THE SOCIETY OF PENSION PROFESSIONALS
leading pension thinking

Email: Annuity.Consultation2015@hmtreasury.gsi.gov.uk

Annuity Consultation
Insurance and UK Regulatory Authorities Team
HM Treasury
Horse Guards Road
London SW1A

Our Ref: JM/JB/4.7 June 16th 2015

Dear Sir or Madam,

CONSULTATION ON CREATING A SECONDARY ANNUITY MARKET

We welcome the opportunity to contribute to the above consultation.

INTRODUCTION TO THE SOCIETY OF PENSION PROFESSIONALS

SPP is the representative body for a wide range of providers of advice and services to work-based pension schemes and to their sponsors. SPP's Members' profile is a key strength and includes accounting firms, solicitors, insurance companies, investment houses, investment performance measurers, consultants and actuaries, independent trustees and external pension administrators. SPP is the only body to focus on the whole range of pension related services across the private pensions sector, and through such a wide spread of providers of advice and services. We do not represent any particular type of provision or any one interest - body or group.

Many thousands of individuals and pension funds use the services of one or more of SPP's Members, including the overwhelming majority of the 500 largest UK pension funds. SPP's growing membership collectively employs some 15,000 people providing pension-related advice and services.

This consultation document has been considered by SPP's Actuarial, Defined Contribution, Investment and Legislation Committees, which comprise representatives of actuaries and consultants, investment houses, pension lawyers and product providers.

The Society of Pension Professionals was previously known as the Society of Pension Consultants (SPC).

GENERAL COMMENTS

1) We consider that the proposals in the consultation document might in principle be most likely to be helpful to:-

   - Holders of annuities for small amounts, with other sources of income. (However, particularly if the original annuity provider is not permitted to buy back the annuity, there might prove to be a limited market for smaller annuities.)

   - People with significant debt, attracting high interest charges, for whom selling an annuity to pay off debt, despite the associated risks and costs, might on balance be the best option.

2) We agree that annuities sold into the secondary market could help to meet a demand from institutional investors for instruments providing a predictable income stream, although we are not sure that enough annuities would be sold to make a meaningful impact on this demand.

3) We would expect that insurance companies would only be significant buyers of annuities in the secondary market if they were able to be taken into account in assessing their solvency. It is not clear that an insurer could use the income from another insurer's annuity book to back its own annuity liabilities.

The Society of Pension Professionals
St Bartholomew House, 92 Fleet Street, London EC4Y 1DG T: 020 7353 1688 F: 020 7353 9296
E: info@the-spp.co.uk www.the-spp.co.uk

A company limited by guarantee. Registered in England and Wales No. 3095982

4) Overall, however, we consider that the proposals for creating a secondary annuity market carry considerable potential risk and costs for potential sellers and for the reputation of retirement provision more generally. We therefore suggest that, if it is decided to proceed with the proposals, this is done in a cautious way, with robust safeguards.

5) Without robust safeguards, the proposals could give rise to significant consumer detriment arising from poor value in exchange for sold annuities. Potential sellers might have reached a stage in life when their ability to make possibly complex decisions associated with selling an annuity is less acute that it was. The outcome could be reduced public confidence, and a reduction in levels of retirement saving at a time when increasing those savings is a policy imperative.

6) We suggest that buyers of annuities in the secondary market should be regulated. We assume that there would be intermediaries between sellers and the ultimate buyers and we suggest that these intermediaries would also need to be regulated.

   We assume that regulation would be by FCA.

7) The risks to contingent survivors of annuity holders would also need to be fully considered, since selling an annuity could deprive them of income in due course, possibly without them even being aware of this.

8) We expect that annuity holders would need to meet significant costs in selling an annuity into the secondary market. The costs would potentially arise from:-

   - Rewriting policies
   - Tracking the survival of insured lives following the surrender of a policy
   - Underwriting the health of those selling annuities
   - Providing advice to people considering selling an annuity

9) It would need to be decided how the principle of insurable interest would apply to annuities sold into the secondary market. If the buyer of the annuity acquired an insurable interest in the life of the seller, how would this work in practice? For example, would it be possible to agree binding contracts on end of life decisions, for example Do Not Resuscitate instructions, in order to protect the buyer of the annuity?

10) There might be greater attractions among annuity holders in a facility to reconfigure an annuity, rather than to sell it outright. For example, possibly adding a dependant, if marriage occurred after retirement, or exchanging an increasing annuity for a lump sum and a level annuity. One could also consider the possibility of allowing some element of an annuity to be given up in exchange for a lump sum benefit paid to the annuitant's estate on death, on the assumption, as the consultation document suggests, that one reason for considering selling an annuity would be to leave some form of inheritance.

    On the other hand, for annuity providers, there would be costs and changed risk and almost certainly some form of underwriting to avoid being selected against. Also annuity risks must be backed in balance sheets, so reconfiguration would potentially change the assets needed for this. If providers have reinsured their annuity liabilities, reconfiguration might not be practical for this reason.

11) The opportunity for annuity holders to enjoy good outcomes should be supported by informed decisions and annuities remain an appropriate option for many. Any extension of the new freedom and choice to those who had already secured an annuity needs to avoid generally reinforcing the perception that annuities automatically represent poor value. Any extensions of flexibility should be balanced by steps by the government to raise awareness of the value of a secure income for life.

RESPONSES TO THE CONSULTATION QUESTIONS

We consider that the government should seriously consider whether to proceed with implementing these proposals at all, but, if it does decide to proceed, given what we expect will be significant resource pressures on both the Treasury and DWP, we suggest that bringing these proposals into effect should not be a high priority.

We hope that the following responses to the consultation questions will be of additional assistance in deciding the way forward.

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

We envisage that the number of cases, in which it would be appropriate to assign rights to annuity income would be very limited, but paragraph 2.4 of the consultation document accurately summarises the circumstances, in which assignment might be appropriate.

Question 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 it is more likely that a wide market will develop if a wide range of suitably regulated corporate entities are permitted to purchase annuity income.

We also agree with the proposed exclusion of retail investment. The question refers to restriction, but the consultation document seems to indicate that retail investors would be excluded.

To protect sellers, it would be essential to have a strong regulatory framework to apply to buyers and intermediaries.

Question 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? If you think "buy back" should be permitted, how should the risks set out in chapter 2 be managed?

We consider that this aspect of the government's proposals should be reconsidered.

The consultation document persuasively sets out why allowing an annuity holder to sell his or her annuity would have to be a voluntary decision of the annuity provider in every case. We are not convinced, on the arguments set out in the consultation document, that there is a particular risk that annuity providers will come under extra pressure to buy back annuities, which they have themselves issued.

At the same time the consultation document recognises the potential benefits, in terms of reduced costs and risks, to annuity holders, in allowing them to access the value of their annuity by agreeing to terminate their contract with the original provider. For the annuity holder, barring the annuity provider from buying back might exclude access to the most favourable terms, which the provider might be best placed to offer if market competition was not restricted.

The consultation document refers to the possibility that allowing annuity providers to buy back their annuities could also result in some consumers falsely believing that they could only use the proposed new freedoms through their existing annuity provider. This might be a risk in some cases, but it ought to be possible, through regulation of the annuity provider and a requirement for appropriate advice for the potential seller, to address this risk.

In practice, if annuities are bought in bulk, it might be difficult in any case for annuity providers not inadvertently to buy back some of their own annuities as part of a bundle.

Question 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?

It would simply not be practical without incentive to rely on the original annuity holder's family or estate to notify death and indeed the earlier assignment of the annuity might conceal its existence from those dealing with the death. Such notification would remain fundamental to any solution delivered by market participants, despite the incentive to the annuity provider to cease payment.

The consultation document suggests that establishing a central "death register" would be a disproportionate response for what the government anticipates will be a relatively niche market.

We agree that, if these proposals are proceeded with, there is likely to be only a niche market, but the death notification issue already exists and a central death register would be of assistance not only in the context of a secondary market in annuities, but in avoiding overpayments of State and occupational pensions.

Question 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 with the government's proposed approach to fees and charges.

Question 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?

From the point of view of individuals, the proposal to restrict the measures in the consultation document to annuities in the name of the annuity holder and held outside an occupational pension scheme is likely to appear arbitrary.

We therefore suggest that in principle the measures should certainly apply to <u>any</u> annuity bought with a defined contribution pot.

We also suggest further consideration of the rationale for excluding defined benefits now secured in the name of the member. How in principle would a sale of these benefits differ from a defined benefit to defined contribution transfer? Additionally, we are not sure whether annuity providers would always know whether the benefit arose from defined benefit or defined contribution.

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

It would be helpful to have clarification of whether deferred annuities, Retirement Annuity Contracts and annuities with guaranteed rates would be within the scope of the proposals.

Question 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?

The design outlined in chapter 3 would achieve parity of <u>tax</u> treatment between those who will be able to access their pension flexibly and those who will be able to access their annuity flexibly.

However, it will not be possible to achieve <u>financial</u> parity because of the margins, which will have been applied to annuity holders on the original annuity purchase and the additional margins, which would be applied if they sold their annuity.

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

The consultation document gives two examples of possible tax avoidance risks, to which the proposals give rise, but it is difficult to answer this question in the absence of full details of where the government considers tax avoidance risks to lie.

The government should also acknowledge that sellers of annuities could be subject to a form of double taxation if their original annuity was a purchased life annuity, purchased from already taxed income, and they were then taxed on the proceeds of the sale of their annuity.

Question 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?

Selling an annuity into the secondary market is in effect exchanging a defined benefit (with a guarantee almost always stronger than under an occupational pension scheme) for a defined contribution pot. So advice requirements at least as strong should apply as for transfers out of defined benefit schemes in order to make use of the Freedom and Choice flexibilities, including a minimum annual, amount of annuity, above which advice would be mandatory.

Given that some of the older people considering selling their annuity are likely to be vulnerable consumers, one could argue that the requirements ought to be stronger.

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

As stated in our response to question 10, we consider that the key consideration is that advice, rather than guidance, would be appropriate.

Question 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 agree that the costs of any advice or guidance should be borne by the annuity holder.

Question 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?

Some form of requirement to obtain a minimum number of quotes might be appropriate, if the challenges of establishing a benchmark "selling price" (discussed paragraph 4.17 of the consultation document) cannot be overcome cost effectively but this will largely depend on the actual number of market participants if the proposals are proceeded with.

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

The government recognises the vulnerability of dependants under its proposals and we consider that it has correctly identified that annuity providers might well be unwilling to agree to the sale of an annuity unless they are satisfied that dependants consent to the sale.

As the consultation document acknowledges, accurately identifying the contractual position of dependants at the point of potential sale would be extremely important. It needs to be recognised that a dependant is not a party to an annuity contract until benefits actually come into payment.

We would expect annuity providers to want to be satisfied that the interests of all beneficiaries have been properly protected, including minors and former spouses or civil partners.

The practicalities of applying these proposal to attachment orders would be formidable, as they would also be in the case of annuities providing for a refund of original payments.

Question 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 agree with the government's assessment, that separating out the rights of primary annuity holders and dependants may well prove costly and difficult contractually.

Even if it proved to be technically feasible, we are not sure that it would be tenable to have a secondary market when different annuity providers had different arrangements for dependants' income streams.

Question 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?

This is a complex area and it is difficult to be confident that the proposed consumer protections will be able to ensure that the impact on means tested entitlement is understood by all those considering whether to assign their annuity income.

The same underlying concerns apply to the existing Freedom and Choice flexibilities.

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

We have no comment.

Question 18: What are the likely impacts of the government's proposals on groups with protected characteristics?

As previously indicated, we consider that a group with protected characteristics, most likely to be at risk from the proposals, are older people.

While we are not experts on disability, but we suggest that disabled people might be another group at risk.

We understand that disabled pensioners might be more likely to be financially pressed than other pensioners, and may have particular concerns over their own life expectancy. They might also be at risk of receiving a lower annuity valuation (by virtue of “being disabled”) that is not necessarily supported by the particular medical circumstances/evidence relating to their specific condition.

Yours sincerely

John Mortimer
Secretary