Consultation Response

Creating a Secondary Annuity Market

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About this consultation

Following the introduction of greater flexibility in pension decumulation in April 2015, this consultation explores how the Government can extend some of these flexibilities to people who have already purchased an annuity. It looks explicitly at how a market for re-assigning annuity income in exchange for a cash lump sum can be created, including how the process should work and what consumer protections might be necessary.

Key points and recommendations

- Polling undertaken for Age UK suggests only limited demand for re-assigning or re-selling an annuity. Among people aged 60+ whose only private income is from a pension annuity (from a Defined Contribution source), just six per cent said they would consider exchanging their income for a cash lump sum.
- While there are certain groups of consumers who may derive a genuine benefit from re-assigning or re-selling their annuity income, for example people with very low income streams or who are in poor health, many people will be tempted to re-assign or re-sell because they are in a desperate situation, even when not in their long-term interests. The re-assignment process must build in safeguards to ensure that people *only* act in their own and any dependants' interests.
- Consumer protection is therefore of paramount importance. The message that 'this is not the right option for most people' should be clear.
- Everybody considering cashing in their annuity should be compelled to take either financial advice, or if disproportionately expensive, guidance through Pension Wise.
- Whether or not consumers will need to pay for formal advice should be clear upfront. Age UK recommends basing any thresholds on the value of the monthly income stream rather than the lump sum to be received, which is unknown at the start of the process.
- The Government should allow buy back from the annuity provider for consumers with low value annuities.
- It is essential the reforms work for consumers with low value annuities. If the new market fails to deliver a fair, transparent and good value option for this group then it cannot be considered a success.
- An independent central portal should be set up to provide an indicative or notional price to each individual that they might receive should they continue with the process.
- The written consent of named dependants should be secured before people can re-assign or re-sell their annuity income.
- People receiving means-tested benefits should be allowed to re-assign or re-sell their annuity income.
- The Government should establish at the outset how the reforms will be monitored and what defines a success.

1. Introduction

Age UK cautiously welcomes the aim of allowing existing annuity holders to exchange their annuity income for a cash lump sum. While this option will not be right for most people, we agree the pension flexibilities should be extended to existing retirees, subject to the existence of sufficient consumer protections. We consider that in some circumstances it will be in the consumer's best interests. However, there are significant barriers that might prevent the development of a viable market that delivers good value to consumers, particularly those with lower value annuities, which need to be addressed before the market's inception.

We agree that there are likely to be some older people who would derive a genuine benefit from re-assigning their annuity in exchange for a cash lump sum. However there are big potential risks for older people, and it is essential that these are investigated and mitigated before the reforms go ahead.

It is far from clear that the marketplace will be able to deliver, at least on terms that represent 'good value'. For this to be achieved, any reforms must allow consumers with an average or below average sized pension annuity to re-sell their annuity at a fair and transparent price.

If 'good value' for those on a low income is not delivered, or the flexibilities are not on offer for this group, the reforms will not be workable. For example, people with very low value annuities paying just a few pounds a month or those who are in poor health, should have the option to cash in their income stream, assuming the consumer protection is in place.

Age UK polling suggests limited demand

In order to gauge the potential level of demand, and understand more about the reasons why people might want to re-assign their annuity, we commissioned polling of people aged 60 and over who currently receive an income from a private pension.[i]

We first asked a general question of all participants who had any sort of private pension income (either a pension annuity from a Defined Contribution (DC) source, or final salary income from a Defined Benefit (DB) source, or both). There was little interest in exchanging this income for a cash lump sum, with only four per cent of respondents stating they would consider doing so. This was slightly higher among women (six per cent) and for the DE socio-economic group (seven per cent).

Among those with only income from a pension annuity, we found that six per cent of people said they would consider exchanging their income for a cash lump sum.

This suggests there is potentially a limited level of demand for re-assigning or re-selling annuities.

In practice, demand is likely to be affected by other factors such as marketing and how the process operates, but these figures indicate that people already receiving their pension income are comfortable with their arrangements and generally do not wish to change.

With this is in mind, before going ahead, the Government should consider the costs involved in setting up this system and evaluate whether doing so represents good value for consumers and the taxpayer.

In this response we flag up some concerns and suggested remedies that we believe ware necessary before this major change takes place and make it work for typical lower net worth consumers. These are set out below in response to the questions.

Consumer protection is paramount

In establishing this new market, the Government must minimise the risk of consumer detriment and carefully examine how a range of potential issues can be mitigated, including:

- **Supporting people to make the right decision**. As the consultation paper points out, ‘for most people, keeping their annuity income will be the right decision, given the lifetime certainty and security that annuities provide’. This is an important message that needs to be reflected loud and clear in all future communications, and the government must ensure that the default position for individuals remains to keep hold of their pension annuity income stream.
- **Fairness of costs** – the price consumers receive must reflect reasonable value based on longevity, and the value of the annuity minus payments received. We note that past experience with Pension Incentive Exercises, or PIES, showed that employers did not always provide a fair price when buying out individuals’ pension rights, and that consumers find it very difficult to evaluate the true worth of a lump sum offer. In facilitating a secondary market, the Government must ensure that it learns the lessons of past experience and puts protections in place before, not after, things go wrong.
- **Transparency of costs** – consumers must be aware of the full range of charges and costs they are likely to incur, and what this means for the value of the lump sum on offer.
- **Clarity** – all information, including but not limited to costs, must be clearly set out so consumers can understand the deal they are getting.

We would welcome some indication of what ‘good’ looks like, even if just relating to accessibility and simple consumer outcomes, and the government should commit to firm plans for monitoring the marketplace, especially consumer outcomes.

2. Consultation questions

A new secondary market for annuities

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

We envisage that the main group who would might derive a benefit from re-assigning (or re-selling, see response to Question 3) their annuity are likely to be those with a very low monthly income. For this group of consumers, having a cash lump sum might be of more practical use than continuing to receive a very low monthly payment.

However, as stated earlier in this response, our polling suggests a limited level of demand for re-assigning annuities, with just four per cent of people aged 60+ who receive a private pension income from any source, and just six per cent who have only a pension annuity income, saying they would consider exchanging this for a cash lump sum.

There does appear to be slightly more demand among lower-net worth individuals – nine per cent of those with less than £750 per year of DC income compared to just three per cent of those with above this level – but nevertheless the market is likely to be muted.

People in poor health or who are terminally ill might also benefit, as might surviving partners of someone with a single life annuity, while there are various groups for whom cashing in an annuity would be a low-risk option, for instance those with significant Defined Benefit income.

Ultimately, it will be down to the unique circumstances of each individual, coupled with the price offered for their annuity, which determines whether it is in someone’s best interests.

There are, however, potential issues with the market, such as adverse selection, which may impact on the price that these groups would receive. Even if, in theory, someone might benefit from cashing in, the government needs to consider how best to ensure that all consumers can receive a fair price.

Shorter term concerns vs. long term protection

Many people who are interested in receiving a lump sum may be desperate – for example, people with real debt problems, people wanting to support a family member who is themselves sick or in debt, or anyone who is the victim of unfair pressure or abuse from a family member or fraudster. And while some surviving partners might benefit if they are left a lump sum, there is a risk that other partners may lose out if they are relying on future income from a joint life annuity, or that annuity assignment may become a weapon in a contested divorce. It is vital that consumers (and their dependants) should receive support with the underlying issue and understand *all* their options, before they make an irreversible decision at what could be a very poor price. Annuity assignment should not be a sticking plaster for an underlying problem.

Marketplace concerns

We are concerned that the marketplace will evolve to service only higher income consumers, leaving lower income consumers – for whom we believe there may be a genuine case for re-selling or re-assigning – with no realistic means of doing so. If the reforms go ahead, the government and regulators must make sure the needs of this market segment are met.

However the market is created and develops, consumer protection and ensuring people are aware of the longer-term consequences of their decision making are paramount (see Section 4).

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 support proposals to restrict retail investment. All corporate entities should be regulated by FCA, so that they are placed under a duty to deal fairly with consumers.

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 think that ‘buy back’ should be allowed for smaller annuity values, with judgement of whether to extend this to those of higher value being reserved.

While we accept there are valid arguments against allowing ‘buy back’ of annuities by the original seller, we are concerned that allowing only re-assignment will ultimately mean that consumers with smaller value annuities fail to receive a fair price, or that there will be no offers at all.

The underwriting costs to a third party are likely to be substantive and render purchasing a small value annuity unprofitable. However this might not be the case for the original seller, for whom the underwriting will have previously been carried out, and they may welcome the opportunity to use their reserves in order to reduce their on-going liabilities.

We recognise that this could create a ‘monopoly’ supplier and the level of price competition will often be unclear, and that past experience with annuities indicates that many consumers are unlikely to shop around to find a better deal. This must be factored in to the buy back process, and if the government adopts a ‘central clearing house’ approach for providing quotes, the option should be offered through this.

Phased approach

In addition to introducing buy back for lower value annuities, to ensure the market works adequately for all consumers, the Government could consider a phased approach to rolling out the reforms.

The initial stage should be for people with low value annuities that pay only a few hundred pounds a year, for whom the providers are more likely to be prepared to offer buy back due to lower risk and the opportunity to use their reserves to purchase future liabilities.

Once it has been demonstrated that the market is working for this group, and based on further consultation with the industry and consumers, re-assignment and potentially buy back could be extended to higher value annuities.

If this approach were to be followed, the government would have to decide the upper limit for the marketplace to operate at during phase one. Although there is no clear cut off point, this could be set at a fairly low level, for example annuity incomes of under £25 per month.

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 government needs to be more proactive in dealing with high fees than set out in the document. Firstly, absolute transparency of costs and charges must be a key priority from the outset. Secondly, simply monitoring is unlikely to be enough. A ‘plan of action’ should be put in place to set out in detail how the FCA and government will deal with unnecessarily high fees, and the timescale with which such issues will be dealt with should be clear and swift, with the possibility of reimbursing consumers who may have paid over the odds.

Legislative change

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?

Yes.

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

The government needs to set out a clear plan for monitoring and evaluating the impact of the reforms on annuity holders and their dependants before considering extending these reforms.

Consumer protection

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?

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

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?

Either guidance or advice should be mandated for all consumers, depending on the value of their annuity.

Our polling included the worrying finding that only 36 per cent of those who receive a private pension income would seek financial advice before deciding whether to re-assign or re-sell their annuity. This was slightly higher among people with a DC income of over £750 per year at 38 per cent, compared to only 30 per cent of those with less than this amount.

Compelling people with smaller value annuities to receive paid-for formal financial advice may be desirable but is likely to be disproportionately expensive. Instead, a requirement to fulfil a free face-to-face or telephone appointment with Pension Wise may be more appropriate.

The message that 'this is not the right option for most people' should remain clear at all times.

Breadth of issues

There are potential issues surrounding the expertise of both financial advisers and Pension Wise. For example, the interaction with means tested benefits and state funding for care is potentially complex and unique to each individual's circumstances. Pension specialists may well not have sufficient knowledge of state support to be able to advise or provide sufficient information to clients.

We argue that every person considering annuity re-assignment or re-sale with an annuity below a certain value should receive a benefits check (see also response to Questions 16 and 17). In addition, as people are already retired, the adviser, guidance service or annuity provider may need to check that the individual has mental capacity and that any underlying issues (e.g. debt) are dealt with. People will also need to fully understand any tax liability if they were to receive a lump sum payment.

Even so, it is essential that everyone considering re-assigning or re-selling their annuity receives some form of advice or guidance. Pension Wise as currently set up will not deliver personalised recommendations that would ideally be required to help consumers make the best decision possible.

We strongly believe that if annuity re-assignment or buyback is introduced the remit for Pension Wise will need to be expanded, but it may also need to work in partnership with other specialist agencies that are likely to require extra funding to meet the extra demand.

Valuation of the annuity

Mandating regulated advice for consumers with an annuity value of £30,000 or above is likely to place the majority of people below the threshold. Whether the threshold should be maintained at this level, for consistency with Defined Benefit transfers, or set at a lower level, depends on the quality of advice or guidance available to those falling below – it is imperative that all consumers understand the consequences of re-assigning their annuity and this should not be compromised.

Clarity about the process is also important. Consumers need to know whether they would be expected to pay for independent financial advice before embarking on the journey. However, with the advice threshold being based on a particular cash valuation of the annuity which is not clear at the beginning of the process, it will not be possible for the consumer to know until further down the road whether they would have to take formal advice. Publicly available tools, such as the central portal referred to below, will be necessary.

We suggest that to ensure clarity thresholds for mandated advice should be based on the level of income being foregone. For example, a consumer receiving £500 per month from a level annuity might be required to seek advice, whereas someone receiving £450 per month may not. It may be suitable to set different thresholds depending on the type of annuity product held.

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?

We do not support putting the onus on consumers to obtain formal quotes. It assumes that a number of firms are willing to buy, which is by no means certain, and involves an underwriting cost, which risks putting providers off dealing with lower-net-worth consumers.

'Anchoring effects' are a potential problem in ensuring good value – if an initial low offer is made (quite likely if a firm is less interested in low-value annuities) then this sets the parameters that determine whether future offers are accepted, so the consumer is likely to accept a subsequent offer even if it is well below the true value.

Instead, we favour the proposal of establishing a central portal through which consumers can obtain an indicative or notional price that is as accurate as possible, based on details of their annuity, basic underwriting information such as health, and current marketplace information. This would hopefully filter out consumers with unrealistic expectations and help people avoid placing too much emotional energy into the process. If administered by a body independent of the industry, it should also help to counteract the ‘anchoring effect’ described above.

In the case of buy-back, the consumer should still go through this process to compare the buy-back price against the indicative or notional prices on offer from providers offering re-assignment.

If such a system were adopted it must be regularly updated to reflect market conditions and ensure the suggested price was fair and representative. This would need to be coupled with a ‘reality check’ to examine the deals consumers were actually getting.

Digital access

An online only portal will not service the needs of many annuity holders, some of whom could have retired many years ago. 67 per cent of people age75+ and 30 per cent of those aged 65-74s do not use the internet, and these non-users are particularly focussed among lower socio-economic groups. For example, among people aged 75+ in the DE socio-economic group, 78 per cent do not use the internet compared to 39 per cent in the AB group.[ii]

Furthermore, many existing users would be unlikely to consider re-assigning their annuity online – doing this is a far cry from reading the news or watching a video clip. A substantial proportion of older internet users (45 per cent of those aged 75+) are defined as ‘narrow users’ by Ofcom, and are less confident and considerably less willing to use unfamiliar websites than the ‘medium’ or ‘broad’ user groups.[iii]

Any service must account for this and should provide alternative methods of obtaining a notional valuation.

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?**

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 are concerned about the rights of dependants on re-assignment and agree that guidance should be issued. Re-assignment or re-selling is likely to disproportionately affect women (see also question 18). We support the proposal to seek written consent from any named dependants or beneficiaries prior to the re-assignment going ahead.

In addition, the consequences of re-assignment for dependants must be very clearly set out in the advice or guidance received. The rules regarding pension sharing on divorce may also need to be updated to reflect the change.

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?

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

It is imperative that the secondary annuities market works for all consumers, including establishing sufficient consumer protection, no matter what the value of their annuity.

Lower-net-worth consumers must be able to utilise the reforms when in their interests to do so. In fact, as stated earlier our polling indicates that this group might be more likely than others to consider re-assigning or re-selling their annuity income.

We understand the argument that it would be unfair to the taxpayer if people could assign their annuity and then automatically have an increase in benefit income to replace lost income, but we believe that it is equally unfair to simply disallow benefit claimants from using the new rules. People may have legitimate and pressing reasons for needing a lump sum payment that are unrelated to any desire to increase their benefit entitlement.

Fairness is also about ensuring that those who have contributed to a pension through their working life and were forced to purchase an annuity at retirement are better off from having done so when compared to others who did not save. The debate about fairness should also recognise that those who retire before 6 April 2015 have fewer options for using those savings.

Future entitlement to benefits

In the context of the current benefit rules we feel that those receiving benefits should be able to assign or re-sell their annuity. This should affect entitlement only in circumstances where there is a deliberate intention to replace private income with state benefits.

We would be particularly concerned if the lump sum received from selling back or assigning an annuity affected someone's entitlement in perpetuity, as their circumstances could very well change markedly in future.

To remedy this, one approach could be to have a time period during which replacement benefits are forfeited, before the consumer becomes re-eligible. This would provide the taxpayer with some protection against intentional deprivation, while still allowing the consumer to access the welfare safety-net if needed in future. We note that similar rules apply with inheritance tax on Potentially Exempt Transfers, although we would argue that a timescale shorter than seven years should apply in the case of means tested benefits.

In addition, it is unclear whether consumers would have to declare that they had previously re-assigned an annuity when making a benefit claim in the future. As the value of the lost income is relevant, this would add to the difficulty of the benefits assessment, and in some cases (for instance if the consumer had previously received income from an index-linked annuity, or was unsure of exactly what they had previously received) it would be difficult to establish the value of forgone income.

Deprivation rules need reviewing

The interaction between benefits, re-assignment of annuities, and the new flexibilities for Defined Contribution pension pots have highlighted the difficulties that low income pensioners face when making decisions which could affect their future benefit entitlements. In particular the deprivation rules introduce great uncertainty for individuals as well as challenges for those administering the schemes. We believe there should be a review of the current deprivation rules and the interaction with pension choices with the aim of introducing a clearer system.

Above all, however the rules are implemented for benefit recipients, it is essential that people have good information and guidance.

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 agree that the most significant equality impact will be on women. The issue raised in the consultation paper about dependants will disproportionately affect women, while there is also a risk that among older couples going through a divorce the main annuity income recipient – typically male – could in some circumstances cash in his annuity in order to avoid liabilities.

However, people with disabilities are also likely to be affected. They may particularly want and need a lump sum from their annuity; however, they are likely to be least attractive in the secondary marketplace. For some this could mean losing out twice, in addition to the time of purchasing the annuity if they also failed to receive an enhanced rate. The terminally ill are another group for who there would be a clear advantage for buy back.

The guidance or advice that people receive must clearly reflect the full range of risks posed by re-assigning or re-selling your annuity.

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[i] TNS Polling for Age UK, carried out June 2015. Contains 1,481 individuals aged 60+, of whom 787 receive a private pension income with 225 receiving a pension annuity income only, and 101 getting both this with additional income from a Defined Benefit pension.

[ii] Ofcom, Internet non-user statistics provided to Age UK, 2015

[iii] Ofcom, Adults internet use and attitudes report 2015. Narrow users undertake between 1 and 6 out of 17 internet-based tasks considered, 'medium' users between 7 and 10, and broad users 11 or more.