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Private and Confidential
Annuity Consultation
Insurance and UK Regulatory Authorities Team
HM Treasury
1 Horse Guards Road
London
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Date: 12 June 2015

Dear Sirs

Creating a Secondary Annuity Market Consultation

Capita Insurance & Benefits Services ('CIBS') is the UK's leading third party administrator, overseeing 23 million life and pension policies for some of the largest insurers in the UK.

We welcome the opportunity to respond to the call for evidence on 'Creating a secondary annuity market'. Our comments on the questions set out within the paper have been included below.

<u>A new secondary market for annuities (Chapter 2)</u>
The government welcomes views on how it envisages the secondary annuities market working, and its proposed approach on the scope of these reforms

1. In what circumstance do you think it would be appropriate to assign one's rights to their annuity income?
We believe that, if the proposals for a secondary annuity market are to be carried forward, it should be mandatory for providers to allow their annuities to be assigned, subject to sufficiently strong consumer protection measures. This is particularly important if, for example, there is to be no age limit on assignment of annuities and if assignment of enhanced annuities is to be permitted. Allowing providers to choose whether to do so or not, and even to choose which annuity products they will allow to be assigned, would be confusing for consumers and unfair to those holding an annuity that no longer meets (and in some cases, has never met) their needs.

We see no reason why individuals should only be able to take the proceeds as cash or use them for flexi-access drawdown and flexible annuities. If an annuity can be sold for cash, to prevent the individual from using it instead to secure an alternative retirement income would seem to undermine the principles of pension provision. Where annuitants' circumstances have changed, they may have good reasons for changing their traditional annuity from one type to another. For example, an annuitant who has married after retirement or who wants to provide for a non-dependent successor may wish to exchange a single life annuity for one on a joint life basis. Alternatively, this flexibility could be achieved by allowing annuity holders to switch within the same product.

Partial assignment or encashment should not be permitted.

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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 this type of investment is unsuitable for direct retail investment, and should be restricted to firms, investment funds and other institutional investors that are appropriately regulated. However, we believe that indirect retail investment should be permitted: for example by allowing a consumer to invest in funds holding secondary annuities as an asset.

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 there is a strong argument for permitting insurers to buy back their own annuities. The concept of buyback is much easier for the consumer to understand than a traded annuity market, and the consumer may be able to obtain better value from their current provider. This may be the case even if the provider does not offer a better price for the annuity, as third party investors may levy additional fees or charges that will reduce the amount the customer receives, particularly if the market operates through intermediaries. Furthermore, we believe this is better aligned with the principles of offering a wider choice as to what consumers can do with their retirement benefits.

Paragraph 2.15 of the consultation paper argues that buyback could undermine the solvency of firms. We believe this to be unlikely, since providers are required to set aside reserves for annuities and will be able to release those reserves if a significant demand for buyback reduces the value of their annuity business. We would expect the impact of buyback on the annuity market to be similar to that of pensions flexibility: until the April 2015 changes were announced, providers had expected 75% of most pension funds to be used to purchase an annuity and it is already clear that this pattern is changing.

Whilst we acknowledge the concern that buyback may lead to customer disengagement, by giving the impression that there is no other option, this could be overcome through appropriate consumer protection measures. Our views on consumer protection are considered in more detail in our answer to question 16.

If a decision is made not to permit buyback, we would like some clarification as to how this ban is intended to apply. For example, would it also prevent annuities being purchased by another company within the same group as the annuity provider?

As an alternative to buyback, the trivial commutation rules could be extended to increase the commutation limit for annuities in payment and/or to give consumers the right to cash in very small annuities with their current provider (rather than leaving it to the insurer's discretion). We understand this would be reversing amendments in the Taxation of Pensions Act 2014, but for money purchase crystallised funds it would seem a sensible alternative approach.

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 the issue?

Consumers will have no vested interest in keeping the existing annuity provider advised of changes in their circumstances once the annuity is assigned. If annuity providers cannot keep in touch with them, establishing whether they are still alive will become increasingly difficult over time. We do not believe the proposal for a 'split' annuity, where a nominal amount continues to be paid to the original annuitant, would be practical or cost-efficient.

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If the annuity provider no longer has an ongoing business relationship with the original annuitant, the implications from a data protection point of view need to be considered. For example, will providers still be permitted under that legislation to hold information about the annuitant and to enquire about their ongoing existence? When the annuity is assigned what obligations will be on annuity providers to provide data to third parties about the annuitant, including personal data?

The concept of stopping the annuity at a certain age is similar to existing practice, whereby some providers will cease an annuity if they have not had confirmation that the annuitant is still alive within a given timeframe. However, this practice results in complaints and, in a secondary annuity market, may impact the price the customer can obtain (because there is a risk that in a proportion of cases it will not be possible to establish whether the life assured is still alive and so reinstate payments). This could result in poor value to those consumers in good health with greater life expectancy.

Our view is that a government-owned central death register is the best solution, although there is scope for the government to establish this through a commercial organisation; for example, a tracing company. Such public registers are already available to a limited extent, if the enquirer knows where the individual died.

A central register could deliver savings to insurers by providing a simple and efficient means of reducing annuity overpayments and the costs of establishing continued existence of the annuitant. It would therefore not be unreasonable to charge providers a levy for using the register, to cover the cost of setting up and maintaining it.

A central register would also deliver other benefits, such as making it easier for providers to check whether individuals who retain their existing annuity are still alive; in enabling a wide range of financial services providers to better manage untraced client assets; and in preventing identity theft.

5. Do you agree with the proposed approach of the government working with the FCA regarding the fees and charges imposed by annuity providers?
Yes, in the interests of consumer protection. However, the FCA is not a price regulator and we do not believe it would be appropriate for it to set a fee cap. To do so could stifle competition and thus have an adverse impact on consumers by driving down the price they can obtain for their annuity. The FCA's role should be to monitor fees and charges to ensure they are fair, as it already does in other areas of the financial services market.

In addition, the costs imposed by third parties in an offer to an annuitant who wishes to give up their income stream from the annuity provider should also be monitored.

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?
We would support inclusion of annuities held by occupational pension scheme trustees, although we have some concerns about trustees' fiduciary duties and the amount of protection afforded by the statutory discharge. Trustees can choose to buy a scheme pension or annuity for the member, or to pay an uncrystallised fund pension lump sum, so it seems arbitrary to exclude the option to cash in the annuity. Paragraph 2.26 describes annuities in the name of the trustees (which is not that common for DC trust-based schemes) and an assumption that the income stream is paid from the annuity provider to the scheme; in our experience, despite the product not being in the name of the member, the annuity provider would still pay the member direct in most cases.

However, we believe there could be an argument for excluding annuities that include a Guaranteed Minimum Pension (GMP) built up during periods of contracted-out employment, if practical difficulties could be overcome. Although in such cases the annuity will have been set up to meet the minimum GMP requirements, annuity providers do not commonly retain a record of the GMP element on their system once the annuity is set up and so may not be able to easily identify which annuities include GMP. We believe it should be the responsibility of the party purchasing the annuity to establish that it does not include GMP, by obtaining relevant paperwork from the annuitant and, where necessary, confirmation from the originating scheme.

7. Are there any other types of products to which it would be appropriate for the government to extend these reforms?
We believe deferred annuity contracts that are not yet in payment should also be included in scope, since consumers' reasons for wanting to cash these in will be similar to those for annuities already in payment.

This can already be effectively achieved by transferring the deferred annuity to a new pension scheme that will then pay an UFPLS, which is unnecessarily complex for the consumer and incurs two lots of transaction costs.

We would welcome clarity on whether the sale of annuities will be available to those who purchase their annuity on or after 6 April 2015, as well as to those who were already in receipt of an annuity before that date. Clarity is also needed on whether there is to be any limit on the number of times an annuity can be assigned, for example if an investor wishes to sell on an annuity to another party in order to rebalance their portfolio.

<u>Legislative changes (Chapter 3)</u>
The government welcomes views on how it proposes to change the tax rules relating to the assignment of annuity payments. In particular, the government would welcome views on the following:

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 money purchase annual allowance should apply once the annuity has been assigned or sold back to the provider, to make it consistent with other flexible pension options.

One practical consideration is that, where the individual opts for a taxable lump sum in exchange for the annuity, the organisation making the payment will need to deduct PAYE at source. Many of these organisations will have neither the infrastructure nor the experience required to operate PAYE and will incur significant costs in setting this up, either in-house or through an external payroll operator. This cost is likely to be recouped from the customer either through fees and charges or by reducing the price offered for the annuity. The taxable lump sum would also need to be classed as a new 'authorised payment' under the tax legislation.

The proposals do not mention any timescales following assignment for the member to use the lump sum from the third party to operate flexi-access drawdown or purchase a flexible annuity. Is it the intention that this transaction should happen within a certain time period?

9. How should the government strike an appropriate balance between countering tax avoidance and allowing a market to develop?
The government needs to set out a very clear framework and rules for the new market, with sufficient opportunity for regulators and firms to be able to comment fully on the rules and to allow time to bring the rules into play.

Consumer protection (Chapter 4)

The government welcomes views on how it proposes to ensure consumers are appropriately informed when making decisions relating to the assignment of their annuity income. In particular, the government welcomes views on the following questions:

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?

Annuitants should be given sufficient information to make an informed decision, while taking care not to create a barrier through overload.

In most cases, they should be required to take advice before assigning their annuity or before taking buyback, if it is to be permitted. With the experience of recent pension reform changes, careful consideration should be given to how such advice (if required) is provided, especially if a 'free' service is intended. However, where the annuity is very small the costs of advice are likely to far outweigh any benefit to be gained and so we believe it would be appropriate to set a minimum value at which advice should be mandatory. This de minimis level could be set at £30,000 for parity with pensions flexibility. However, it may be more appropriate to set it at the level at which means-tested benefits would be lost or reduced, since the sale of an annuity will have a direct impact on many claimants.

Tailored risk warnings should apply on the same basis as for pensions flexibility under the FCA rules for those who do not take independent advice.

We believe that a benchmark would be of limited value, because there are so many factors that can influence price, especially the health of the primary and any secondary annuitants. Furthermore, benchmarking is difficult to achieve in a new market because of the time taken to gather sufficient data, and it is unlikely to be practical to obtain historical data.

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

While it may be simpler for the annuity provider to deliver information and warnings about cashing in an annuity, the annuity provider will not be a party to the assignment and may not know it is taking place early enough to deliver the warnings, unless there is a statutory obligation on the customer or the purchaser to notify them.

This could be overcome by requiring the provider be a party to the assignment - this at least makes sure they know about it before it is concluded, but adds to the cost and could therefore impact the amount the customer receives.

Furthermore, it seems unfair to force responsibility for implementing these safeguards onto providers, since they will already have additional costs in dealing with the assignments. They will be unable to recoup those costs, as they get no benefit from the assignment, and those additional costs should therefore be kept to a minimum. If it is to be optional for insurers to allow their annuities to be assigned, we believe these extra costs could be a strong disincentive for them to participate.

Experience to date with pension flexibility suggests that around half of independent advisers are refusing to give advice where it is a statutory requirement (i.e. for transfers or conversions from safeguarded to flexible benefits), through fear of future complaints about poor advice. Sale of annuities is a new and potentially more complex arena, and it may be difficult for consumers to get advice for similar reasons. The government will need to make it easier for IFAs to get involved, by setting a clear framework, especially in relation to the approach to be taken by the Financial Ombudsman in relation to any such complaints. Any determinations based on a retrospective view must be avoided.

We believe it is too early at this stage to involve Pension Wise in the process – the service is very new and needs time to embed its current processes before taking on any further responsibility. However, consumer information about sale of annuity contracts should be made available on the Money Advice Service website, with links from the Pension Wise website.

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, the cost should be borne by the annuity holder. This achieves parity with existing requirements for pensions flexibility and it would be unfair to expect the annuity provider to pay, since they will gain no benefit from the sale. There is no advantage in making the purchaser pay, because they will simply pass the cost on to the consumer through fees, charges or a reduced purchase price.

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?
If the individual seeks independent advice, this should not be necessary, since the adviser should obtain and consider a variety of quotes and options and guide the customer accordingly. The FCA should set rules for advisers and create new permissions that determine the skill set required to deliver appropriate advice.

However, where advice is not required or sought, the consumer should be required to obtain a minimum number of quotes from different market participants, including a quote for buyback if permitted. This would highlight the benefits of shopping around, and would also overcome one of the stated objections to buyback, that the customer may opt for buyback in ignorance of any other option.

Competition has to be market-driven, but the government can help by striking a sensible balance between protection and prescription, and by making the boundaries clear.

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 civil partnership?***
- ***Are there specific equality impacts that should be considered in this context?***

The approach to dependants' rights should be consistent, so that all providers protect dependants' interests in the same way. It should not be left to each to decide how they will tackle this, since this will result in confusion and unfairness to dependants. We therefore agree that the government or FCA should issue guidance.

However, any prescribed process should take into account that there are situations where it may not be practical to obtain dependants' consent to an assignment or buyback. For example, some annuity contracts provide benefits for an unnamed spouse and will be paid to whoever the primary annuitant is married to at the date of death, which may be a different person to the spouse at the date of assignment.
Very clear guidance is also needed on the impact on settlements in the event of divorce or dissolution of a civil partnership. For example:

- What measures might be put in place to prevent circumvention of an existing earmarking order, by cashing in the annuity that has been earmarked?
- Will an ex-spouse be able to cash in their share of an earmarked annuity once it is in payment?

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 believe a consistent approach is needed to protect dependants – it should not be left to providers to determine how they will do this.

Allowing the principal annuitant to assign only their own rights will add a great deal of complexity to the assignment and to ongoing administration of the annuity. It also raises further questions around whether the dependants should then be permitted to assign their rights, either before or after the principal annuitant has died. We therefore believe that the simplest solution would be for any known dependants to be a party to the assignment.

16. How can the proposed consumer protections for the assignment of annuities ensure that any impact on means-tested benefits is understood by those deciding whether to assign their annuity income?
A clear statement is needed from the DWP on the impact on means-tested benefits. The system is opaque and it is already very difficult for customers to understand what they are entitled to, without the added complication of annuity assignment.

Consideration needs to be given not only to the impact on current claimants, but also to the potential for abuse of the system by future claimants. For example, individuals could deliberately cash in their annuity and spend the proceeds, to enable them to qualify for benefits.

17. Should those on means-tested benefits be able to assign their annuity income?
Yes, provided they have received sufficient information and guidance to understand what the implications are and provided there are measures in place to prevent abuse of the system as referred to in our answer to question 16.

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.
Unless individuals can only assign their own rights under an annuity contract, dependants could be disadvantaged, and most dependants of existing annuitants are women. In particular, the impacts on provision for divorce and dissolution of civil partnerships must be given careful consideration, as referred to in our answer to question 14.

We believe there is a risk of undue influence by beneficiaries on more vulnerable annuitants, such as those suffering from dementia. These annuitants could be persuaded to cash in annuities in order to increase the size of the estate for those beneficiaries, who may not receive anything if the annuitant dies while the annuity is still in payment. Guidance would also be needed on whether third parties, such as someone holding Power of Attorney, can assign an annuity on behalf of the annuitant.

Measures should be put in place to ensure that those annuitants in social care cannot be forced to sell their annuity to fund that care. Similarly, individuals going through bankruptcy or divorce proceedings should not be forced to sell their annuity.

Yours sincerely

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