for over 900,000 European policyholders. Through its UK life insurance provider, Guardian Assurance Limited, the group manages approximately 440,000 annuities in payment.

Guardian fully supports the government's goal of giving increased flexibility to pension annuity holders. However, as the government outlines in the consultation paper, there are many potential issues that would need to be addressed if a well-regulated and efficient secondary annuity market is to be created successfully. Moreover, while Guardian does not believe that there should be any "showstoppers" preventing the creation of such a market, it does believe that introducing all the required changes with effect from April 2016 will prove extremely challenging.

Reponses to specific questions raised in the Consultation Paper

Circumstances in which assignment might be appropriate

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

Guardian believes that the government has, in the consultation paper, correctly identified many of the circumstances in which it might be appropriate for annuity holders to assign their future annuity income.

In practice, the question of whether it is in the best interest of policyholders to assign their annuity could depend largely on the price offered for such assignment. In this context, Guardian notes that there might, in certain circumstances, be a significant mismatch between the price which the annuity holders expect to receive and the actual price that providers are prepared to offer. Thus while some annuity holders might expect there to be a straightforward correlation between the assignment price that they are offered and the original premium that they paid (with the assignment price being based, for instance, on the original premium paid as adjusted to reflect actual annuity payments received), in practice the relationship between the two amounts will clearly be more complex. Thus factors impacting the assignment price are likely to include:

- Longevity expectations in respect to the policyholder, expectations that could be affected not only by specific data relating to his/her health but also general concerns on the behalf of providers regarding the risk of adverse selection;
- Movements in investment markets and interest rates between the date that the annuity was originally purchased and the date on which it is assigned; and
- Expenses associated with the assignment process.

In the event that a secondary annuity market develops, one of the key potential challenges facing both providers and financial advisers will be to articulate clearly to consumers the factors that explain why the "re-sale prices" of an annuity will often appear on first glance to be poorly correlated to the "original purchase price."

Development of the market

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?

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?

As noted elsewhere in our response, Guardian believes that it is very important that effective competition emerges in the secondary annuity market. Clearly allowing a wide range of corporate entities to enter the market would help to facilitate this market.

However Guardian shares the view expressed in the consultation paper that, given the complexity of the product, it would not be appropriate for retail investors to enter this market. Moreover Guardian also believes that steps should be taken to ensure that firms entering into the market have both the expertise required to price annuities appropriately and the skillsets and ethos required to deal with potential customers and other firms in an efficient, fair and transparent manner. In this context we note that, as well as being required to make payments in respect of assigned annuities, market participants will also be required to:

- Take steps to put in place appropriate consumer safeguards, providing suitable risk warnings and, where appropriate, ensuring that policyholders have received financial advice;
- Ensure that payments are made in the appropriate manner – for instance, by arranging for amounts to be paid, where requested, into a Flexi-Access Drawdown Account, rather than being paid directly to the policyholder;
- Comply with all HMRC requirements in respect of payments made to annuity holders; and
- Work with the original annuity providers in ensuring both that payments cease on the annuitant's death and that, if there are delays in ceasing payments, appropriate refunds are promptly made to the original annuity provider.

For these reasons we strongly believe that there should be a process in place under which any firms wishing to enter into the market are required to obtain authorisation from the FCA.

While supporting the development of a competitive market, Guardian agrees with the government's view that annuity holders should not be allowed to access the value of the annuity by agreeing to terminate their annuity contract with their existing annuity provider. This is subject to one caveat.

Guardian recognises that, in cases of very small annuity pots, the "buy-back" price that the original annuity provider could offer might be higher than the assignment price that third-party providers could offer. Administration costs associated with buy-back are likely to be lower than those associated with assignment and it is likely that this cost differential will have a particularly significant impact on the pricing of transactions where the annuities are small.

For this reason Guardian believes that the tax rules should continue to allow buy-back where the annuity falls below a de minimis threshold. In this context, we think that the government should consider replacing the current tax rules which allow buy-back in cases where the commutation payment is £10,000 or less with rules allowing buy-back in cases where the annual income payable under the annuity is below a minimum level. Our view is a rule which operates by reference to capitalised values is potentially confusing for consumers given that, depending on the age and health of the annuitant or prevailing levels of interest rates, it could translate into annuities paying very different levels of benefits. In contrast, a limit that is expressed by reference to annual income should be far easier for consumers to understand.

However, while supporting the retention of buy-back for small pot annuities, Guardian shares the general concerns articulated at 2.15 of the consultation paper regarding buy-backs and, for this reason, does <u>not</u> believe that it would be appropriate for the government at this stage to dispense with size restrictions relating to buy-back, thereby allowing existing annuity providers fully to compete with third-party providers in the secondary annuity market.

As the consultation paper notes, there is a risk that, if the tax rules were to be changed to remove any restrictions on buy-backs, then existing annuity providers could face significant public pressure to provide this service. This pressure would likely to be particularly intense if, for whatever reason, third-party firms are slow to enter the secondary annuity market, meaning that annuity holders who are interested in selling their annuity might effectively be required to look to buy-back by original annuity providers as their best (and perhaps only) option of cashing in their policy. Guardian is particularly concerned that, given the likelihood of any changes being introduced with effect from April 2016, the resultant pressures on annuity providers are likely to be at their most intense when such firms will be fully engaged in implementing new policies and procedures consequent to the implementation of Solvency II. (In this context, we believe that the government is correct to flag the risk that pressures arising from buy-back could make it far harder for firms to obtain full benefit from the matching adjustment rules that apply under Solvency II.)

There is also risk that, as well as potentially creating potential problems for annuity providers, any move to remove the existing restrictions on buy-backs could result in consumer detriment. As the consultation paper notes, it is possible that, if existing restrictions on buy-backs are removed, some policyholders might mistakenly believe that they can only access their new pension freedoms through their existing annuity provider. This could cause bad outcomes for consumers if the existing annuity providers are unable to offer as attractive a price as some third-party providers. (Thus, for instance, some annuity providers might be less well-placed to deal with the risk of "adverse selection" identified at para 2.9 of the consultation paper than third-party providers.) Moreover, even if consumers are aware of their legal entitlement to seek quotes from third-party providers, there is a risk that they would still look to their annuity provider as their default option, particularly if there are delays in the entrance into the market of third-party providers. This, in turn, could potentially result in some consumers entering into "bad deals" with their existing annuity providers in the months immediately following April 2016 when they would probably have received a better price had they waited for a more competitive market to develop in the following months and/or years.

As is clear from our comments above, we believe that some of the risks associated with allowing buy-back could reduce if a competitive secondary annuity market were to develop. Thus the existence of a vigorous competitive market would likely lessen the pressure placed on existing annuity providers to offer buy-backs. Likewise, the development of an efficient, competitive and well-publicised third-party market for annuities should greatly reduce the risk that consumers looking to dispose of their annuity would automatically see "buy-back" by the original annuity provider as the default option. However, while sharing the government's hope that an active market will develop over time, we believe that there is still significant uncertainty regarding both the timing of such a development and the precise form of the market. In this context, we believe that it is far from certain that the bureau-style bidding which some have envisaged as a solution to the potential problems associated with buy-back will actually develop in the near- or even medium-term. Guardian's view is that until there is greater clarity regarding the form of the secondary annuity market, the risks of relaxing the current restrictions on the ability of original annuity providers to "buy-back" annuities would significantly outweigh any potential benefits.

Operational issues

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?

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

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?

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

Guardian believes that the government is correct in flagging the need for consideration to be given to how the death notification issue might best be resolved. A failure to resolve this issue could mean that original annuity providers could pay benefits long after the payments should have ceased (or reduced) as a result of the death of the policyholder(s). While Guardian's thinking on this issue is ongoing, it believes that part of the solution of lies in ensuring that all firms entering the market agree to sign up to certain "rules of play," including making a commitment to ensuring that they will take reasonable steps to establish whether the annuitant is alive and will also, in cases where it emerges that the annuitant has died, arrange for the refund of any over-payment (In this context, we believe that the death notification issue reinforces the need for all market entrants to be FCA-authorised.)

As the consultation paper notes, allowing annuity holders to assign their income to third parties could have significant cost implications for annuity providers. Thus, for instance, there are likely to be costs associated with:

- undertaking due diligence on the potential assignee (although see below);
- re-drafting the relevant contractual arrangements to allow future income to be assigned;
- ensuring that policyholders and their dependents are aware of the risks associated with the assignment;
- arranging for future payments to be made to the assignees; and
- agreeing protocols with assignees regarding procedures and responsibilities for ensuring that payments cease on the death of the original annuitants.

While some of these additional costs will likely arise in-house, there could also be increases in external costs incurred by annuity providers particularly if, as is the case with Guardian, they have outsourced the administration of annuity books to third party administrators.

In practice, the likely level of costs will depend on a number of factors. Thus it appears that the level of costs could vary significantly depending on the type of assignment that is proposed. For instance, as the consultation paper notes at para 4.22, the costs associated with splitting out the income streams from an annuity between those relating to the principal annuity holder and those relating to his/her dependents could be significantly higher than those associated with a more straightforward assignment of a single life annuity. Moreover we suspect that the level of costs incurred is also likely to be heavily impacted by the type of entrants that are permitted to enter into the market. Government action to ensure that only FCA-authorised firms could enter the market might significantly reduce the level of due diligence that the original annuity providers might need to undertake before entering into contractual arrangements with the assignee. Guardian hopes that a requirement that market participants be FCA-regulated might also facilitate the development of standardised documentation, protocols and procedures relating to annuity assignment, a development that could significantly reduce the ongoing costs of such assignments.

In view of the fact that that the potential costs associated with assignment were not anticipated when the insurance company originally entered into the contract with the policyholders, Guardian believes that the originally annuity provider should, under certain circumstances, be entitled to charge costs incurred as a result of assignment either directly to the policyholder or to the assignee. However it fully agrees with the government's view that, should annuity providers seek to pass the costs, then they should under no circumstances be allowed to use their right of "veto" over assignment to charge consumers fees that are unfairly high. We also believe that there should be total transparency regarding the level of fees charged by the original annuity providers. In this context, the government's proposal that it consults with the FCA regarding the level of fees and charges imposed by annuity providers appears sensible.

Guardian primarily provides annuities that are in the name of individual annuity holders and has limited experience of working with occupational pension schemes. For this reason it does not feel qualified to comment as to whether the proposed measures should be extended to cover members of occupational pension schemes. It is also not aware of any other type of products to which it would be appropriate to extend these reforms.

Tax 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?

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

Guardian believes that the general framework outlined in Chapter 3 should achieve parity between those who will be able to access their pension flexibly and those who will be able to access their annuity flexibly. However it notes that, as with the pension flexibility rules, there is a risk that those who seek to assign their annuity income could end up paying tax at a higher rate than they might otherwise have done. Accordingly it believes that a key point highlighted in any guidance should be regarding the need for annuity holders to consider their tax position and, where appropriate, seek professional advice.

Guardian believes that the risk of tax avoidance is highest where transactions are between connected parties. Accordingly it agrees with the government that the focus of tax avoidance measures should be on such transactions.

Consumer safeguards

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?

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

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?

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?

Guardian shares the government's view that it will be of paramount importance that adequate consumer safeguards are in place. Consumers will, in deciding whether or not to assign their annuities, be faced with decisions that are both complex and potentially of great significance to their future financial well-being. Consumers will need guidance and, in most cases, advice if they are to make the decision that is best-suited to their financial well-being.

Guardian believes several sources of information and guidance should be available to consumers wishing to understand the options available to them as a consequence of the creation of a secondary annuity markets. Thus, as in the case of the new pension flexibilities introduced with effect from the 5th April 2015, we would expect both existing annuity providers and potential assignees to supply standardised risk warnings to any policyholders expressing an interest in assigning their annuities. We also think that the government should consider whether it might be appropriate to allow consumers to access guidance through, for instance, an extension of the remit of Pension Wise.

However we believe that customers should, in most cases, be required to obtain regulated advice prior to assigning their annuity. Deciding whether to assign an annuity is potentially an extremely complex decision, one which will require consideration of a large number of factors including its potential impact on the policyholder's general financial well-being, tax position, entitlement to receive means-tested benefits, ability to ensure that his/her dependents are financially-supported, and ability to fund long-term care (if required.) Accordingly, while we think that Pension Wise and the provision of standardised risk warnings might play a useful rule in providing policyholders with general information on the available options, we believe that regulated financial advice will be essential if individuals are to make appropriately informed decisions.

In this context, we appreciate that financial advice can be expensive and that there is a risk that an universal advice requirement could deter some consumers, and in particular those with small annuities, from assigning their policies. For this reason we recognise that there might be a case for exempting those with annuities below a de minimis value from obtaining advice prior to assigning their policies (see below). Nevertheless we would recommend that the government exercises caution in deciding whether, and at what level, such a de minimis exemption should apply. As the government noted in its consultation paper, "for most for most people, keeping their annuity income will be the right decision." We believe that it follows from this that the possibility that an advice requirement might deter policyholders from seeking to sell their annuity should be regarded as a much less serious risk than the possibility that, in the absence of a requirement advice, policyholders might assign their annuities despite the fact that such a step is not in their long-run financial best interests.

In the event that the government does decide to set a de minimis threshold below which advice is not required, we would recommend that the threshold be set by reference to the annual amounts payable. For reasons outlined elsewhere in our response, we think that a rule based on annual incomes would be much clearer for annuity holders and providers than one which operated by reference to an annuities' potential capital value.

With respect to the costs of providing the necessary safeguards, our assumption is that consumers should be able to access some guidance free-of-charge (such as, for instance, guidance provided by Pension Wise.) However we believe that, to the extent that annuity holders either elect or are required to receive regulated financial advice, there is no alternative but for the cost of this advice to be borne by the annuity holder.

Guardian shares the government's view that effective competition will be key to ensuring that consumers can enjoy the best possible prices. The importance of competition is heightened by the fact that, due to the lack of any straightforward correlation between the assignment price and the original annuity premium, it could be very difficult for consumers otherwise to gauge whether the price offered by any provider is fair. However while believing that both the government (through Pension Wise) and original annuity providers (through risk warnings) should encourage consumers to seek more than one quote, we are not convinced that it would realistic to expect annuity holders to obtain more than one quote in all situations. There could, for instance, be some areas of the market which become very specialist, with very few providers operating in them. Thus, for instance, it might be the case that few providers are prepared to offer quotes to policyholders who have serious health problems or whose policies contain unusual provisions in respect of dependant benefits. In such instances, imposing a requirement to obtain more than one quote could prove unduly onerous to consumers.

Protecting the rights of dependants

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

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?

Guardian believes that it is of paramount importance that, should assignment occur, then the rights of dependents be protected. However, while achieving this goal should be relatively straightforward in many cases (e.g. where there is a joint-life annuity with a named spouse), it is concerned that there could be situations in which the position is far more complicated (e.g. annuities with "any spouse" provisions.) We also note that, given the complexities in this area, there is a risk that different annuity providers could adopt different practices. Should this occur then this could obviously create confusion and frustration among annuity holders.

In this context, Guardian believes that it would be helpful if the FCA could issue guidance regarding the types of permission required from dependents in particular circumstances. While such guidance might not cover all contractual arrangements, it could provide annuity providers with assistance in relation to the most common situations. An important benefit of such guidance would be to promote the adoption of common practices amongst annuity providers.

Guardian believes that, while theoretically possible, allowing a principal annuity holder's income to be assigned while dependants retain their own income stream could prove complex (and costly) from a contractual and operational perspective.

Interactions with Means-tested benefits

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?

Guardian believes that standardised risk warnings should be used to ensure that those deciding whether to assign their annuity income are aware of any potential impact on means-tested benefits.

Guardian has not yet developed a fixed view on whether annuitants on means-tested benefits should be able to assign their annuity income. However it notes that, should the government decide to prevent those on means-tested benefits from assigning their annuity income, then consideration would need to be given to how this rule would be "policed." Thus, while original annuity providers and/or assignees would be able to require a declaration from annuity holders that they are not in receipt of means-tested benefits before allowing assignment to occur, they would clearly not be in a position to validate the accuracy of such a declaration.

Impact on groups with protected characteristics

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.

Guardian agrees with the government's view that policy has the potential to impact groups with protected characteristics, given the likely age, gender and disability profile of those who will be likely either to be seeking to assign their annuity income or to be impacted by such assignments.

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