Establishing new regulated activities for the secondary market in annuities

HM Treasury

RPC rating: fit for purpose

Description of proposal

In April 2017 the Government will remove the existing tax restrictions that deter many annuity holders from selling their annuities for a lump sum. This will create a secondary market in annuities that does not currently exist. HM Treasury proposes to regulate for the first time the following three activities in the secondary market in annuities:

- intermediation of the sale of an annuity;
- buying back an annuity; and
- buying an annuity income stream by way of assignment.

The proposal requires all firms that wish to carry out one of these new activities to obtain permission from the Financial Conduct Authority (FCA). This is intended to ensure that the FCA can effectively monitor and supervise the secondary market for annuities.

The FCA's April 2016 consultation document 'Secondary Annuity Market – proposed rules and guidance' notes that the tertiary market (subsequent trade in annuities after they have been sold by annuity holders) will be regulated by the FCA under pre-existing Financial Services and Markets Act 2000 (FSMA) rules.

Impacts of proposal

Costs to business

HM Treasury explains that the only costs to business of the proposal arise from the requirement to apply to the FCA for a variation in permission to carry out one or more of the newly regulated activities. The activities described are already regulated by the FCA within their regulation of designated investment business, so under the 'do nothing' option firms would continue to be subject to those rules and guidelines. Further, the *additional* costs under the proposal from applying for permission to carry out one or more of the newly regulated activities are only incurred by currently FCA-authorised firms, as opposed to new entrants and firms not currently authorised by the FCA. This is because new entrants to the market who are currently not regulated by the FCA already have to apply for full FCA authorisation to carry out these activities and incur the same associated costs as under the proposal.

Based on evidence from industry and the FCA HM Treasury expects:

- 9 existing firms to apply for permission to intermediate in the secondary market in annuities;
- 10 firms to apply for a variation in permission to buy back annuities; and
- 20 firms to apply for a variation in permissions to purchase annuities as a third party.

HM Treasury expects all existing firms who wish to participate in the market to choose to apply for permission in the first year of the secondary market in annuities, 2017 and that few firms will seek to enter in subsequent years. This is based on the assumption (certified by the Office for Budget Responsibility and used in other costings) that the majority of consumers will seek to sell their annuities in the first year of the market.

HM Treasury explains that FCA application fees for permissions will vary depending on the regulated activity the applicant is intending to carry out. Applying to be an intermediary will be treated as a 'straightforward case' with a fee of £750, while applying to buy back an annuity income or buy an annuity as a third party is expected to be treated as a 'complex case' with a fee of £2,500. Therefore, the total cost to business will be £6,750 for the 9 firms expected to apply to be an intermediary, £25,000 for the 10 firms expected apply to buy back annuity incomes, and £50,000 for the 20 firms expected to apply to buy annuities as a third party, which is assumed to include the 10 annuity providers applying for permission to buy back their annuities.

Firms will also incur administrative costs from completing applications. HM Treasury expects completing an application to act as an intermediary in the secondary market to take 2 days, while applications to buy back annuities or to purchase annuities as a third party are expected to take 5 days. It is expected that submitting applications will take a further 12.5 hours and 30.5 hours respectively. Using a mid-level professional salary of £28,000 uplifted for non-wage labour costs, this results in administrative costs for firms of £340 and £820 respectively. This results in estimated administrative costs for the 9 firms applying to be an intermediary of £3060, estimated administrative costs of £8200 for the 10 firms expected to apply for permission to buy back annuities, and administrative costs of £16,400 for the 20 firms expected to apply to purchase annuities as a third party.

The total cost to business of the proposal is therefore estimated to be £109,410.

Benefits to business

HM Treasury expects the proposal to benefit firms by contributing to a strong regulatory framework that can mitigate risks in the secondary market in annuities and the wider financial services industry.

Wider benefits

HM Treasury expects the proposal to improve the supervisory capacity of the FCA regarding the secondary market for annuities, which is an area of particular consumer protection concern. This is expected to improve the standards in the market by improving compliance with market rules and guidance and to enable the FCA to take regulatory action against misconduct, which may in turn reduce the likelihood of consumers underestimating the value of their annuity income or becoming victims of investment scams.

The RPC verifies the estimated equivalent annual net direct cost to business (EANDCB) of £0 million. This will be a qualifying regulatory provision that will score under the business impact target.

Quality of submission

HM Treasury explains that the secondary market for annuities will be a new market; therefore, there is considerable uncertainty as to the number of firms interested in purchasing annuities or operating as intermediaries in the market. However, the impact estimates have been formed in consultation with FCA and industry and the IA presents sensitivity analysis covering a reasonable range of expected impacts.

The IA would benefit from providing further discussion of the basis for the assumption that all existing firms wishing to participate in the market will apply for permission in the first year of the market, 2017, even though the evidence presented suggests that this is not likely to significantly affect the EANDCB. The RPC notes that this assumption implies that the consumer protection benefits will also only be felt in the first year of the appraisal period.

Small and micro business assessment (SaMBA)

HM Treasury explains that the majority of firms expected to enter the secondary market in annuities will be large firms. It is expected that some small and micro businesses will be interested in applying to be intermediaries in this market. However, HM Treasury explains that exempting small businesses from the requirement would limit the FCA's ability to carry out its regulatory functions across the whole market. This appears reasonable.

Departmental assessment

Classification	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£0 million
Business net present value	-£0.11 million
Societal net present value	-£0.11million

RPC assessment

Classification	Qualifying regulatory provision (IN)
EANDCB – RPC validated[1]	£0 million
Business Impact Target (BIT) Score[1]	£0 million
Small and micro business assessment	Sufficient

Michael Gibbons CBE, Chairman

[1] For reporting purposes, the RPC validates EANDCB and BIT score figures to the nearest £100,000.