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Response by the Financial Services Consumer Panel to the call for evidence on creating a secondary annuity market

This is the response of the UK's Financial Services Consumer Panel to the Treasury's call for evidence on creating a secondary annuity market. The Consumer Panel provides advice and challenge to the UK's Financial Conduct Authority (FCA) on the extent to which the FCA's general policies and practices are consistent with its general duties. The Panel represents the interests of all groups of financial services consumers and operates independently of the FCA.

The Panel understands the government's desire to extend the freedom and choice allowed by the 2015 pension reforms to individuals who purchased an annuity prior to the reforms being introduced. However, unlike the pension freedom reforms, the successful implementation of this initiative requires the development of an entirely new and untested market. To date there has been little time to consider thoroughly what such a market might look like and, vitally, how it might offer fair value to consumers.

The Panel feels strongly that such a radical proposal should not be introduced without robust analysis to ascertain the impact on the supply and demand for annuities in the primary market and the money's worth of those sold in the secondary market. Annuities are not necessarily a 'bad' decision. The FCA's research shows that consumers like the option of a guaranteed income for life – it is purely the name 'annuity' that carries with it the perception of poor value.

Moreover, the consultation paper acknowledges that, for most people, keeping their annuity income will be the right decision. Given this, and the currently confused thinking on what type of advice might be available to help consumers with this complex decision, the Panel feels strongly that thorough analysis and research is needed to consider whether a secondary annuity market should be developed at all.

It would be helpful to simulate a secondary market, and the impact on the primary market, using a representative spread of existing annuitants, existing providers, potential purchasers (asset managers, pension funds etc), as well as financial advisers and other distribution channels.

Undertaking such an analysis would be likely to delay the implementation of a secondary market beyond April 2016, but the Panel's view is that delay is preferable to allowing an uncompetitive market to develop that offers poor value to the majority of its potential customers, and attracts individuals who should not be its customers at all.

The Panel has serious concerns that the proposals as they stand now will lead to consumers suffering great detriment. For example:

- 1 As the Treasury notes in the consultation, it is questionable whether the average seller would be able to evaluate value for money. Sellers would be exposed to the risk of

predatory pricing. The remedies proposed are untested and likely to be ineffectual. The historic record of regulation in this market does not inspire confidence.

- 2 For buyers there is the fear of adverse selection. The seller may be presumed to have inside knowledge of his or her mortality, depressing the price. An 'Akerlof lemons' market syndrome could develop. Long life annuitants could be put off selling by the average low prices on offer in the secondary market, which would be increasingly dominated by those with presumed inside-knowledge of short life expectancy, leading to a further drop in prices and a market collapse.

Another important issue is how consumers will get the advice they need to determine whether they should sell their annuity at all and if they do, whether the price being offered is fair.

The Chancellor states in the introduction to the paper that "the government will work with the Financial Conduct Authority to consult on how best to support people's choices through consumer protection, and protect those who are most vulnerable".

However, the Panel believes there is currently no market solution to the question of how adequate advice and support can be provided to consumers, irrespective of income level, to help them assess whether they are being offered a fair price for relinquishing the right to such a valuable asset. Regulated financial advice may be available, but at a high price. The call for evidence says that it is unlikely advice will be mandatory, as to force people to pay to be told they shouldn't transact seems perverse. And let's be clear, in most cases any reputable financial adviser would recommend that the annuitant should not sell.

So how will the government work with the FCA to support people? One answer might be to extend the scope of Pension Wise so that free, impartial advice (and it is advice – not guidance) is provided through this service. This would mean existing Guides being equipped with the same level of knowledge and experience that regulated financial advisers possess in order to assess an individual's position correctly and provide a recommendation for action. Consumers would also have to have access to redress in the same way they would if they took regulated advice. Guidance with no responsibility and the absence of a clear recommendation – as with the current Pension Wise service – will not do for this decision.

The pension freedom reforms have had little time to bed in, and the impact on the market has not been assessed. There has also been no assessment of the Pension Wise service (indeed even the number of sessions held has not been published to date). But early, anecdotal, information seems to show that consumers are not accessing the service, but going straight to their providers demanding their money.

Surely this behaviour is likely to be replicated when consumers are told they can sell their annuities?

We have answered the consultation questions where we feel we can add value, but these should be read in the context of our overarching response, which is to urge the government to undertake a thorough analysis before deciding whether or not to implement this reform.

Yours sincerely,



Sue Lewis
Chair
Financial Services Consumer Panel

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

The logic of pensions freedoms is that the government has no locus in determining what people do with their money. It follows that there are no circumstances where it is inappropriate to assign one's annuity income.

In reality, many people will be unable to access the information or advice they need in order to help them make a decision that is right for them. People typically underestimate their life expectancy. The rush to cash in pension pots is also indicative of high personal discount rates. Both these factors suggest people would be likely to accept an upfront lump sum that is of less value than they perceive. There is also a risk that those individuals least suited for disposing of their guaranteed income (i.e. those with the least income) may come under pressure to do so, for example to pay off debt.

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 products? What entities should be permitted and not permitted to purchase annuity income and why?

If a market is to develop we agree that this should not be extended to retail investors for the reasons stated. We cannot comment on which entities should be permitted to purchase annuity income other than to say this market should be strictly regulated and monitored to ensure the maximum consumer protection. That protection should include cooling-off periods (which should also be extended to lump sum withdrawals from pensions).

The market that develops will be dictated not only by the range of entities allowed to participate, but also the commercial viability. Industry consensus is that to make it work companies will need to buy in bulk, which is likely to make for a relatively small pool of participants without the incentive to compete on value. The dynamics of the market also need to be considered.

It is likely there would be an initial rush to sell unwanted annuities. But once we have a market where individuals are annuity holders by choice, this will reduce the numbers for sale. Has the Treasury analysed the long-term competitiveness of this market, and therefore the willingness of entities to engage in it?

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 ('buy back')? If you think 'buy back' should be permitted how should the risks set out in Chapter 2 be managed?

The Panel agrees that 'buy back' should not be permitted for the reasons stated. If an annuitant's existing provider is one of the buyers this might lead the annuitant to revert to a choice which is familiar believing that it is better to transact with a known entity rather than an unknown one – particular in a market this complex. This would have the same effect as the 'roll over' market in annuities and drawdown products and in which the problems are already well known.

Potentially the only method where 'buy back' might be allowed is through a blind bidding process where the annuitant's existing provider bids for the annuity on the open market (as has been suggested, we understand, by providers). However, the Treasury would need to analyse how this might work in order to be sure it would not lead to an artificial market where the provider of the annuity will always outbid competitors, thus depressing the market price.

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?

The Panel believes that the death notification issue should be resolved between the provider and the purchaser of the secondary annuity.

There are some options open to annuity providers to pro-actively check whether any of the annuitants on their books has died. As deaths in the UK are required by law to be registered, we understand it is possible to subscribe to services that track death notices as some pension firms already do this as part of 'unclaimed assets' campaigns.

Another solution might be for annuity providers to send a declaration form to the last known address of the ex-annuitant on a regular basis asking for the ex-annuitant to confirm they are still alive (similar to the DWP process for people in receipt of the state pension who live overseas).

However, irrespective of whether the provider pro-actively checks whether any of its annuitants have died, any liability for payments made following the death of the original annuitant should be a risk for the purchaser of the secondary annuity to bear. The Panel strongly believes that it should not be the concern of the original annuitant's estate.

Although the deed of sale could include a clause which requires the seller's executor to inform the relevant parties of the death of the annuitant, this may be unworkable in practice because it presupposes that the seller has made a will or, if a will exists, that the seller updates or amends it.

More generally, it is also unclear how the requirement to notify the annuity provider of the seller's death could be enforced, or what sanctions should be in place if the executor or personal representatives fail to do so, or are unaware that they should have made such a notification.

In any event, this is an administrative issue that needs to be agreed between the annuity provider and the secondary annuity purchaser. No liability, responsibility or cost should be transferred to the ex-annuitant. However, we have concerns that a transaction cost to cover the costs of finding the notification will be built in at the time of the sale either by the annuity provider or by the purchaser of the annuity. We would ask the Government to be vigilant about any moves to make the original annuitant pay for the costs which should be for the purchaser of the secondary annuity to bear.

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?

The Panel is unclear as to what this means. Is the intention to impose a charge cap on the fees that can be charged for these transactions? If so, yes, we would agree that the FCA should lead on this work. The FCA would, of course, regulate the market so we are unsure what HMT/DWP means by 'working with the FCA regarding fees and charges' and would welcome more clarity.

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?

In theory, yes. We can understand that where the annuity is an asset of the scheme, reassigning the income stream might affect the economic health of the scheme itself which would not be desirable – especially for vulnerable schemes. However, as the reforms relating to pension freedom are available to members of DC occupational pension schemes, some scheme members who are not permitted to assign their annuity may perceive this as unfair.

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

No. We are particularly concerned that a subsidiary market might develop in the pre-assignment of annuities with guaranteed rates even before scheme pension age has been reached. Can the government confirm that any such request for extension of this legislation would be refused?

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?

Yes, although paragraphs 2.25 and 2.26 suggest that individuals in occupational pension scheme are excluded (for the reasons covered in Question 6) even though those in DC schemes are eligible to access their pension pot through the pension reforms. We are not aware of any other tax rules which should apply.

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

No comment

Question 10: What consumer safeguards are appropriate – is guidance sufficient or is a requirement to see advice necessary? Should the safeguards vary depending on the value of the annuity?

The Panel believes that regulated financial advice will be necessary in most circumstances. However, all the issues that are currently surfacing as a result of the pension freedom reforms will also apply here: the cost of advice (especially for those with small annuities) and therefore access to advice and the issue of the 'insistent client' (those customers who want to proceed against the recommendation of their adviser). There is also increasing evidence that consumers required to take regulated financial advice are resentful of having to pay for something they don't believe they need.

Liability for financial advisers will need to be clarified, otherwise the advisers most qualified to provide this specialised advice will refuse to do so.

If regulated advice is not a legal requirement this leaves consumers vulnerable to approaches from firms seeking to conduct the business on a 'non-advised' or 'execution-only' basis, with all the same problems that arise from this type of business in the annuities and drawdown markets.

The conundrum about financial advice is another reason why we feel this legislation is being introduced too soon. It would have been helpful to track the outcome from the recent pension reforms before placing another potential 5 million consumers into an untested market.

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

We are already disappointed with the narrow scope of the Pension Wise service and would urge the government to extend it to include guidance on the interaction with benefits and the rights of those in debt.

As we have said on many previous occasions, guidance or advice on complex issues such as these needs to be delivered by qualified specialists and we are not convinced that the current Pension Wise Guides (possibly with the exception of some TPAS Guides) have the experience and knowledge necessary to do this. No analysis has yet been carried out on the competence of the Pension Wise service and it is therefore inconceivable that the service should be extended to cover the complex decision on whether or not to give up part of an individual's guaranteed income, without further analysis.

We would suggest that, at the very least, only those Pension Guides holding similar qualifications as those required by regulated financial advisers should be permitted to deal with secondary annuity market calls. The FCA should devise and implement safeguards.

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?

If the Pension Wise service is extended to cover the secondary annuity market, this should be free as with guidance relating to pension freedom. If regulated advice is mandated, this will need to be paid for by the annuity holder.

Consumers are reluctant to seek regulated financial advice because they have no way of knowing up front how much it will cost, nor do they understand the value of advice. There is emerging evidence to show that individuals seeking to transfer from defined benefit schemes are resentful of the fact they are forced to seek and pay for advice. The government has acknowledged that assigning their annuity will be the right decision for very few people so, as with DB to DC transfers, individuals will be paying a fee to be told they shouldn't do what they want to do.

We have two suggestions:

- Either provide a voucher to subsidise the cost of advice – having first established that advice can only be given by suitably qualified and regulated advisers at a fixed fee which could be determined in conjunction with the relevant professional bodies
- Establish a free service within Pension Wise provided by suitably qualified and experienced guides (already qualified to level 4 and in addition holding G60/AF3 or equivalent). These Guides should be separately monitored and regulated by the FCA and if inappropriate advice is given, consumers should have course to redress through the Financial Ombudsman Service.

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?

The onus should not be on the individual to obtain a minimum number of quotes in order to ensure the market works competitively. If all charges relating to the transaction are transparent and individuals have the ability to compare quotes this should be sufficient. Compulsion would not be consistent with the pensions freedoms ethos.

It is possible that the market will respond in different ways. Some firms may discount the price heavily and require less health information while others require full underwriting but offer a price that more accurately reflects fair value. In these circumstances consumers will find it difficult to compare like with like. In addition, where a third party purchasing the annuity is also providing a new financial product it is possible that pricing may become more complex – it being possible for firms to offer what seemingly look like an attractive price for the annuity, but cover that loss by charging higher fees on the new product. This dual pricing may not be evident to consumers attracted by the 'headline rate'.

We would suggest that an independent comparison tool is made available to individuals – along the lines of the Money Advice Service's annuity comparison tables. The tool should have information on all the third party purchasers so consumers can compare across the whole market from one independent source. The FCA should require streaming of information to the central tool. Medical questions would need to be fairly detailed in order to gain as accurate quotation as possible, but individuals could still be encouraged to submit a standard application form to a variety of providers in order to obtain the best price after underwriting.

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

Around a third of all annuities are bought on a joint life basis, so there needs to be a fair mechanism for protecting the rights of the dependant while allowing the annuitant to sell the income they would receive under the contract.

However, a joint life annuity is the property of both parties, therefore both parties must agree to the sale of the annuity before the transaction can take place. We cannot see the purpose of FCA guidance in this instance. Regulation should insist that all parties to the annuity must agree.

The requirement for all parties to the annuity (or their representatives if a vulnerable adult or minor) to agree to the assignment should be sufficient without giving special consideration to particular classes.

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?

The Panel believes this would be a useful addition to the rules. This would help to alleviate potential conflict between separated or divorced joint annuitants. The decision should be left to the discretion of the parties to the transaction. However, splitting the rights should not be looked on as another opportunity to increase transaction costs.

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?

It will be essential that people on means-tested benefits be provided with the right information about the impact on their future eligibility for benefits. However, it is clear that those on means-tested benefits will not be able to afford paid-for regulated advice.

We would therefore suggest that the relevant benefits agencies and Pension Wise are properly equipped to be able to provide face-to-face or telephone advice on this subject. Online or printed information will not suffice as the advice needs to be personal. Pension providers and third party purchasers of annuities should be directed by the FCA where to send people on means-tested benefits before allowing the transaction to proceed.

The alternative would be to supply those on means-tested benefits with a voucher for advice through regulated financial advisers.

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

It will be essential that those on means-tested benefits (or near the threshold) understand the full implications of assigning their annuity. With the existing pension reforms the impact on benefits is not covered in the Pension Wise session and customers are referred to another agency. This is a disjointed and difficult journey for people who are often already vulnerable. In the consultation document the government estimates that 13% of annuities are paid out to those in receipt of means-tested benefits, and that around 15% of those receiving state support with their social care currently have annuities.

The consultation document also makes it clear that individuals assigning their annuities and thus reducing their income will be subject to the deprivation rules and not be entitled to additional benefits as a result of reduced income. Indeed with the capital injection from the assignment of the annuity they may well lose existing benefits.

The Panel believes this is an area where further analysis and research is essential before the introduction of a secondary annuity market can proceed.

Question 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.

The Panel does not have any specific evidence or research that relates to groups with protected characteristics, but we do have concerns about individuals with guaranteed annuity rates. These

individuals might prove a very specific target for third party annuity purchasers. In addition, it may well be in the interests of providers of guaranteed annuity rates to offer a high price in order to remove these costly contracts from their back books.