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Annuity Consultation
Insurance and UK Regulatory Authorities Team
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Dear Sirs

Creating a secondary annuity market

I am writing on behalf of the Association of Consulting Actuaries (ACA) to respond to the consultation on *Creating a secondary annuity market.*

We set out our comments in detail in the **Appendix** to this letter, but include below some general observations as follows:

1. **Consumer protection**: In general, while there may be some benefit to annuitants and demand from institutional investors for such assets, there are a number of substantial risks to consumers and sellers (and ultimately the industry) of introducing a secondary annuity market without robust safeguards and sufficient lead-in time to get this right. There is a concern that vulnerable older relatives may be pressurised by their families to cash in their annuity income when they can ill afford such action. It is challenging to see how this can be adequately safeguarded against.

2. **The precise definition of 'annuities in the name of the annuity holder and held outside an occupational pension scheme'**: The easiest approach to defining whether the facility is available would be to look at whether the annuity is currently held in the member's name outside an occupational scheme – regardless of where it started out. But this will include buy-out annuities (or buy-in annuities assigned to members) covering defined benefits. HMRC need to be clear that this is their intention (and be aware that this will expand the scope considerably).

3. **Whether this should be extended to annuities purchased from 6 April 2015 (and indeed into the future):** Arguably this should not be necessary in the Money Purchase arena – but may help to prevent further reduction in the annuity market due to the flexibilities. And depending on the conclusion in 1, it may expand the scope of the

facility by allowing new buy-out exercises such that members can then access the flexibilities

4. **And in connection with recent developments on the post-April flexibilities (providers not being willing to offer full flexibility, and possibly intervention by the Government to ensure that providers do offer the flexibilities):** there may be concerns that although the secondary annuity market is intended to be voluntary, there could be similar enforcement if annuity providers refuse to allow assignment.

I hope you find our comments helpful. If you wish to follow up any matters, please contact me at jillian.pegrum@aonhewitt.com

Kind regards

Jillian Pegrum
Deputy Chairman
Pensions Taxation Committee
On behalf of the Association of Consulting Actuaries

About the Association of Consulting Actuaries (ACA)

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes. Members also advise thousands of smaller pension arrangements and many life and general insurers.

The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

Appendix: Creating a secondary annuity market

Response to questions from Association of Consulting Actuaries (ACA)

(Chapter 3)

A.2 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 circumstances do you think it would be appropriate to assign one's rights to their annuity income?

Assuming the facility will be made available for individuals to assign their rights to annuity income, we envisage that assignment might be appropriate in the following circumstances :

- Larger levels of annuity (where expenses and costs of obtaining appropriate advice will be less disproportionate, and perhaps where access to advice is easier) although we recognise demand might be largest for people with modest annuities
- Where the annuity is single life only, or provides a contingent pension to a spouse at the annuitant's death (rather than to the spouse at retirement)
- Individuals wanting to re-profile (eg joint life to single life)
- It may also need to be considered whether dependant annuities in payment (as opposed to contingent annuities not yet in payment) should be allowed to be assigned in the same way.
- It may also be suitable for the facility to be given to split a joint life annuity, so that the member's own annuity is assigned but the contingent annuity remains with the original provider (this would also limit the issues of death notification discussed below)
- It may also be suitable to allow partial assignment, with the annuity provider retaining liability for part of the payments, but the remainder passed to a third party (this would again limit the issues of death notification discussed below)

Although the consultation document indicates that this facility will be available only to those who purchased annuities before 6 April 2015, we understand that the scope may be extended to those who purchased annuities subsequently or in the future. Allowing later reversal of a new decision to buy an annuity might also reduce the disincentive for people to buy an annuity now. However the possible difficulties of pricing annuities in the future if they may be assigned at a subsequent stage may make it impractical to extend the facility to newer annuities.

There are also certain circumstances in which it would not be appropriate to assign rights:

- Where means-tested benefits are involved – as this may bring risks to the Exchequer unless appropriate rules are introduced to deal with the treatment of the resulting assets (see comments below)
- Where a contingent annuity would be paid to an unspecified spouse or other beneficiaries after the death of the annuitant, or where particular conditions apply to continued payment of income – as pricing may be more complex
- For older or vulnerable annuitants or minors
- Benefits that started out within the occupational environment are discussed below, but we certainly agree that if benefits are held in the trustees' name the member should not be allowed to assign the payments in this way.
- Any temporary annuities set up (for example to back bridging pensions)

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 do agree that a wide range of entities should be allowed to purchase annuities. However in relation to the second question it is crucial that in order to protect the public, the types of entities allowed to purchase annuity income should be limited. In particular only authorised firms should be allowed to participate. This will also mitigate against money laundering risks.

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 the existing provider should be allowed to purchase the annuity income. We note that buy back would bring risks - both in terms of consumer protection (if consumers do not shop around) and the impact on annuity providers' investments (if the providers came under significant public pressure to buy back), but the consumer protection risk will apply regardless of who purchases the annuity income, and the investment risk may be managed if there is no compulsion for the annuity provider to buy back the income. There are other complications: if the annuity business has been reassured and is bought back by the original insurer it is not clear what would happen to the reinsurance arrangement; and the potential impact on the Matching Adjustment also needs to be considered. And insurers would be subject to selection risk from annuitants who are in poor health but who had the annuity initially priced on a pooled basis.

However we do not agree that the disadvantages noted in the consultation document outweigh the advantages. The transactional relationship that annuity providers already have with their annuity holders is a distinct practical advantage, and the rules on the taxation of their own income might mean that the providers are better placed to use this facility than third party purchasers. A key advantage of the buy-back facility is expected to be better pricing for the annuitant (which would seem to cut across the policy intention if excluded)

Note that (depending on the scope of the assignment facility, for example whether it is to apply to new annuities) there is a risk that defined benefit schemes wishing to manage their liabilities could encourage members to buy out benefits (in their own names) in order to access the assignment facility, and allowing the existing provider to buy back would make this easier. Assuming this is not policy intention, safeguards against this should be considered.

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 solutions proposed in paragraph 2.21 all have disadvantages. We doubt that sufficient and clear instructions would be given to executors at the point of annuity assignment (there may not be existing executor arrangements or the instruction may have been forgotten by the time an executor is appointed). A 'maximum age approach' may still not solve the problem and reduces the facility to assign income (although in general it may reduce some of the underwriting uncertainty). The nominal payment approach will incur additional costs which may be disproportionate to the level of continued payment.
We believe that there should be a nationwide register online – this would have advantages not just for those who buy and sell annuity income but in many other situations where payments may be continuing because death has not been notified in a timely manner.

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 do agree with this approach. There needs to be transparency in fees, and there must be a balance between firms covering expenses and not making undue profit. However annuity providers must be allowed to recoup the reasonable costs of any assignment, otherwise they will refuse to participate. This is particularly the case where assignment will be permitted only for annuities bought before say 5 April 2015 (where the annuity has already been priced and this new complication had not been envisaged) – where newer annuities will be permitted to be assigned then it is possible that pricing will make some allowance for the possibility of subsequent assignment.

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?

The simplest definition for the scope of the measure would be that anyone who holds an annuity in their own name should be able to assign it. Any other definition may be difficult to work with as it may not be easy to identify whether the annuity has arisen from a personal pension or an occupational arrangement.

It is very likely that an annuity held in the member's name may have originated from an occupational scheme (directly, if a scheme pension has been bought in a member's name but out of DC funds or indirectly if benefits have been bought initially in the trustees name and later assigned, or if a member has transferred). Annuities may even have originated from a defined benefit scheme (for example if the annuity has been set up as part of a buy-out exercise).

If the intention was to limit the new flexibility to benefits derived from money purchase funds, then it may not be possible to segregate these annuities to make this distinction. However although the post-2015 flexibilities are limited to money purchase funds, it is clearly possible for defined benefit members to use the flexibility via transfer, so the outcome of the 'simple definition' is not inconsistent with the outcome of the current approach. If the scope is extended to newer annuities, members may transfer benefits or seek buy-out annuities in order to leave the occupational scheme environment (but this is akin to someone transferring into a money purchase arrangement at retirement to access the new flexibilities).

The disadvantage of the wider 'simple' definition is that it may then bring a very large number of policies into scope and may upset the investment market underlying the annuities. If annuity assignment is restricted to non-defined benefit pension annuities then there is less of an investment issue as the release of gilts into the market will be well received by defined benefit pension schemes and potential other annuity providers. If it is extended to defined pension annuities from buy-ins and buy-outs then it could see more pressure on gilts if a market develops for individuals to sell the annuity back to the insurer and then reinvest long term.

Another difficulty with the simple definition is that this would permit members to give up valuable guarantees that have arisen within the occupational scheme – and runs counter to the various protections that such schemes have offered and their members have enjoyed.

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

Defined benefit pensions (where these are met out of annuities in a member's name) are discussed above. Outside the pension environment there are other income products that might be given the same facility – such as sickness or disability products. However the pricing and underwriting issues are even more complex here as are the consumer protection issues.

Legislative changes (Chapter 3)

A.3 The government welcomes views on how it proposes to change the tax rules relating to the assignment of annuity payments.

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 proposals achieve parity. In comparison with the post-2015 flexibility provisions (which now allow pension reduction, and essentially permit commutation in its entirety) the annuity assignment proposals need to expand the authorised payment provisions to permit the same pension reduction (even to nil) in the member's hands (the original annuity will continue in line with the contractual agreement) plus the facility for assignment so that the payments can be re-profiled. Similar facilities will be needed for annuities which are transferred, and the recognised transfer rules would need to encompass the provisions. Depending on what limitations are placed on the annuities that can be assigned (eg pre-April 2015) it will be necessary to ensure restrictions re not circumvented (or the facility is not lost) by transferring

However it is important to ensure consistency with the other taxation provisions under Finance Act 04 and subsequent amendments/regulations.

- For an annuity already set up after April 2006, a Benefit Crystallisation Event will already have occurred, and there should be no further need for assessment, hence no further lifetime allowance issues. However where annuities were set up pre April 2006 there should perhaps be an assessment. And there may need to be safeguards to prevent arbitrage – see below.
- Similarly no new Annual Allowance problems should arise (although re-structuring income might give rise to a benefit that would have been assessed differently had the AA assessment been carried out at the time).

The legislation needs to be worded carefully to ensure the provisions work as intended. We agree that assignment (or rather accessing the resulting funds) should trigger the £10K MP annual allowance as for the flexibility provisions (we note that many of those assigning annuities might be older and not intending to contribute into pension arrangements). However if it does trigger this test there will be associated information requirements, and a new set of providers (ie those to whom the annuity income has been assigned) will need to be brought into scope of the requirements.

The other recent changes and implications of the 2015 flexibilities also need to be borne in mind

- The new taxation treatment of annuities or other payments on the member's death (depending on whether before or after age 75): we note that the intention is for the assigned annuities to be treated consistently but this does mean that the provisions which were designed to apply only to post 2015 annuities but would now be achieved by assignment, and may be achieved from defined benefit annuities (depending on the scope of the facility)
- Currently the annuity provider will apply a tax deduction under PAYE as pension income. Once that income is assigned, the annuity purchaser will then need to apply a tax deduction in relation to any payment or payments it makes to the member. For example if the entire assigned payment is paid out as one lump sum this will be taxed in a similar way to the taxable element of an UFPLS. Would the annuity purchaser be able to use the tax code that the seller would already have for the recipient? There will need to be controls to ensure that proper tax is deducted, and also to ensure that correct tax is applied if the buyer is located outside the UK.

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

The different LTA and AA treatment applied when benefits were first set up (if after April 2006) compared to treatment of assigned funds may give rise to avoidance plans; for example where an insured scheme pension was set up within a money purchase fund (generating a lower LTA assessment than a lifetime annuity would have done but providing the same income) and then the annuity is assigned for a lump sum which is then used to provide similar income.

Apart from this we agree that there are risks if the assignment is not carried out at arm's length.

Consumer protection (Chapter 4)

A.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.

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?

We agree that advice is crucial in this complex area, and is likely to require specialist knowledge which is likely to be outside the experience of many IFAs. This includes consideration of current health impairments for both member and contingent beneficiary, and how these affect life expectancy, as well as consideration of the pricing already allowed for (for example if the annuity had already been purchased based on impaired life assumptions).

It may be appropriate to widen the PSA15 s48 requirement for advice before transfer or conversion, but with a similar de minimis level. However this brings the risk of reducing the annuity value to bring a member under the advice limit. One option may be to use a standard set of GAD tables by age that annuities could be tested against in deciding whether the annuity is of a size that warrants advice. Or a simpler approach might be to set a de minimis limit by annual pension of say £1,000 pa rather than a value.

Should there be a compulsory cooling off period as for other transactions (noting that this would be complex to unravel)?

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

We agree that expansion of Pension Wise would be a start but doesn't go far enough, because the issues involved are so complex and require tailored advice – the best Pension Wise could do is highlight the issues and list the questions a member must ask. We certainly agree that risk warnings are a sensible requirement.

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?

It will be the annuity holder who is requesting the sale, so any costs need to be paid by them (assuming the deal goes ahead) - but annuity providers may be faced with costs in relation to abortive exercises - and for annuities already set up this disclosure will not have been priced into annuity rate. If annuity provider has to provide certain simple disclosures, they might be allowed to make a one-off charge against the sale price or the annuity retained if the deal doesn't go ahead (or they could ask for this once a year via disclosure, subject to charging)

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 requirement for individuals to obtain a number of quotes would ensure reasonable competition but we do not think this will be achievable. In addition, obtaining a number of quotes will increase overall costs which will need to be funded by someone. However if the current policy is required to give a quote for replacing the annuity (assuming standard mortality) as a benchmark for the value offered by the purchaser this will help to ensure competition and transparency. This approach may be suitable if buy back is to be allowed. (The disadvantage with the provider's own quote is that it may rely on information already used in the past for the initial annuity which may now be incorrect and would not be consistent against a quote from a totally new purchaser.)

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

We believe that dependants who are named on the annuity policy as benefitting after death should be required to consent to the assignment (or if they refuse then only the single life annuity should be assigned). Where annuity policies pay out to any spouse at death, the approach should be consistent with the position at retirement under the new flexibilities (for example CETVs for DB schemes with contingent spouse's pension).

However not requiring consent from the current spouse is likely to have a disproportionate effect on female pensioners who may also be more likely not to have adequate retirement provision in their own right. As noted above there may be complex arrangements for paying annuities to minors (or indeed nominees/successors if these are brought within scope) and these would be difficult to price and monitor. Where annuities are the subject of pension attachment, it should be required for the annuitant (or the provider) to inform the ex-spouse in the same way as for a transfer – but there needs to be a consideration of what rights the ex-spouse should then have (in a similar way to the current considerations where benefits might be taken flexibly).

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 that this should be permissible at the discretion of the parties to the transaction. This would also help to deal with cases where a current spouse is required to consent to assign rights but refuses to do so although we recognise that this may have a repercussion on provider costs.

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?

The issues should be the same as those for flexibility – those accessing their funds flexibly should not be allowed to use this to 'play' the benefits system (whether means tests benefits or long-term care funding rules etc). We would expect that Pension Wise should give general information on this (and this should be backed up by public information).

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

On the assumption that the current annuity is being counted towards the means testing assessment, it would not be appropriate for someone to be allowed to assign that income and reshape it to generate an increase in means tested benefits.
If they are permitted to assign, the means testing rules should ignore the assignment and treat the individual as receiving the original income. As a general point however, such individuals might be regarded as 'vulnerable' and perhaps should be protected against a decision to assign that may not be in their best interests.

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.

We have no particular comments.

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