

Creating a Secondary Annuity Market: A consultation response from Phoenix Group

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About Phoenix

Phoenix Group is the UK's largest consolidator of closed life assurance funds. The group has £52 billion of assets under management and serves around 5 million policyholders.

Executive Summary

Phoenix supports the creation of a secondary annuity market to enable pension freedoms to be available for customers that have retired as well as those approaching retirement.

Customers need to make fully informed decisions and we expect safeguards to parallel those in the primary market as far as possible. An assignment is a transaction between customer and the purchaser, so the purchaser should be appropriately regulated and the role and rights of the existing annuity provider made clear.

Although not referred to in the regulations as being a 'buy back', there is already the ability for customers to 'access the value of their annuity by terminating their annuity contract' in limited circumstances under the small pot rules. We believe that this should continue as it will allow customers to obtain value for what is otherwise an uneconomical income stream. For larger pots, customers should shop around by approaching the secondary market rather than obtain a cash-in value directly from their current provider.

Answers to specific questions

1. **In what circumstances do you think it would be appropriate to assign one's rights to their annuity income?**
 - 1.1 The circumstances largely parallel those of the primary market such as the examples listed in paragraph 2.4 of the consultation document. We assume that assignment would also be permitted for those customers that take an annuity from 6 April 2015, for example if their circumstances had changed.
 - 1.2 The option will be appropriate for many customers. However it carries significant risks to those customers where a guaranteed income for life may be the best option. Therefore appropriate safeguards are needed.

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?**
 - 2.1 Ideally the market should be as wide as possible to encourage competition. However, it is essential that the market is adequately and consistently regulated. Although the purchaser will possibly only have a transactional rather than ongoing relationship with the individual, it is essential that the purchaser is in a position to deliver the relevant risk warnings. Therefore we would expect all purchasers to be FCA regulated.
 - 2.2 The requirement to be regulated would rule out individuals from direct investment in secondary annuities.
 - 2.3 Some purchasers may want to repackage secondary annuities for onward investment. Retail investors could potentially gain access through this route.
 - 2.4 Repackaging may be attractive for corporate investors, for example a portfolio could provide a predictable income stream. If the market could develop structures that meet Solvency 2 Matching Adjustment criteria, then this could be an attractive asset class. To be successful the market would require an adequate supply of funds as well as customer demand, to ensure competitive pricing. The market would need to work with the PRA to ensure that the objectives for both solvency and effective structures are met.
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?**
 - 3.1 'Buy back' is a very different solution to that of assignment, although the customer outcome should be broadly similar. Phoenix believes that 'buy back' should generally not be allowed other than for small pots. Customers do not have the contractual right to require providers to buy back their annuities and the consultation paper rightly notes that consent from the provider would be required.
 - 3.2 The consultation paper sets out sound reasons why 'buy back' should generally not be allowed.
 - 3.3 Many providers would not want unsolicited requests for buy back for the reasons given in the first bullet in section 2.15 of the consultation paper. In addition, the level of adverse selection risk may impact solvency if providers were required or felt obliged to buy back annuities. There would likely be a significant adverse impact on annuity rates in the primary market if providers felt the need to price in a surrender option.
 - 3.4 Hence it is important in establishing the secondary market that customers are not given the impression that they can simply cash in their annuity from their current provider but instead they must sell it to a third party. This will require clear sign-posting in any promotion of the secondary market.

- 3.5 We would expect legislation to require customers to shop around. Note that this differs from the primary market where customers are encouraged rather than required to shop around. Such customers may have a reasonable expectation or even a contractual right to buy an annuity from their existing provider, but this will not be the case in the secondary market.
- 3.6 It is unlikely that there will be a viable secondary market for small pots due to the costs involved. However, there is likely to be a significant demand for cashing in small pots. Customers are likely to appreciate the value of a lump sum from a small pot rather than continuing with a small income stream.
- 3.7 Current HMRC rules allow 'buy back' of small pots and Phoenix has previously completed a bulk exercise where a number of its customers benefited from these rules. In a bulk 'buy back' exercise, eligible customers are approached by their provider. Costs and adverse selection risks can be reduced due to the high take-up rate which could make this option viable for both provider and customer.
- 3.8 At the time of the Phoenix 'buy back' the small pots limit was £2,000 and this limit has now been increased to £10,000. This would seem a natural upper point to allow providers to offer a 'buy back', given the primary market generally operates above that level.
- 3.9 Hence Phoenix believes that the current rules that allow such 'buy back' should continue unchanged.
- 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?**
- 4.1 The issue identified in section 2.20 of the consultation paper is significant. There does not yet appear to be an easy and effective solution for managing the risk. Each of the solutions suggested may be only partially effective.
- 4.2 Many customers would not have written a will and therefore requiring an instruction to their executor may be impractical. It may be seen by customers as a potential barrier to obtaining their cash.
- 4.3 It is unlikely to be clear to customers why they would need to be contacted, particularly if this requirement started several years after cashing in their annuity. Such an obligation would require clear communication.
- 4.4 It is unlikely to be clear to customers why they should be paid a nominal amount. If set too low then it may be meaningless but if set too high it would reduce the amount that could be cashed in. It would also significantly increase costs as providers would need to split the annuity into two parts.
- 4.5 Requiring the purchaser to obtain evidence of entitlement may be considered. However, the relationship between the customer and the purchaser may only be transactional at the point of assignment rather than ongoing and so this may be difficult in practice, particularly if policies are subsequently re-assigned.

- 4.6 A central death register has some appeal. The DWP already has an effective process at a small cost for identifying deaths, where individuals can be reliably identified (e.g. using NI number). Therefore the infrastructure and source data would already seem to exist. Volumes should be manageable based on this being a relatively niche market as anticipated by the government.
- 4.7 We would expect that the legal structure of the assignment to mean that any overpayments, for example after death, should be reclaimable from the purchaser. If that were not to be the case, recovery of overpayment from grieving relatives for monies which they have not received (and for which the benefit was obtained some years ago) would be very challenging.
- 4.8 Any process would need to allow for customers that moved abroad. This makes verifying entitlement more difficult.
- 5. Do you agree with the proposed approach of the government working with the FCA regarding the fees and charges imposed by annuity providers?**
- 5.1 We agree that the reforms should not be an opportunity for firms to generate an excessive profit stream, nor use costs as a barrier. However, firms need to cost realistically.
- 5.2 We consider that the FCA should allow the market to set charges. It is desirable that there is full transparency of costs.
- 5.3 Whilst there are costs of the transaction, there may also be additional costs, for example the additional costs of demonstrating continuing entitlement to payment.
- 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?**
- 6.1 Yes.
- 7. Are there any other types of products to which it would it be appropriate for the government to extend these reforms?**
- 7.1 In the interests of clarity, we believe the reforms should apply to those who have annuitised, including those from 6 April 2015 as well as before.
- 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?**
- 10.1 It would make sense to align the secondary market with the primary market as far as possible. Currently this would suggest that those with annuities worth over £30k should

be required to take advice from a qualified adviser and provide confirmation that advice has been received, in line with current regulation. This minimises the risk of customers inadvertently making a poor decision whilst also not imposing a significant advice cost in relation to the value of the benefit.

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

11.1 This should mirror the primary market for Pensions Freedoms. The onus should be on the purchaser (rather than the provider) to provide risk warnings on the basis the purchaser is regulated and is likely to be approached by the seller first, having shopped around.

11.2 It would make sense to expand 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?

12.1 Yes, costs should be paid for by the seller of the annuity.

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?

13.1 We believe that shopping around should be a required part of the sales process. This should be covered by the third party purchasing the annuity as part of this process. Although a mandatory requirement for a number of quotes may not be appropriate there could be a regulated panel put in place to achieve shopping around.

13.2 It is not clear how practical it would be to require a certain number of quotes. There is no precedent for this in the primary market. The setting up of the secondary market will require co-operation between purchasers to standardise the approach. This has worked before, examples being the way OMOs and transfers are set up via Origo and also the common quotation form for enhanced annuities.

13.3 We do not believe that it is appropriate for existing providers to provide a benchmark selling price. Many will be closed to new annuities and hence would not necessarily be able to assess the likely value. It would be clearer for customers if the process of pricing as well as the provision of appropriate risk warnings were provided by purchasers. The annuity provider would then only be required to assign the policy once the customer had made a decision. This is consistent with how customers shop around in the primary market.

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?**

14.1 Second lives are not normally parties to the policy and so it is not clear that there is a legal obligation or right for them to be required to be included in the decision.

14.2 A requirement to consult dependants may not be popular with customers.

14.3 In the primary market the risk warnings provide some protection at the point a decision is made to include or exclude second lives as beneficiaries, who are not required to be consulted. There would appear to be a parallel here. The onus is on the policy owner to make an informed decision.

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?

15.1 It would be operationally difficult to keep the dependants benefits in place. This would increase the 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?

16.1 This could be covered via risk warnings or guidance from Pensions Wise.