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Secondary annuities market

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Summary

Until April 2015, most people with defined contribution (DC) pension saving had to use them to buy an annuity or face a significant tax charge. However, under the 'freedom and choice' reforms, people aged 55 and over now have much more choice about when and how to draw their DC pension savings (*Taxation of Pensions Act 2014).*

People who have already purchased an annuity do not generally have the option to exit from that arrangement – it is typically a one-off and irreversible purchase (Cm 9046, March 2015, para 3.1).

This left some annuity holders feeling that they were unfairly excluded from the choices being extended to others. So, in the last Budget before the 2015 general election, the Coalition Government proposed allowing people in receipt of an annuity to sell that income to a third party from April 2016 (para 1.229-231). In July 2015, the current Government said implementation "should be delayed until 2017 to ensure there is an in-depth package to support consumers in making their decision." (HM Treasury, Summer Budget 2015, para 1.229)

In December 2015, following consultation the Government gave details of how the new market would work (see HM Treasury press release, December 2015). A core theme running through responses to the consultation was the importance of consumer protection and ensuring people understood the value of their annuities (HM Treasury, December 2015, para 4.2).

On 18 October 2016, the Government announced that it had cancelled plans to create a market for secondary annuities market. The reason was that it had become increasingly clear that creating the conditions to allow a competitive market to emerge could not be balanced with sufficient consumer protections (PQ 49517, 26 October 2016). An FCA consultation on proposed rules and guidance was withdrawn at the same time.

In an urgent parliamentary question the following day, Liberal Democrat MP Greg Mulholland expressed disappointment at the "huge U-turn" and the failure to "build a reasonable secondary annuity market." (HC Deb 19 October 2016 c810). In response, the then Economic Secretary to the Treasury, Simon Kirby said it had become clear that consumer protection would not be adequate:

> Throughout our investigations, one of our very highest priorities was to establish whether people could get a good deal through such a market. In the course of our efforts to investigate the viability of a secondary market in annuities, two things became clear. First, without compromising on consumer protections there would be insufficient purchasers of these annuities to create a competitive market in which British pensioners could get a good deal. Secondly, pensioners trying to sell their annuities would also be likely to incur high costs in doing so.
>
> This Government have made it very clear that we want this to be a country that works for everyone, and that includes making sure that everyone gets a high level of consumer protection. It has

> become clear, through our extensive research, that a secondary market would not be able to offer this. Rather than being to the benefit of British pensioners, it would instead be to their detriment. It is for that reason that we are not prepared to allow such a market to develop, and we will not be taking this policy further. (Ibid c809)

Shadow Treasury Minister Peter Dowd asked why the Government had not done the analysis at the outset (Ibid c811). SNP pension spokesperson Ian Blackford welcomed the "U-turn" but asked, why the matter had not been brought to the House (Ibid c812).

The Government's decision was welcomed by industry commentators, on the grounds that the market would have come with considerable risk to consumers. On the other hand, former Pensions Minister Ros Altmann said it would be a disappointment to some who had been required to buy to annuity "they didn't want and didn't need" (BBC news, 19 October 2016).

The Government says it has no plans to review its decision:

> The government announced in October 2016 that it would not be continuing with proposals to remove the restrictions on the sale of existing annuities.
>
> As these proposals progressed it became increasingly clear that the conditions required for a competitive market to emerge, with multiple buyers and sellers of annuities, could not be balanced with sufficient consumer protections.
>
> This could have led to consumers receiving poor value for their annuity income streams and suffering higher costs in the sales process. Consumer protection is a top priority for the government and it would not have been acceptable to allow a market to develop which could produce poor outcomes for consumers.
>
> There are no plans to review the decision not to continue with proposals for a secondary market in annuities at this time. (PQ 135978, 19 April 2018).

EDM 1459, which calls on the Government to "legislate to allow 5 million retirees to safely partially sell their annuity", currently has six signatures.

1. Background

1.1 Introduction of 'pension freedoms'

In the past, most people (75%) with DC pension savings used them to purchase an annuity.[1] This was strongly encouraged by pension tax legislation, which applied a 55% tax charge on lump sum withdrawals, except in limited circumstances. The advantage of annuities is that they provide a guaranteed income throughout retirement, reducing the likelihood that individuals exhaust their savings prematurely and have to fall back on the state. However, their popularity had declined in recent years, in part due to falling annuity rates, but also because of emerging evidence that parts of the market did not work well for consumers.[2]

In Budget 2014, the Coalition Government announced that from 6 April 2015 it would allow people aged 55 and over more flexibility about when and how to draw their DC pension savings, and allow them to do so at their marginal rate of income tax, rather than the 55% rate. Chancellor of the Exchequer, George Osborne, said that people "should be trusted with their own finances."[3] This was legislated for in the *Taxation of Pensions Act 2014.*

1.2 Support for decision-making

Although many welcomed the increase in choice, there were concerns that it would place a significant burden of responsibility on individuals, requiring them to make complex decisions, taking account a mix of longevity, inflation and investment risk, and the implications of withdrawals for tax, entitlement to means-tested benefits and help with social care.[4]

The Government recognised that people would need help to navigate those choices.[5] It therefore proposed to introduce a new guidance guarantee so that from April 2015 "everyone who retires with a defined contribution pension will be offered free and impartial face-to face guidance on their choices at the point of retirement."[6] The then Pensions Minister Steve Webb, explained that the new service would provide guidance on the options available – not financial advice.[7]

In addition, there is a 'second line of defence', in the form of an FCA requirement on firms to "ensure that firms give consumers appropriate retirement risk warnings at the point they decided to take a specific

1 HM Treasury, Freedom and choice in pensions, Cm 8835, March 2014
2 FSCP, Annuities: Time for Regulatory Reform, December 2013; See also Annuities and the annuitisation process: the consumer perspective – A review of the literature and an overview of the market ; FCA, Thematic Review of Annuities, TR 14/2 February 2014, p30
3 HC Deb 19 March 2014 c793
4 See, for example NAPF comments on 2014 budget, 19 March 2014
5 HM Treasury, *Freedom and choice in pensions,* Cm 8835, March 2014, para 4.7-9
6 HM Treasury, *Budget 2014,* HC 1104, March 2014
7 HC 1248, 30 April 2014, Q23 and 30 and 41; *Financial Services and Markets Act 2000,* as amended by the *Pension Schemes Act 2015,* s47 and Sch3

action to access their pension savings."[8] The FCA reviewed this post-implementation and decided that the risk-warnings remained appropriate but decided to set a threshold of £10,000 (pot size) for the requirement to apply.[9]

Pension Wise was provided for in the *Pension Schemes Act 2015* (s47). The service is delivered by the Pensions Advisory Service (TPAS) (telephone) and Citizens Advice (face-to face). HM Treasury worked with the Money Advice Service (MAS) to develop the website.[10]

In October 2015, running alongside the FCA's Financial Advice Market Review (FAMR), HM Treasury launched a consultation on how public financial guidance should be structured and how it could be made more effective for consumers.[11] The Government legislated in Part 1 of the *Financial Guidance and Claims Act 2018* to bring together three existing government-sponsored guidance services – the Money Advice Service, the Pensions Advisory Service and Pension Wise – to create a new Single Financial Guidance Body. The intention is to help ensure that members of the public can access good-quality, free-to-client, impartial financial guidance and debt advice.

These issues are discussed in more detail in Library Briefing Papers CBP-08033 Financial Guidance and Claims Bill 2017-19 (April 2018), SN-07042 Pension Wise: the guidance guarantee (September 2017) and SN-06891 Pension flexibilities (October 2017).

8 FCA, Retirement reforms and the guidance guarantee: retirement risk warnings, February 2015, para 1.6
9 FCA, Pension reforms – feedback on CP 15/30 and final rules and guidance, PS/12, April 2016, para 3.25
10 HM Treasury, Delivery pensions guidance: January 2015 update, 12 January 2015
11 FCA, Financial Advice Market Review, November 2015; HM Treasury, Public financial guidance – a consultation, October 2015

2. Consultation

Buying an annuity is "typically a one-off, irreversible decision."[12]

The legislation applying to annuities purchased before 6 April 2015 (when the pension freedoms were introduced) provides that the annuity contract must:

- be purchased from an insurance company that the member had the opportunity to select,
- be payable for the member's life,
- be paid at least once a year, either in advance or in arrears,
- only allow the amount paid each year to either stay level, increase or go down in circumstances prescribed by HMRC regulations - for more details see below,
- not allow the payment, either directly or indirectly, of a capital sum triggered by the member's death, (apart from annuity protection) (also see later below), and
- not be capable of assignment or surrender (except to give effect to a pension sharing order).[13]

In March 2015, HM Treasury explained that it was these requirements that typically deterred individual from assigning their annuity:

> […] Under current tax legislation, if an individual assigns their annuity to another party, any proceeds they receive from the assignment are subject to the "unauthorised payment" tax charges, which are normally 55%, but can be up to 70% in some circumstances. The current tax rules also require that the annuity must be payable for life and that payments under annuities bought before 6 April 2015 may not reduce other than in prescribed circumstances.[14]

It explained that while the legislation was designed to ensure that individuals who purchased an annuity received a steady income for life, it also effectively "locks annuity holders into their existing contract and in some cases may be reflected in the standard contractual terms of their annuity."[15]

In its last Budget before the 2015 general election, the Coalition Government proposed allowing people in receipt of an annuity to sell the income stream from it to a third party:

> **1.229** This government has already introduced major reforms to allow people entering retirement much more flexibility over how they use their defined contribution pension pot, instead of being required to purchase an annuity. The government now wants to allow people who have already bought an annuity to also enjoy flexibility in how they access the value of their annuity, without interfering with binding contractual requirements.

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12 FCA, Retirement income market study: Interim Report, Executive Summary
13 HMRC Pension Tax Manual: Member benefits: pensions: lifetime annuity; *Finance Act 2004,* Sch 28 (3)
14 HM Treasury and DWP, Creating a secondary annuity market, Cm 9046, March 2015, para 3.1
15 Ibid

> **1.230 From April 2016, the government will therefore change the tax rules to allow people who are already receiving income from an annuity to sell that income to a third party, subject to agreement from their annuity provider.** The proceeds of the sale could then be taken directly or drawn down over a number of years, and would be taxed at their marginal rate, in the same way as those taking their pension after April 2015.[16]

In March 2015, the Government launched a consultation on how to implement the reforms. This would include:

- Changing the tax rules in relation to annuity holders and remove the unauthorised payment tax charge of up to 55% (or even 70%) that deters annuity holders from assigning their annuity; and
- Working with the Financial Conduction Authority to ensure appropriate consumer protection was in place for annuity holders as they consider their options. This could include the provision of guidance or a requirement to seek advice so that individuals "are in a position to consider fully the impact of their decision and ensure they are receiving a competitive price."[17]

The Government proposed to create the conditions for a secondary market in which annuity holders could assign the right to the income stream from that annuity to a third party (such as an asset managers pension fund, insurer and intermediary) in return for a lump sum, flexi-access drawdown fund or flexible annuity (which they could either provide themselves or arrange through a third party).[18] There would be no interference with contractual agreements:

> Instead, where annuity providers agree, it allows the annuity holder to access the value of their assets where they can find a willing buyer. The annuity provider would continue to hold the underlying assets and pay the annuity income to the third party for the lifetime of the annuity holder.[19]

The third party buyer would offer a price to the annuity holder, which would reflect a number of factors including "their estimate of the actuarial value of the annuity, transaction costs and a profit margin."[20] To protect both consumers and providers, the existing provider would not be able to buy back an annuity.[21] Retail investors would be excluded from the market because of "the complexity and difficulty in determining a fair price."[22]

Initial responses

In a response to consultation published in June 2015, the ABI expressed its support in principle but thought there were "considerable challenges

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16 HM Treasury, Budget 2015, HC 1093,18 March 2015, paras 1.229-31
17 HM Treasury and DWP, Creating a secondary annuity market, Cm 9046, March 2015
18 Ibid, para 2.12
19 Ibid, para 1.7
20 Ibid
21 Ibid, para 2.15-7
22 Ibid, para 2.9

in establishing a functioning market and ensuring adequate protection for consumers, especially access to advice and guidance."[23]

The Pensions and Lifetime Savings Association expressed concern that the new market might be "so expensive as to greatly reduce the value available to most annuitants." It highlighted a number of issues:

- The number of sellers (people with an annuity today) is uncertain and likely to be time-limited. The advent of 'Freedom & Choice' has greatly reduced the market in annuities, so the only likely source of sellers for this market will be people who already have an annuity.
- Buyers will be wary of adverse selection and will compensate accordingly, either through pricing 'short longevity' into all contracts or through individually underwriting each transaction, both of which will increase costs. Either way, the value available to all, or some, sellers will be reduced.
- Many sellers will need protection in the form of independent advice. This will come at a significant cost and reduce the value of the transaction to the seller.
- By releasing the annuity's value in a lump sum sellers risk a higher tax bill than if they had drawn the income from an annuity, further reducing the value the annuitant ultimately receives. The Government's own forecasts suggest the Exchequer will reap over £1bn in additional taxes from the introduction of a secondary annuity market in the first two years.
- The cost of building the infrastructure needed to package and sell annuity contracts will be significant – especially as the lifetime of the market looks limited and all costs would need to be recouped within a short period of time, rather than spread over decades. This will further erode the value to sellers.
- Even if the infrastructure for a market were to be put in place, it is not clear who will be the buyers of the annuities. A NAPF survey of members suggests a very limited appetite from pension schemes for packaged annuities. Only 13% of defined benefit (DB) respondents to our survey expressed an interest, with 67% 'not interested'.[24]

The Government's response

In July 2015, the Conservative Government said it would proceed with the proposals but that implementation would be delayed until 2017:

> 1.229. The government wants existing annuity holders to have the freedom to sell their annuity income. The government will set out plans for a secondary annuities market in the autumn, and agrees with respondents to the recent consultation that implementation should be delayed until 2017 to ensure there is an in-depth package to support consumers in making their decision.[25]

[23] 'ABI sets out what is needed to make secondary annuity market proposals work for consumers', 26 June 2015

[24] 'Value hard to find in secondary annuity market', says NAPF, 18 June 2015; NAPF, Creating a Secondary Annuity Market: a response by the National Association of Pension Funds, June 2015

[25] HM Treasury, Summer Budget 2015, 8 July 2015, HC 264, para 1.230

This delay was welcomed by the Association of British Insurers and the Pensions and Lifetime Savings Association.[26]

In its December 2015 response to consultation, the Government announced that key features of the new market would include:

- setting out that pension annuities belonging to an individual and held in their own name will be eligible for the new freedoms
- requiring that all UK-based annuity purchasers and intermediaries are regulated by the FCA
- allowing annuity providers the choice to buy back an annuity, subject to robust safeguards
- introducing a comprehensive consumer protection package to ensure people make informed decisions about their savings, including:
- extending the free and impartial Pension Wise service to cover the secondary annuity market
- requiring individuals to seek independent financial advice for annuities worth above a certain threshold
- asking the independent regulator, the FCA, to put in place a consumer protection framework which could include consulting on a range of extra consumer protections, such as risk warnings and ways for consumers to understand the fair value of their annuities.[27]

It would remove the relevant pension tax restrictions from April 2017, expand Pension Wise to cover annuity holders and require those with annuities above a set level to take advice:

> We want as many people as possible to be able to access their pension flexibly, but those who bought a pension annuity before April this year are still effectively barred from doing so. We believe that there is no good reason for this. The government welcomes the support of the many stakeholders who agree with our view. So with effect from April 2017, we will remove the pension tax restrictions on people seeking to sell their right to future income streams for an upfront cash sum, whether they purchased their annuity before 6 April this year or since then.
>
> This will open up new freedoms to around 5 million people who currently have an annuity, as well as all future annuity holders. Individuals will be free to use the proceeds they receive from assigning their income stream how and when they want, taxed only at their marginal rate.
>
> With more choice for retirees, it is right that there should be appropriate support. So the government is expanding Pension Wise to cover all those who hold annuities. For those with an annuity above a certain value, the government will put in place a financial advice requirement to make sure they have the support to make the right decision. The government will work closely with the Financial Conduct Authority (FCA) to consider how this will work in practice. The FCA will also consult on other measures that

[26] Summer Budget 2015: ABI response on pension tax reform and delay to secondary annuity market timetable, 8 July 2015; NAPF comments on 2015 Summer Budget, 9 July 2015

[27] HM Treasury press release, Millions given freedom over their pension as government outlines new secondary annuity market; HM Treasury/DWP, Creating a secondary annuity market: response to the call for evidence, Dec 2015

> are designed to both protect consumers and promote competition during 2016.[28]

It would also need to make other legislative changes:

> **6.1 Tax** The government will continue to engage with interested parties and will consult on the detail of the tax framework in spring 2016.
>
> **6.2 Regulation.** In order to ensure that only qualifying categories of entities are permitted to participate in the secondary market for annuities, appropriate amendments will be made to secondary legislation under the Financial Services and Markets Act (FSMA) to create a new specific regulated activity for purchasing rights under an annuity on the secondary market (purchasing rights under an annuity on the secondary market already falls within existing general FSMA regulated activities). The government is also considering whether separate regulated activities are appropriate for annuity providers buying back an annuity and for parties acting as an intermediary in the secondary market for annuities.
>
> **6.3 Pension legislation.** At present, the *Occupational Pension Schemes (Discharge of Liability) Regulations 1997 (S.I. 784/1997)* generally prevent annuities from being assigned, but for very limited circumstances. The government intends to amend the Regulations to remove this general prohibition so that annuities can be assigned for the purpose of the secondary market.
>
> 6.4 With the removal of tax deterrents, it is anticipated that the parties to an existing annuity contract will, in many cases, be able to agree to vary the contract to remove any assignment restrictions. The government is considering whether a permissive statutory override that would permit the variation of annuity contracts and scheme rules when both parties agree is also necessary.
>
> **6.5 Welfare.** The government will continue to investigate whether it would be possible and appropriate to amend the existing deprivation rules to provide greater protection for public expenditure and more certainty over the treatment of these cases in means-tested benefits.[…]
>
> **6.8** The FCA intends to consult during 2016 on draft rules designed to promote FCA statutory objectives in relation to the secondary market for annuities.[29]

Expected impact

The Government said the changes would "open up new freedoms to around 5 million people who currently have an annuity, as well as future annuity holders."[30]

In March 2015, it said it expected income tax receipts to increase in the early years as individuals paid tax on the proceeds of any annuity sale.

[28] HM Treasury and DWP, Creating a secondary annuity market: response to the call for evidence, December 2015
[29] Ibid, Chapter 6
[30] Ibid, Foreword

There would then be reduced income tax on annuity payments in later years:[31]

Exchequer impact (£m)

	2015-16	2016-17	2017-18	2018-19	2019-20
Exchequer impact	0	+535	+540	-130	-120
Welfare cap impact	0	-15	-30	-30	-30

It said the main uncertainties in the costing related to the number of people who would choose to sell their annuities, which in turn was likely to be impacted by the value individuals received in exchange for annuities, which was itself uncertain.

In December 2015, it said an updated assessment would be included in a forthcoming Tax Information and Impact Note.[32]

In April 2016, the FCA said it expected business in this market to peak in the first two years and then to decline significantly to a low but relatively stable number:

- In a 'smaller market scenario', it projected that 75,000 individuals would sell their annuity in year 1, falling to 2,500 by year 3.
- In a 'larger market scenario', it projected that 250,000 individuals would sell their annuity in year 3, falling to 5,000 by year 3.[33]

2.1 Decision to cancel

The Government announced on 18 October 2016 that it had cancelled plans to create a market for secondary annuities on the grounds that creating the conditions to allow a competitive market to emerge could not be balanced with sufficient consumer protections. It said:

> After an extensive programme of engagement with industry, financial regulators and consumer groups, the government has decided not to take forward plans to introduce a secondary annuities market because the consumer protections required could undermine the market's development.
>
> Over the past few months, following a wide range of discussions, it has become increasingly clear that creating the conditions to allow a vibrant and competitive market to emerge, with multiple buyers and sellers of annuities, could not be balanced with sufficient consumer protections.
>
> Many firms have shown they are willing to allow customers to sell their annuities, but the government is clear that there will be insufficient purchasers to create a competitive market.
>
> While exploring this further, it has become clear that the steps that the government would need to take to create purchasing demand in the market would undermine other consumer protections.
>
> Consumer protection is a top priority for the government and we are not willing to allow a market to develop which could produce

31 HM Treasury, Budget 2015 – policy costings, March 2015
32 HM Treasury and DWP, Creating a secondary annuity market: response to the call for evidence, December 2015, chapter 5
33 FCA, Secondary Annuity Market – proposed rules and guidance, CP 16/12, April 2016, p47

> poor outcomes for consumers, such as receiving poor value for their annuity income stream and suffering higher costs.[34]

The decision was welcomed by industry experts, on the grounds that the market would have come with "considerable risk to consumers, including from unregulated buyers." On the other hand, former Pensions Minister Ros Altmann said it would be "disappointing to tens of thousands of people who bought an annuity they didn't and didn't need."[35] Saga commented that many pensioners would be sorely disappointed.[36]

In an urgent parliamentary question the following day, Greg Mulholland for the Liberal Democrats expressed disappointment:

> This is a huge U-turn, which was announced after clear lobbying by an industry that never really subscribed to it, and a failure by the Government to build a reasonable secondary annuity market. Of course it is right that protections are put in place to ensure that people are not exploited on the secondary annuities market, but there are tens of thousands of people trapped in poor value annuities who are eager to be able to take advantage of the new freedoms. Based on the promises in this Government's manifesto, many of them will already have been considering how to take advantage of the plans in order to release themselves from their annuity and invest their savings differently.[37]

The then Economic Secretary to the Treasury, Simon Kirby said it had become clear that consumer protection would not be adequate:

> Throughout our investigations, one of our very highest priorities was to establish whether people could get a good deal through such a market. In the course of our efforts to investigate the viability of a secondary market in annuities, two things became clear. First, without compromising on consumer protections there would be insufficient purchasers of these annuities to create a competitive market in which British pensioners could get a good deal. Secondly, pensioners trying to sell their annuities would also be likely to incur high costs in doing so.
>
> This Government have made it very clear that we want this to be a country that works for everyone, and that includes making sure that everyone gets a high level of consumer protection. It has become clear, through our extensive research, that a secondary market would not be able to offer this. Rather than being to the benefit of British pensioners, it would instead be to their detriment. It is for that reason that we are not prepared to allow such a market to develop, and we will not be taking this policy further.[38]

Shadow Treasury Minister Peter Dowd asked why the Government had not done proper analysis prior to the announcement:

> They were warned at the time. If they had done that analysis at the outset, they may have realised the chaos and confusion that such an announcement would cause for up to 500,000

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34 HM Treasury press release, Government cancels plans to create a market for secondary annuities, 18 October 2016

35 Government right to shelve annuity sales, says industry, 18 October 2016, BBC news

36 'Surprise' cancellation of secondary annuity set to disappoint pensioners – Saga UK, 18 October 2016

37 HC Deb 19 October 2016 c810

38 Ibid c809

> pensioners across the country, who are already worried about their long-term future.[39]

SNP pension spokesperson Ian Blackford welcomed the "U-turn" but asked, why the matter had not been brought to the House rather than MPs having to read about it in the media.[40]

Conservative MP Stephen McPartland asked what the Government intended to do to protect "pensioners on very low incomes who are trapped in difficult annuities." The Minister responded that:

> The Treasury will be considering this very carefully, but my hon. Friend will have to wait until the autumn statement to hear how we are best placed to deal with this. However, those people are absolutely at the centre of our attention, and we will do all we can to help.[41]

He also indicated that the Government would be looking at the existence of statutory override clauses in annuity contracts.[42]

The Government's position was summed up in a parliamentary written answer on 26 October 2016:

> *Julian Knight:* To ask Mr Chancellor of the Exchequer, what research his Department has carried out into the potential for widening of the secondary annuity market.
>
> *Simon Kirby:* At March Budget 2015 the government announced proposals to remove the current restrictions on selling existing annuities, and to create the conditions for a secondary market in annuities to develop. The intention was that pensioners would be able to sell the income they receive from their annuity in return for a lump sum.
>
> The government undertook extensive consultation with industry and consumer groups to understand the conditions that would be necessary for there to be a vibrant market and to achieve good outcomes for consumers. However, it became increasingly clear that creating the conditions to allow a competitive market to emerge could not be balanced with sufficient consumer protections.
>
> It also became clear that there would be insufficient purchasers to create a competitive market. This means there was a high risk of significant consumer detriment as consumers would be likely to get poor value for their annuity income streams and incur high costs for selling. Furthermore, the steps that the government would have needed to take to create purchasing demand in the market would have undermined important consumer protections.
>
> In these circumstances the government concluded that it would not be in consumers' interests to continue with this policy.[43]

Ongoing debate

The issue was debated again when the *Financial Guidance and Claims Bill 2017/19* was before Parliament. This was because it included provision to revoke section 32 of the *Bank of England and Financial*

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39 Ibid c811
40 Ibid c812
41 Ibid c812-3
42 Ibid c814
43 PQ 49517 26 October 2016

Services Act 2016, which had expanded the scope of Pension Wise to enable it to offer guidance to people with a "relevant interest in an annuity such as annuity holders considering selling the income from their annuities to a third party on the secondary market." Former Pensions Minister Baroness Altmann said the provision should not be revoked for two reasons:

- The Government might decide to proceed with the proposal in future; and
- It was already possible to sell an annuity under £10,000.[44]

Liberal Democrat spokesperson Baroness Kramer thought people ought to be allowed to cash in their annuity:

> Given that we have loosened up pension provision very widely, and recognised people's ability to make decisions about their future, I have never understood the Government's decision on taking away the right to sell an unwanted annuity. There are many reasons why this might be the right and appropriate decision for people in some circumstances. People may be facing large mortgages on which, for historic reasons, they are paying very high interest rates and which could be wiped out, to their overall financial benefit, if they could access their annuity. I could understand it if the Government thought that necessary safeguards should be added. In that case, the answer is to add those safeguards.[45]

Shadow Work and Pensions Minister Lord McKenzie did not think the proposals should be resurrected at this stage:

> To illustrate some of the complexity, the players in the secondary market would need to include: individual annuity holders; beneficiaries and dependants; purchasers of rights of an annuity under a specific regulated activity; further regulated activities or providers buying back annuities; regulated intermediaries; EFAs providing mandatory, regulated advice; and authorised entities to check that annuity holders have received financial advice, to name but a few. This is a very complex area and we should let it rest where the Government have recently decided it should be. There are complexities and costs. The big risk is an asymmetry of understanding of how the market would work. Other complex issues are pension sharing on divorce and the impact of these arrangements on people in receipt of benefits and social care. It is a minefield: the Government have looked at it, we have looked at it, we are not happy and it should not be resurrected at this time. There have to be greater priorities in the pensions field.[46]

Work and Pensions Minister Baroness Buscombe said she recognised people were disappointed but that "it would not be acceptable to allow a market to develop that could produce poor outcomes for consumers."[47]

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44 HL Deb 11 September 2017 c2305; HMRC, Pension Tax Manual, when benefit rights may be commuted. *Registered Pension Schemes (Authorised Payments) Regulations 2009 (SI 2009/1171)*, regs 6 and 7; *Finance Act 2004* (section 164 (1) (f))
45 HL Deb 11 September 2017 c2305
46 Ibid c2305-6
47 Ibid c2307

The Government's position was confirmed in response to a Parliamentary Question on 19 April 2018 by Economic Secretary to the Treasury John Glen:

> The government announced in October 2016 that it would not be continuing with proposals to remove the restrictions on the sale of existing annuities.
>
> As these proposals progressed it became increasingly clear that the conditions required for a competitive market to emerge, with multiple buyers and sellers of annuities, could not be balanced with sufficient consumer protections.
>
> This could have led to consumers receiving poor value for their annuity income streams and suffering higher costs in the sales process. Consumer protection is a top priority for the government and it would not have been acceptable to allow a market to develop which could produce poor outcomes for consumers.
>
> There are no plans to review the decision not to continue with proposals for a secondary market in annuities at this time.[48]

An EDM calling on the Government to legislate to allow people to safely partially sell their annuity has six signatures:

> That this House welcomes the launch of the Daily Mail's Unlock our Pensions campaign; notes that the Government proposed in March 2015 to extend pensions freedoms to existing annuity holders, by introducing a secondary market for commutation to be introduced in 2017; acknowledges that in October 2016 the Government announced it would no longer be proceeding with this policy; regrets the Government's statement that there are currently no plans to change policy to level the playing field; recognises that retirees may need to access funds from their annuity in times of need; and calls on the Government to legislate to allow 5 million retirees to safely partially sell their annuity.[49]

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[48] PQ 135978, 19 April 2018
[49] EDM 1459 2017/19

3. Supporting decision making

The Government said that for many continuing to hold their annuity would be the right decision. Reasons for wanting to assign it might include:

- freeing up the value where an individual already had other income sufficient to cover daily needs;
- providing a lump sum for relatives or dependants;
- meeting a particular need or goal, such as paying down debt;
- responding to a change in circumstances; or
- purchasing a more flexible pension income product.[50]

In coming to a decision, individuals would need to consider a range of factors including:

> […] their health, their current financial needs, what other income they will receive, their saved wealth and their aspirations for future needs. Individuals will also have to consider dependants' needs – both now and in the future – and the implications for their own future welfare and social care needs.[51]

They were likely to find it difficult to judge the value of their annuity. This was because accurate calculation of the net present value of an annuity is complex. Furthermore, individuals tend to have a strong preference for payment now over future payments and to consistently underestimate their own life expectancy.[52]

3.1 Advice and guidance

There was a strong case for requiring holders of annuities above a certain value to seek advice:

> **4.8 Regulated advice.** There is a strong case for requiring annuity holders to take financial advice from an Independent Financial Advisor, with a requirement for annuity providers to check this before they enable the annuity to be assigned. This mirrors the requirements now in place for when people convert from a defined benefit to a defined contribution based pension during their accumulation phase, where the value of the pension is above £30,000.
>
> 4.9 Regulated advice would ensure that individuals receive help tailored to their circumstances and a recommendation on whether assigning their annuity to a third party would be in their best interests. People would still be at liberty to choose not to accept a recommendation.[53]

There would need to be a means of approximating the value of the annuity in advance.[54]

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[50] HM Treasury and DWP, Creating a secondary annuity market, Cm 9046, March 2015
[51] Ibid para 4.2
[52] Ibid para 4.3
[53] HM Treasury, Creating a secondary annuity market, Cm 9046, March 2015
[54] Ibid para 4.11

Alongside this, the remit of Pension Wise could be extended to provide access to annuity holders – or guidance could be offered through the annuity provider or third parties.[55]

Firms could also be required to give retirement risk warnings:

> **4.13 Risk warnings.** The FCA is placing a requirement upon pension firms to provide customers seeking to access their pension with a risk warning setting out the potential risks of different options, based upon a consumer's health and circumstances. This so-called 'second line of defence' could be introduced as a requirement upon the original annuity provider to protect their customers looking to assign their annuity income to a third party, with annuity providers being required to provide warnings of the risks and factors consumers should be considering when making this decision:.[56]

In its response to the consultation in December 2015, the Government said any advice requirements would need to reflect the outcome of the Financial Advice Market Review. In the meantime, it would legislate to require some individuals to take advice:

> 4.5 The government has recently launched a consultation around the Financial Advice Market Review (FAMR). The review will consider how financial advice could work better for consumers in the UK and is due to report in March 2016. The government's view is that any advice requirements for the secondary market for annuities should reflect wider advice measures which emerge following the recommendations from this review. However, it is unlikely that the recommendations from FAMR will be fully implemented by April 2017.
>
> 4.6 In the meantime, the government believes that individuals who want to sell an annuity income stream above a certain value should be required to seek advice before proceeding with the sale, and will legislate for this. This will ensure that individuals receive help tailored to their circumstances, a recommendation on whether assigning their annuity would be in their best interests and, potentially, assistance in the sales process. The government will set out in secondary legislation who will be required to take financial advice. The government is further considering whether the threshold should also take into account the individual's wider circumstances.[57]

The expansion of Pension Wise and the advice requirement were legislated for in the *Bank of England and Financial Services Act 2016:*

- Section 32 expanded the scope of Pension Wise so that it can offer guidance to people with a "relevant interest in an annuity such as annuity holders considering selling the income from their annuities to a third party on the secondary market." It also gave the Secretary of State power to specify in secondary legislation what annuities come within the scope of this provision, and what interest a person must have in an annuity to have access to the guidance service.

55 Ibid
56 Ibid
57 HM Treasury and DWP, Creating a secondary annuity market: response to the call for evidence, December 2015, para 4.6

- Section 33 provided for advice requirement, including a requirement on the FCA to make rules to require certain authorised persons to check that an individual with an annuity of a specified type or value, who is considering transferring or dealing with the income stream from that annuity on the secondary market, has taken appropriate financial advice. [58]

However, the Government legislated in the *Financial Guidance and Claims Act 2018* to revoke section 32.[59] Work and Pensions Minister, Baroness Buscombe explained:

> The Government have made it clear that they do not believe it makes sense to mandate guidance on a market that no longer exists, and that therefore it is far better to revoke the legislation. However, the broad remit of pensions and money guidance gives the body the option of guidance on this if it is appropriate.[60]

The FCA launched a consultation in April 2016 on Secondary annuity market – proposed rules and guidance (April 2016). However, this was withdrawn on 18 October 2016, when HM Treasury announced that it was no longer taking forward plans to introduce a secondary annuities market.[61]

3.2 Interaction with means-tested benefits

The Government estimated that around 13% of annuities are paid out to those in receipt of means-tested benefits, primarily Pension Credit and Housing Benefit. Changing an income stream for capital could change the level of support an individual was entitled to.[62]

The means tests for social security benefits, social care and council tax reductions take into account levels of income and capital. In addition, there are 'deprivation of income and capital rules', under which an individual can be treated as possessing income or capital they no longer have if they are considered to have deliberately deprived themselves of it in order to increase their entitlement.[63]

The Government said it did not intend to compensate people through the welfare system for any loss of income resulting from assigning their annuity to a third pay. It was therefore considering whether people on

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58 *Bank of England and Financial Services Act 2016*, para 159-163; These provisions and the debate in Parliament are discussed in more detail in Library Briefing Paper CBP-07509 Bank of England and Financial Services Bill [HL]: Commons committee stage proceedings (April 2016), CBP-7476 The Bank of England and Financial Services Bill (January 2016), CBP-07338 The Bank of England and Financial Services Bill [HL] Lords Stages (January 2016)

59 Section 25 and Schedule 3 (32)

60 HL Deb 11 September 2017 c2307

61 FCA website – CP 16/12 Secondary annuity market – proposed rules and guidance, April 2016, updated 18 October 2016

62 HM Treasury, Creating a secondary annuity market, Cm 9046, March 2015

63 For benefits, the rules are in the State Pension Credit Regulations 2002 (SI 2002 No. 1792), reg 18 and the Housing Benefit (Persons who have attained the qualifying age for State Pension Credit) Regulations (2006 No. 214), reg 41 DWP, Decision Makers Guide, para 85408-30

means-tested benefits or in social care should be prevented from doing so.[64]

In December 2015, the Government said it had decided they would not. However, clear information would be needed on the impact of doing so. Changes to guidance would be needed to make clear how existing rules might apply in relation to people taking advantage of the new secondary market for annuities.[65]

The FCA consultation proposed that providers should warn annuity holders that sale could "seriously and permanently affect your eligibility for important welfare benefits" and that they should make sure that they were aware of the potential impact on any means-tested benefits they receive or may receive in the future.[66]

3.3 Protecting dependants and beneficiaries

The FCA consultation paper also pointed out that there would need to be measures to protect dependants and beneficiaries of annuity holders:

> 4.19 Many people will hold annuities that contain rights for more than one party to receive an income. Most typically, they include the rights for a dependant to receive an income after the principal holder's death. This may also include the commuted value of a guarantee period or the continuation of the original annuity for a guaranteed period.
>
> 4.20 Beneficiaries of contracts are generally protected by third party rights legislation which restricts the ability of the contracting parties to reduce or sign away their rights without their consent, though this legislation allows parties to "contract out" of these protections, and in many cases these statutory rights are dis-applied by the terms and conditions of annuity contracts.

One approach would be to require the written consent of any dependants before rights under an annuity could be assigned. Another would be to prevent the rights of the dependant from being assigned.[67]

In December 2015, the Government asked the FCA to consider a number of issues further:

> […] whether a requirement could be placed on the annuity provider or other relevant parties to ensure that the dependant or beneficiary of an annuity has consented to its assignment, enforced through FCA rules.
>
> 4.24 The government will ask the FCA to consider how FCA rules could take in to account challenges including:
>
> - obtaining consent where dependants or beneficiaries are unnamed (for example if the beneficiary is "any spouse" of the annuitant) or where they are particularly vulnerable (for example if they are mentally impaired or a minor)

64 Cm 9046, para 4.27
65 HM Treasury and DWP, Creating a secondary annuity market: response to the call for evidence, December 2015
66 FCA, Secondary annuity market – proposed rules and guidance, CP 16/12, April 2016, p17
67 HM Treasury, Creating a secondary annuity market, Cm 9046, March 2015, para 4.27 para 4.21-22

> - ensuring that appropriate protections are in place for income streams which are payable to former spouses or civil partners of an annuity holder, as a result of pension sharing or attachment agreements made upon dissolution.
> - 4.25 One option considered in the consultation document is whether the government should prescribe that only the rights of the primary annuity holder, and not those of any dependant or beneficiary, may be assigned. The potential income stream for the dependant or beneficiary would be separated from the primary annuity income, and would continue to be payable upon the death of the primary annuity holder. However, many respondents to the consultation stated that partial assignment/buy back of annuity rights would be too complex and create additional costs (which would be passed on to consumers). The buyer would also attain fewer legal rights from partial assignment and the transaction may create complexities from a tax perspective.
> - 4.26 The government will also ask the FCA to consider the potential for putting in place further rules protecting consumers (including dependants and beneficiaries) who show vulnerable characteristics.[68]
>
> The Government considered it is important that material developed by industry to encourage consumers to consider selling their annuity income is "clear and fair and not misleading, and that people do not feel forced into a decision." UK purchasers of annuity rights would have to be FCA regulated and will therefore be subject to FCA rules and enforcement powers. However, purchasers outside the UK would be outside the FCA's remit. To ensure providers were protected in such circumstances, the Government was considering requiring at least one party in every transaction within the secondary market for annuities to be authorised by the FCA.[69]

In its April 2016 consultation, the FCA asked for views on proposals that:

> […] at first contact all sellers should be informed about the possible need for contingent beneficiary consent, and that FCA should make rules in relation to contingent beneficiary consent[70]

On 18 October, when HM Treasury announced that it would not proceed with plans for a secondary annuities market, the FCA withdrew this consultation.[71]

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68 HM Treasury and DWP, Creating a secondary annuity market: response to the call for evidence, December 2015
69 HM Treasury and DWP, Creating a secondary annuity market: response to the call for evidence, December 2015
70 FCA, Secondary annuity market – proposed rules and guidance, CP 16/12, April 2016
71 FCA website – updated 18 October 2016

4. Regulation

In April 2016, building on consultation undertaken the previous year, the Government published a further consultation on the changes that would need to be made to the regulatory framework. It sought view on:

> […] draft secondary legislation to create three new specified activities in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 that will apply to any person wishing to operate in the new secondary market for annuities.[72]

Its proposals would:

> The government's proposals will require anyone wanting to operate in this market to be authorised and supervised by the Financial Conduct Authority (FCA) and will make it easier for the FCA to apply specific, tailored rules to participating UK firms.

4.1 FCA consultation

In a consultation on changes to its rules in April 2016, the Financial Conduct Authority (FCA) said that although a secondary market in annuities might deliver flexibility for some consumers, consumers could be exposed to significant risks:

- **longevity risk** – a consumer selling an annuity income is giving up some or all of their income and insurance against longevity risk, depending on the other income (including other annuities) they have. They may therefore face an increased risk of running out of money in retirement
- **value for money** – some consumers may struggle to value their annuity incomes in respect of the benefits being forgone. Consumers will need to be helped in making an informed choice about whether to sell, and at what price
- **consumer inertia** – if consumers do not shop around they may not find the best price for their annuity income
- **vulnerability** – there is a higher incidence of reduced mental capacity among potential annuity income sellers. Individuals who have debts may come under pressure to sell their annuity income in order to pay off those debts, although this may not be in their best interests. Sellers who are, or may become, reliant on means tested benefits may also be vulnerable
- **potential conflicts of interest** – conflicts of interest exist that have the potential to cause detriment to sellers, for example, in respect of relationships between brokers and buyers
- **potential risk of investment scams and fraud** – the FCA has a key role in seeking to reduce investment scams and fraud, this includes monies released from pensions and obtained via annuity income sale on the secondary annuity market

72 Gov.UK, Creating a secondary market for annuities secondary legislation, April 2016; HM Treasury, Consultation: creating a secondary market for annuities - secondary legislation, April 2016

- **market depth** – it is impossible to know in advance how many buyers will seek to participate in the secondary annuity market. If insufficient buyers participate, this may reduce the price offered to consumers for their annuity income.[73]

In its April 2016 consultation on changes to its rules, the FCA identified five areas where consumers would need protection: disclosure; presentation of offers; restrictions on charging; compensation and prudential arrangements; and other regulatory requirements[74]

It proposed new rules and guidance which would aim to deliver the protections set out below:

- sellers should, at least once, and as early in the process as possible: –
- receive the relevant risk warnings (see 1.16 below)
  - be made aware of the possible existence, and where possible the likely amount, of charges and costs they may bear in selling their annuity income
  - be made aware of the possibility of taking advice, or using the Pension Wise guidance service, and be encouraged to use such services
  - be made aware of the possible legal requirement for them to take advice and the possible need to obtain consent from contingent beneficiaries
  - be encouraged to shop around for better quotes for their annuity income
- all quotes made for a seller's annuity income should be presented net of the firm's estimated forthcoming costs where possible. This should also be accompanied by a quote of the replacement cost of the annuity income were it to be bought new on the open market
- broker remuneration must not introduce conflicts of interest
- sellers will be able to complain to the Financial Ombudsman Service (ombudsman service) and, if necessary, seek redress from the Financial Services Compensation Scheme (FSCS), subject to all the appropriate eligibility criteria being satisfied.[75]

The Pensions and Lifetime Savings Association commented that the proposed rules looked sensible.[76]

The FCA withdrew the consultation on 18 October 2016, when HM Treasury announced that it was no longer proceeding with plans for a secondary annuities market.[77]

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73 FCA, Secondary annuity market – proposed rules and guidance, CP 16/12, April 2016

74 Ibid

75 Ibid para 1.15

76 Consultation reveals industry support for secondary annuities market, Pensions Age, 21 June 2016

77 FCA website – CP 16/12: Secondary annuity market – proposed rules and guidance (updated 18 October 2016)

5. Pension tax legislation

5.1 Removal of the 55% tax charge

The March 2015 consultation document identified a number of changes to pension tax legislation that would need to be made. The main one was to remove the 55% tax charge that would currently apply if an individual assigned their annuity to a third party:

> Under current tax legislation, if an individual assigns their annuity to another party, any proceeds they receive from the assignment are subject to the "unauthorised payment" tax charges, which are normally 55%, but can be up to 70% in some circumstances. The current tax rules also require that the annuity must be payable for life and that payments under annuities bought before 6 April 2015 may not reduce other than in prescribed circumstances. This legislation was designed to ensure that individuals who purchase an annuity receive a steady income for life. However, it also effectively locks annuity holders into their existing contract, and in some cases may be reflected in the standard contractual terms of the annuity. Additionally some secondary pensions legislation might need amending to ensure that annuities purchased by or on behalf of individual scheme members are capable of assignment.
>
> 3.2 To allow individuals to assign their annuity, the government proposes to remove these tax charges. Instead of being taxed at up to 55% (or more), individuals who choose to assign their annuity to a third party will be taxed on the payment they receive in return at their marginal rate of tax.[78]

Under the new tax rules individuals assigning an annuity would have three options:

- A lump sum cash payment, subject to income tax at their marginal rate;
- Having the funds transferred to a flexi-access drawdown account, from which they could make withdrawals over time, with the withdrawals taxed at their marginal rate;
- A flexible annuity, with income tax deducted at source as is usually the case with annuities.[79]

5.2 £10,000 annual allowance

Pension tax legislation restricts the amount of tax-free saving an individual can make in a pension over a year by subjecting savings above the 'annual allowance' (£40,000 in 2016/17) to a tax charge.[80]

When it introduced the 'pension freedoms', the Government decided to introduce a 'money purchase annual allowance' of £10,000 that would apply once people had accessed their savings flexibly. This was to prevent tax avoidance – for example, by people diverting salary into

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[78] HM Treasury, Creating a secondary annuity market, Cm 9046, March 2015
[79] Ibid, para 3.3
[80] *FA 2004*, s227, 228 and 228A

their pension (thus avoiding income tax), taking it out immediately and receiving 25% of it tax-free.[81]

The Government decided that this would also apply to people assigning their annuity to a third party:

> 3.5 To ensure consistency of treatment, the government proposes to apply the £10,000 annual allowance to individuals who assign their annuity to a third party. This will apply in the following circumstances:
>
> - for individuals who receive their payment in the form of a cash lump sum, this will apply from the date that they receive the cash payment
> - for individuals who use their payment to reinvest in a flexi-access drawdown fund, this will apply from the date that they first draw down from this fund
> - for individuals who use their payment to purchase a flexible annuity, this will apply when the first payment is made under the flexible annuity.[82]

Other "anti-avoidance" provisions might, for example, ensure that:

> […] an assignment will trigger an unauthorised payment charge where the assignment is made between connected persons, or is made to a registered pension scheme with less than a certain number of members.[83]

For more on the £10,000 money purchase annual allowance, see SN-06891 Pension flexibilities (section 4.8).

5.3 Tax treatment of unused funds on death

The tax treatment of unused funds on death would be in line with the rules applying to other individuals accessing their pension savings. This would mean:

- Individuals who receive a cash lump sum payment in return for assigning their annuity, any money remaining from that lump sum will form part of their estate upon death. Gifts made during their lifetime will be subject to the usual tax rules on such gifts;
- Individuals who put the funds into a flexi-access drawdown fund, the funds will be treated in line with the new rules for drawdown. This means that where that individual dies below age 75 with unused funds held in a flexi-access drawdown fund, they will be able to pass these free of income tax to any beneficiary who is an individual. Where an individual dies having reached the age of 75 with unused funds held in a flexi-access drawdown fund, they will be able to pass these to any beneficiary, who will then be able to draw down on these, or buy an annuity – in

81 HM Treasury, Freedom and choice in pensions: Government response to consultation, Cm 8901, July 2014, para 2.27; *Taxation of Pensions Act 2014*, Sch 1 (Part 4)
82 Ibid
83 HM Treasury, Creating a secondary annuity market, Cm 9046, March 2015, para 3.11

each case liable to income tax at their marginal rate on the payments; and

- Individuals who use the funds to purchase a flexible annuity, payments under the contract in respect of a dependant, nominee or successor will be free of income tax where the original annuity holder dies below age 75, and will be taxable as pension income if the original annuity holder dies after this age.[84]

For more on the background, see Library Briefing Paper CBP-07318 Tax treatment of pensions on death (October 2015).

A detailed consultation on changes to the tax framework was published in April 2016: Creating a secondary annuity market: tax framework.

[84] Ibid, para 3.6-7

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