

18 May 2015

Annuity Consultation
Insurance and UK Regulatory Authorities Team
HM Treasury
Horse Guards Road
London SW1A 2HQ

Dear Sirs

Creating a secondary annuity market

Introduction

HM Treasury has invited responses to the above consultation paper and Tenet Group welcomes the opportunity to provide feedback on these matters on behalf of its personal investment firms.

Tenet Group is the ultimate parent undertaking of three intermediary firms, Tenet Lime Ltd, Tenet Connect Services Ltd and Tenet Connect Ltd. The Tenet Group operates a number of other companies which provide services to Financial Advisers and mortgage brokers.

If further clarification of any matters in this document is required you should please contact:

Tenet Group Ltd
5 Lister Hill
Horsforth
Leeds

Purpose

The purpose of this cover letter is to set out the context of our response, to positively challenge certain assumptions contained within the paper from a broad perspective and to comment on other points which we believe are valid to the debate but the specific questions do not lend themselves to highlighting these points.

We generally welcome the changes brought about by the Government's most recent pension reforms as striking the right balance between appropriate incentives in the form of tax reliefs to encourage pension savings, and the removal of barriers to accessing those savings in way that suits the needs of individual pension savers.

We also believe it is fair and equitable to offer the same freedoms to existing holders of annuity contracts, although our expectation is that for the majority of individuals continuing to hold their existing annuity will be the right outcome.

A period of stability in terms of the legislative programme would now be beneficial in allowing consumers, intermediaries and Providers to acclimatise to the new environment and for regulators to observe the conduct of the market.

As a firm heavily involved in the provision of regulated advice we support the steps taken through Pension Wise to support those prospective retirees in making good decisions where they may not necessarily want to or be able to access professional, regulated financial advice which is at the core of our business.

We acknowledge that there is a sound rationale for extending the remit of Pension Wise to support the secondary annuity market and also believe that this service will highlight to many customers the need for regulated advice. How Pension Wise should be funded is a broader question and is outside of the scope of this response.

There are some issues raised by this paper which are identical to the issues currently being experienced in the primary DB to DC transfer arena, particularly in terms of the compulsory advice requirement and the threshold that this is required at, insistent clients and some Providers not being willing to accept transfer of funds without a positive recommendation from a regulated financial adviser.

All of the points are driven by concern over regulatory uncertainty (and in particular the role and remit of FOS) so it is to be hoped that actions taken to resolve these industry concerns will have equal applicability to any secondary market.

Creation of a Secondary Market

We agree with the premise that individuals may have purchased an annuity either with or without advice and may have or feel that they have missed out on the benefits of the pension reforms.

Others may feel that the impact of improving longevity and the state of the gilt market, especially in the light of the impact of the government policy of quantitative easing, has resulted in the annuity they purchased representing poor value.

Additionally, if the client has not benefited from the increased availability of impaired life annuities they may well be justified in believing they have missed out through lack of knowledge or if they have experienced some other changes in personal circumstances such as the death of a spouse this may cause them to review their current position.

For many annuitants the security offered by the annuity may be undervalued because there is a tendency for consumers to underestimate the value of a guaranteed income for life. Indeed, when presented as such without mentioning the product name, i.e. annuity, then clients are more willing to consider the product for what it is, i.e. certainty of income. So for many if not most people we would also agree with the premise that keeping the annuity will be the right thing to do or to at least keep some portion of it.

The potential to be able to unwind an annuity is potentially attractive to some whose circumstances have changed and in limited circumstances we agree that this could be right for some albeit by definition a minority of annuitants.

We note that some Providers have already indicated their willingness to participate or otherwise but do feel that the timescales proposed for introducing the secondary market are ambitious given the impact that this may have.

The sale of annuities has many potential processing similarities to that of Life Settlements and there are many lessons to be learnt (good and bad) from that industry which can be applied here without needing to reinvent the wheel. These include the ability to conduct intelligence based telephone underwriting to mitigate mortality arbitrage and reduce time/costs and the contractual documentation to ensure that the buyers, intermediaries, sellers and dependents are suitably informed and protected. There is also a proven 'proof of life' of life process where the buyer of the annuity or the annuity provider periodically checks that the annuitant is still alive and the annuitant is incentivised to respond in receipt of a small financial benefit (or deferred purchase price consideration).

We subscribe to the view that all parties commercially involved in the sale and purchase of annuities should be regulated entities and whilst it should be possible to securitize the packaged policies they should be prohibited from subsequently being sold to retail investors (life settlements and traded annuities prove the point that customers do not understand the risks involved). If the market proves large enough we see the opportunity for specialist regulated intermediaries to operate in this space.

We also believe it would be essential for the FCA to prescribe the purchase quote documentation to enable a like for like comparison but prescribing a minimum number of quotes may not be practical as we don't yet know the size of the market and it may also drive up the acquisition costs thus depressing the purchase price.

The size of the secondary market is likely to depend most on the customer's perception of value for money whether it is value for money or not.

Other points:

Veto Power - Throughout the Consultation Paper it refers to Providers having to give permission for the contract to be assigned and effectively having the power of veto. Whilst contractually true today, from a TCF perspective we wonder why new regulation

allows Providers to refuse the transaction without good cause. There are many historic examples of policy wordings and agency contracts being made null and void or modified by virtue of new regulations or legislation.

Buy-Back - The paper also suggests that the existing Provider should not be allowed to 'buy-back' their existing annuity and by inference not be able to restructure the annuity. Whilst we agree that they should not be compelled to 'buy back' the annuity we believe that they should be given the opportunity to do so as this may result in a better outcome for the customer by virtue of lower purchase cost overheads. Given the anticipated low volumes we believe that the risks associated with this activity are overstated and a number of Providers and the ABI have publicly made the same point.

Occupational Pensions - The paper states that the options do not apply to Occupational Pension schemes but we do not follow the rationale. The annuity is presumably already in payment and the payments will not change irrespective of whether the benefits are assigned or not. There may even be circumstances where the Trustees would like to crystallize their exposure to future payments. If it is not to be applied to Occupational Pensions then this needs to be made very clear to the public as we do not believe they will understand the distinction and that expectation has not been expressed in the Press to date as far as we are aware.

Scope – The paper suggests (but does not state) that the secondary market will be made up of annuities purchased before the pensions freedoms were announced. Whilst we believe that this will be largely true we see no reason why this should not apply to all annuities going forward as individual circumstances or priorities may change in the future. It could also discourage investment in developing the secondary market participants if limited in this way.

Responses to HM Treasury Questions a new secondary market for annuities

Q1. In what circumstances do you think it would be appropriate to assign one's rights to their annuity income?

A1. We broadly agree with the examples provided in section 2.4 however we do feel that cashing in the income stream to pay down debt may not be the right thing to do where annuitants are in financial distress and may then fall back onto the welfare state due to a reduced income. The DWP have already issued statements about deprivation where the pension freedoms are used to gift money away or to spend it recklessly with regard to accessing means tested benefits and this should equally apply here.

Q2. 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?

A2. We believe that this will be a niche market. Whilst it may seem counter intuitive, if there are too many players in this space it may actually reduce the purchase price offered to the customer. This is because the overheads associated with failed bids will have to be absorbed by those purchases that do proceed.

We support the view that all parties commercially involved in the sales and purchase of annuities should be regulated entities (by the FCA) and whilst it should be possible to securitize the packaged policies they should be prohibited from being sold to retail investors in any form and this should be extended to care home companies. Life settlements and traded annuities have proved the point that customers do not understand the risks involved.

Q3. 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?

A3. No we do not support this view. We do not believe that the Provider should be compelled to buy-back but by eliminating this option additional costs are likely to be incurred by the consumer which will offset the potential benefits of a competitive market. Given that the number of Providers engaging in a secondary market may be small, allowing buy-back will allow an annuitant access to at least one purchaser and this could be used to benchmark alternative offers. The risks set out in 2.15 could be managed through appropriate warnings and the extension of the Pension Wise guidance and second line of defence per the FCAs PS15/4, to increase consumer knowledge and understanding.

Q4. 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?

A4. We think that the best solution would be the central death register but accept that the cost/benefit argument put forward by HM Treasury is valid. We believe that the option of using an executor to notify the provider is unreliable and should be discarded as a possible solution.

As indicated in our cover letter there are lessons which can be learnt from the life settlement industry here where either the Purchaser or the Provider undertakes periodic 'proof of life' testing beyond a certain age and we believe that such an approach is applicable here especially if the former annuitant is incentivised to co-operate in the process.

Q5. Do you agree with the proposed approach of the government working with the FCA regarding the fees and charges imposed by annuity providers?

A5. We consider this to be potentially problematic. The FCA has stated repeatedly that they are not a price regulator although their competition and consumer protection powers do enable them to act in such a way as to have an impact on fees and charges. Explicitly tasking the FCA to monitor fees and charges seems to bring them directly into the role of price regulation which would be a concern to the industry especially in the light of material increases in regulatory fees and levies. As the government is proposing this change it could act as it did with Stakeholder products, to cap by legislation the product costs and this we feel would be a better solution.

Q6. 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?

A6. No as we do not follow the rationale. The annuity is presumably already in payment and the payments will not change irrespective of whether the benefits are assigned or not. There may even be circumstances where the Trustees would like to crystallize their exposure to future payments. If it is not to be applied to Occupational Pensions then this needs to be made very clear to the public as we do not believe they will understand the distinction and that expectation has not been expressed in the Press to date as far as we are aware.

Q7. Are there any other types of products to which it would it be appropriate for the government to extend these reforms?

A7. We would suggest that the legislation consider whether this would apply to a deferred annuity and should not be limited to annuities which were purchased prior to the announcement of pension freedoms in acknowledgement that individual circumstances and priorities can change in the future.

Q8. 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?

A8. An annuitant who assigns their annuity will be subject to income tax on the full amount received when drawn. Unless there is the ability as part of the market to offer staged payments over a number of years to spread the tax burden then those using flexible pension access will have an advantage although we acknowledge that there is parity where the full pension is drawn at one time.

Q9. How should the government strike an appropriate balance between countering tax avoidance and allowing a market to develop?

A9. As a former Chancellor said "the difference between tax avoidance and tax evasion is the thickness of a prison wall". The government must draft legislation with sufficient care such that the opportunities for avoidance are limited but that does not impair the fair operation of the market.

If it becomes too easy to stumble into a large tax liability (e.g. as with withdrawals from Investment Bonds) consumers may legitimately feel that the complexity of the system operates against the majority and only favours those who can afford the advice to navigate through the tax legislation which is already complex.

Avoidance will occur where the tax saving is greater than the cost of achieving it, where this is done within the law and the government feels there is a "tax loss" (albeit where there is no tax due under the law this is a somewhat biased interpretation), it is for the government to change the law to prevent it. The public are not prevented from arranging their affairs in their own interest and not those of the public purse.

Q10. 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?

A10. If the cost of obtaining advice is greater than the benefit which can be derived from receiving that advice then it will be self-defeating exercise so we do believe a de-minimis amount should apply.

This does therefore lend itself to implementing a financial threshold where regulated advice is required prior to transacting or where certain guarantee features exist. Unlike the primary market where a transfer or cash value will be known upfront, any financial threshold can only realistically be applied in the secondary market once a prospective purchase price has been established.

Although it could be argued that the safeguards should not vary with the value of the annuity as this ignores the materiality of the income to the individual it is consistent with the new pension freedoms for new retirees.

Q11. What is the best way to implement these safeguards? Should the safeguards include expansion of the remit of Pension Wise?

A11. We agree that including these safeguards within the Pension Wise remit is potentially a good solution. This would involve further training for the Pension Wise Services and therefore potentially increased costs and the fairness of how those costs are allocated today and in the future are already subject to a wider industry debate.

Q12. 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?

A12. Advice will need to be paid for and it is appropriate for the recipient and beneficiary of the advice to pay for this. In many cases advice charges are facilitated by the product provider and this is not covered within the consultation. It is assumed that advice would amount to intermediation in these cases and would not therefore be subject to VAT even where the recommendation was not to assign the annuity for a lump sum.

Q13. 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?

A13. We expect this to be a niche market and without knowing how many Providers will be willing to operate in this space at outset it will be difficult to set a minimum number of quotes required.

Whilst it may seem counter intuitive, if there are too many players in this space it may actually reduce the purchase price offered to the customer. This is because the overheads associated with failed bids will have to be absorbed by those purchases that do proceed.

We do believe that the process should include a series of risk warnings, should signpost Pension Wise and the value of obtaining multiple quotes but prescribing a minimum may not be feasible at outset.

However, the FCA should define the format of the illustrations such that a fair comparison can be made on a like for like basis so that the best deal can be identified simply.

Q14. Does the government's approach sufficiently protect the rights of dependants upon assignment? If not, what further steps should the government take?

A14. The majority of annuities in payment today are on a single life basis (with no spouses benefit) and there is an increased likelihood of a vulnerable client being involved due to the potential age profile of prospective selling customers and their dependants.

This can be a problematic subject as the annuitant may argue that it is their asset to do with what they want without the need for the spousal agreement. However, although the contract is in the name of the annuitant the divorce courts often recognise a pension benefit as a joint asset for the purpose of division of assets.

In the circumstances, we believe the safest option is to obtain spousal approval whether it is a single or joint life annuity and for existing vulnerable clients policies to apply where applicable.

Q15. 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?

A15. We do see this as potentially problematic. Separation of the benefits would give further flexibility but would also add complexity and therefore cost into the process.

Q16. 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?

A16. The welfare benefits system is complex and a specialism in its own right.

Most advisers will have an awareness of the treatment of benefits but will not necessarily have an understanding of all the conditions that must be satisfied in order to access them as this is typically not their target market.

The answer would appear to be clear signposting of the issue to prospective sellers as part of the quotation process and suitable second line of defence risk warning which could summarise the benefits that could be affected by receipt of a capital sum.

CAB under Pensions Wise is the natural referral point as they have day to day familiarity with the intricacies of the benefits system.

Q17. Should those on means-tested benefits be able to assign their annuity income?

A17. Whilst an outright prohibition would offer a solution to Q16 above, making this an outright prohibition may still disadvantage some vulnerable consumers and lead them to

use high cost short term lending as an alternative which could ultimately prove of greater detriment. On balance therefore we would not support this option.

An alternative may simply be to take into account the pension payments they were receiving on a regular basis and assume that these payments are still being received for the purpose of calculating any entitlement to means tested benefits. Whilst this is a one off increased administrative burden it is probably a fairer consumer outcome.

Q18. 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.

A18. It is inevitable that some consumers will either be poorly advised or will make poor decisions against good advice leading to their own detriment over the long term.

Dissatisfaction with annuities is primarily around the much lower rates currently available to those in normal health and the inflexibility of the annuity itself.

We anticipate that there will be a continued need for consumers to provide a certain amount of guaranteed income throughout life and an annuity fulfils that need. Those with higher levels of pension saving will be able to afford a blended solution taking full advantage of the new pension freedoms.

At the less wealthy end of the spectrum, the annuity may still be the most suitable retirement income solution and the ability to undo this decision may help consumer for whom this is the right choice, become more accepting of the fact.

Our view is that for most people with an annuity they will be best served by keeping it and that given the extra costs and charges that will be incurred as a result of the assignment along with the potential tax and benefit implications, even the small number for whom there are over-riding reasons why this might be in their interest will not receive the full value of the income stream being given up and will by definition be worse off.

We would highlight that this last point does make the work of intermediaries in this market higher risk, especially in the absence of clear rules and guidance from the FCA and the Financial Ombudsman Service (FOS) and that this will be an impediment to consumers accessing advice as a result. We would cite the very limited uptake of Simplified Advice in the IFA sector a similar situation where regulatory uncertainty has severely dampened interest in this option.

We trust that you find these comments constructive and helpful.

Yours faithfully

