

Creating a secondary annuities market
Response from the Low Incomes Tax Reform Group (LITRG)

1 Introduction

- 1.1 We welcome the opportunity to respond to the consultation document on the creation of a secondary annuities market in the areas which are relevant to our interest of taxation of those on low incomes. Clearly much of this document concentrates on financial matters, consumer protection and mechanisms for operating such a market, aspects which are outside our professional sphere, yet we may still make comment where we feel that the overall interest of our constituency may be affected, for good or ill.

2 About Us

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.
- 2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Executive Summary

3.1 In short,

- We support the broad thrust of the changes.
- There should be equality of treatment between pre- and post- April reform annuitants just as there should be equality between different options.
- It will be very difficult for the financially aware to decide what is best for them or whether a price is fair. The less financially aware will need considerable help and advice.
- For those who have the means, the advice will be costly, especially as a proportion of the amounts involved if their pension pots are small. For those who do not have the means, advice should be available from PensionWise. However that advice is most unlikely to be sufficient. Among other things, it should cover the impact of any decision on the tax position and on benefits.
- These difficulties are likely to be exacerbated if the market makers are unwilling to deal with people with small annuities. They will need a buy-back provision with the original provider.
- There may be problems reporting the death of an annuitant. We discuss below possible routes towards a solution.
- There will be a need for strong FCA supervision and authorisation of every organisation involved in giving advice or engaged in the market.

- 3.2 There is no doubt in our minds that the intention of Government to level the playing field and create consistencies across the realm of pensions is worthy of support. The pensions reforms of 2015 have changed the opportunities dramatically for pension savers to deploy their savings in the way that seems best to them, in contrast to the regime of the last 90 years which imposed a straitjacket on the vast majority of savers, certainly those with modest pots, who had little choice but to purchase an annuity whether appropriate to their circumstances or not. Thus we currently have two classes of pensioners with or entitled to annuities, pre- and post- the April reforms. They may be coeval and from identical circumstances, yet one will be bound by a rigid and irrevocable contract while the other has the freedom to deploy and vary their pension pots as suits them at different times and over an extended period.

- 3.3 Just as as the pensions reforms endeavour to bring about equality of tax treatment between the different options, e.g. the taxation of continuing annuities and drawdown schemes before and after the pensioner's 75th birthday, so it would seem fair to bring about equality of treatment between those who had for whatever reason crystallised their pensions before 6 April 2015 and those who did so after. It would be inequitable, even harsh, to condemn those trapped in old-style annuities to remain in a state not necessarily of their own making.
- 3.4 We agree that there are serious questions raised about the financial benefits or detriments involved in the proposed triangular market and that it will be extremely difficult for even the financially aware and numerate to assess the implications and effects of the decision to exchange the security of an annuity for some other form of pension provision, quite apart from being able to judge whether the price offered is a fair one. The costs of the transaction and compliance for the pension provider and third party must be as unknown to the annuitant as is the longevity and risk of the annuitant to the third party.
- 3.5 These risks are factors which an independent adviser must take into account when considering the appropriateness of exchanging an annuity for some other benefit, whether it be a cash lump sum or some other form of pension provision and it is hard to see how the current PensionWise guidance service can possibly manage to assess and guide on such complex matters in the mere 45 minutes currently allowed for pensions guidance. In our opinion, an IFA would be unlikely to spend less than 2 hours on the necessary factfind before discussing the pros and cons and writing up the recommendations. Such an exercise will surely cost many hundreds of pounds at least which, for someone toying with trading in an annuity of, perhaps, £800 a year would be a hefty percentage of the lump sum or transfer. There is a very clear need for deep thought on how to protect the consumer from both themselves and the market makers. We are especially aware of the difficulties for those of modest means or perhaps more limited literacy and numeracy in obtaining reliable independent advice either free or within their price range.
- 3.6 These difficulties are exacerbated if market makers show little or no inclination to accept any assignment of income from those with only small annuities, as is already the case when someone trying to exercise the open market option in the first place finds no takers beyond the pension company with whom they have saved, and this absence of competition should require both the option of "buy back" from the original provider and firm regulation by the FCA to prevent those providers from depressing values by using their monopoly.
- 3.7 The same need for deep thought is apparent when considering the question about how the annuity provider becomes aware of the death of either the single-life annuitant or the first (or indeed the second) death of a joint-life annuity. Not only does the third party receiving the annuity have no interest in that source of income ceasing, they also may have no further contact with the original annuitant once the transaction has been completed. If the entire lump sum has been handed over or the capital passed on to another provider for annuity or drawdown, then communication with the original annuitant ceases. We make a suggestion in our answer to Q A. 4.2.4.

- 3.8 A related matter is the need to minimise scammers profiting from poor communications over the death of an annuitant. A disreputable third party operating in the market could easily continue to receive annuity payments indefinitely regardless of the existence of the original annuitant unless there are secure and reliable rules for reporting deaths and also strong FCA supervision and authorisation of every organisation and intermediary engaged in an annuities market. This goes some way beyond the measures on consumer protection suggested in Chapter 4 and is probably more restrictive of the range of market makers suggested in Chapter 2.
- 3.9 In the same spirit we offer some thoughts on the impact on means-tested benefits in A.4.4.7 since these are more likely to be of relevance to our low income constituency than are the possibilities of aggressive tax avoidance which are raised in Chapter 3.

4 Questions

- 4.1 We answer them in the order taken from the Summary of questions on pages 27 and 28 of the consultation document and use the same numbering.
- 4.2 ***A.2 (Chapter 2)***
- 4.2.1 Question 1: It would seem appropriate whenever an annuitant wishes to take advantage of a more flexible drawdown or lump sum option as envisaged by the April 2015 reforms, in particular those who took out an annuity when that was their only option, and also those who took out an annuity after April 2015 but whose circumstances have now changed, e.g. they have received a terminal diagnosis.
- 4.2.2 Question 2: As mentioned above, we believe that any corporate entity entering this market should be as stringently regulated as the pensions industry is already; there is no difference between the original pension companies' regulation in the matter of pensions savings and ultimate products and that of any secondary organisation undertaking the same task. Likewise any intermediary or independent financial adviser should be regulated by the Financial Conduct Authority to minimise fraud and scamming. If they are not regulated effectively, there is a danger of pressure from the unscrupulous on vulnerable annuitants to assign their annuity income and pay a hefty fee for the process.
- 4.2.3 Question 3: There is no overwhelming reason why annuitants shouldn't be able to arrange "buy back" with their existing provider. The opportunity for underselling does, of course, exist just as it does in selling the annuity in the first place. Pension companies have not always placed the open market option prominently in their "wake-up" packs to savers and FCA figures have shown that over 60% of customers have failed to exercise this right while some 80% would have benefited had they done so. Provided that companies are compelled to give clear guidance on the right to shop around, there might be financial advantage in an in-house buy back, which minimises the costs involved in a third party transaction. The original annuity provider already has most of the information required and might merely need to update it.

- 4.2.4 Question 4: Since reporting a death is both compulsory and a matter of general Government involvement with its citizens, there is no reason why this should be left to commercial interests to resolve haphazardly. It is a misuse of data protection legislation to invoke it in order to hide the fact of someone's death which is after all a matter of public record. There is obviously no need to disclose personal or financial information about the deceased (although even their will becomes accessible to the public after probate) but the view expressed ten years ago by the pensions industry during consultation on pensions simplification that data protection forbade them from telling HMRC that one of their members had died was patently absurd. It is ridiculous to consider that it is obligatory for an employer to notify HMRC when an employee leaves their job, yet a pension company cannot tell them when he or she leaves this life.

There is a widespread (apart from Northern Ireland) and well-tested network operated by DWP in Tell Us Once (TUO) whereby with the consent of the reporter of the death the registrar can disseminate the information to all relevant Government departments. It would seem worth exploring whether this system could be extended to appropriate non-Governmental organisations where there is some contractual relationship with the State. This could obviously include pension providers who are at the least required to collect tax on behalf of the State and report back on P14s and P35s, while equally obviously it would exclude the deceased's golf club or Royal British Legion branch who have no duty to report their membership to Government.

This would get round some of the uncertainties of relying on surviving spouses or personal representatives (if either exist) to report deaths to an original annuity provider, when they may well be totally unaware of the existence of the original annuity anyway. There could equally be similar ignorance of the third party who paid out a lump sum years previously. This lack of knowledge means that using TUO would not be watertight but information technology and digital systems should make it possible for receipt of a P14 or similar information to flag up against an HMRC record that the annuitant was dead. An annual submission to RTI with details of those on whose behalf the provider is paying an annuity would enable HMRC to liaise effectively. At the most it would mean a delay of one year. It would also reduce considerably the shortage and inaccuracy of information among the majority of the population who do not make a will.

This raises a question not asked in the consultation and not strictly within our remit. What reporting route would a pension provider take, since they are no longer paying a taxable annuity to an individual but rather an income stream to a commercial entity who will be treating that income as trading receipts, not pension (3.12)? Should there be something similar to a P14 which the pension company would continue to send to HMRC?

- 4.2.5 Question 5: There is a clear case for regulating the level of fees to protect the financially unaware and the unrepresented from disproportionate and unwarranted costs, and the combination of Government and the FCA should work well.
- 4.2.6 Question 6: No comment.

4.2.7 Question 7: No comment.

4.3 **A3 (Chapter 3)**

4.3.1 Question 8: As we mentioned at the beginning of this response, we welcome a measure which aligns the rights and opportunities of those trapped in pre-reform contracts with those now available to those with similar pension schemes. In particular we support the opportunity to provide access to flexible annuities and drawdown plans as well as the much-publicised lump sum route. To achieve parity it is important to provide the same choices to those wishing to review their annuities as the ones which are now available to new pensioners. Not to do so would undermine the whole point of the proposed reform.

We would like to add a question not asked in connection with the above. Would an annuitant who had originally not taken the tax-free Pension Commencement Lump Sum but rather purchased an annuity with the entire pot subsequently be able to take a 25% tax free sum on assigning their original annuity and taking out a secondary annuity?

In response to the second part of this question, we would recommend consideration of introducing some form of relief (perhaps a variant on the Trivial Commutation Lump sum rules) for those taking a lump sum for assigning their annuity income in circumstances where it is clear the individual otherwise might not have paid tax on the annuity income had they continued to receive it. This would only apply to those on low incomes and we believe it should be relatively easy to set a single monetary limit to achieve this.

The above comments apart, the tax rules suggested seem well-balanced to achieve the desired equal status by placing the tax charge on the outcome, not the process. Likewise the tax rules on death would seem to give equal treatment to the pre-reform annuitants.

4.3.2 Question 9: While fully supporting the government's approach to forestalling and countering the use of a secondary annuities market as a vehicle of aggressive or artificial tax avoidance, we do not consider that the financial circumstances of our constituency are likely to permit them to become involved in any such complex schemes and we therefore have no further comment to make beyond an expectation that Government regulation would protect the vulnerable from being sucked unwittingly into such schemes. For the same reason we take no view on the £10,000 annual limit which is probably as much as most of them have paid into their pensions during their entire working lives.

This may be the appropriate point to insert the question not asked in this document, as requested in A.1. Will the proposed changes offered to pre-reform annuitants be available to those who take an annuity under the new regime and later change their minds? This situation does not appear in the consultation which seems to be addressing past "injustices" and providing equality with the new regime. This would suggest that once everyone is on an equal footing, then all has been redressed. It should be made clear whether there will be the chance of a second bite at the cherry. Should such an option be available, we would fear for a chaotic pensions market, not to mention much opportunity for mis-selling, scamming and churning. There could, however, be circumstances where it could be desirable or

appropriate for such an option as we remark in our answer to Q1 and perhaps allowance should be made for post-reform annuitants to assign their income within certain parameters to prevent unfairness resulting from total rigidity. For example, one of the triggers for allowing a “second bite of the cherry” might be if the annuitant gets divorced. There could then be a clean break with the ex-spouse taking a lump sum, if they choose, instead of part of the annuity.

It may be stretching the bounds of this consultation too far to wonder whether the same flexibility should therefore be available to Defined Benefit pensioners who subsequently decide that the options under a Defined Contribution route would be to their advantage, but perhaps the question should be asked

4.4 **A4 (Chapter 4)**

- 4.4.1 Question 10: Since the intention is to put pre- and post-reform pensioners on the same footing, it would seem logical to provide them with the same sources of guidance. It is not obvious that the need for information and advice is any more or less for those seeking to escape from an old-style annuity than for those newly making a choice since 6 April. It may well be the case also that a low-income annuitant is in need of advice and guidance just as much or even more so than those with greater financial resources who can afford access to paid-for advice more readily than the former. The sources of guidance must therefore be equally accessible and free to rich and poor alike. We have elsewhere¹ expressed our concerns about the inadequacies of the new guidance delivery system, but have no doubts that this must be the minimum standard for those assigning their annuity income. The same factors and expectations must be considered for an informed choice as under the reform regime.

Seeking independent advice is only a requirement under the new regime when transferring from a defined benefit scheme exceeding £30,000 but not otherwise. Desirable it may be, but not compulsory. Perhaps similar criteria might be appropriate for assigning an annuity on the grounds that the annuitant is surrendering known benefits for uncertain ones and the risks could be more emphatically demonstrated by an independent adviser. If so, then there should be a *de minimis* annuity income below which it would be uneconomic to pay for such advice. Alternatively there could be a minimum annual income above which the annuitant could afford to take the risk of a wrong decision, rather on the lines of the old-style flexi-drawdown where a minimum guaranteed income from elsewhere permitted the pensioner to drawdown any amount he wished

- 4.4.2 Question 11: It follows from the preceding that we would expect the Pension Wise system to be extended to include assignment of annuities. As the consultation document says, it is likely to be a much smaller market and would not require a huge new input of resources, thus not putting much extra on the industry levy which will fund it from 2016.

¹ Letter to Steve Webb, Minister for Pensions, dated 27 January 2015

- 4.4.3 Question 12: The first half of this question is ambiguously phrased. If it means that assigning an annuity should be treated in the same way as transferring from a DB scheme to a DC one, as in our second paragraph above on Question 10, then it would be logical to impose the costs of the independent advice in the same way. If, however, the question is referring to the PensionWise advice on possible options, then, as in our first paragraph above, that guidance should be free. It would be contradictory to aim for parity but impose different conditions for the two classes.
- 4.4.4 Question 13: Although not directly relevant to our tax interest, nevertheless our concerns for the low-income unrepresented individual lead us to express support for the idea that those seeking to market their annuity should be required to shop around for competitive quotes in the same way – but rather more compulsorily – as the open market option is offered to new annuitants. There is a connection here with our answer to Q3. Those with small annuities which they wish to reassign may well find that other market makers have no interest in the small values (and profits) involved and the small annuitant might find it difficult or impossible to obtain other quotes. If so, then it should be compulsory for the original pension provider to “buy back” even if there is a risk that the offer may be at the lower end of the range, a situation we are familiar with already when annuitants wish to exercise the open market option with a small pension pot. There clearly will be a need for Government and FCA to police such situations vigorously to protect the vulnerable and low-incomed from monopolistic malpractice.
- 4.4.5 Question 14 and 15: Where an annuity includes or could potentially include the annuitant and dependants, the same safeguards should apply as to variations of trusts, i.e. all beneficiaries or potential beneficiaries who are *sui juris* should consent, and any minor interests or those lacking mental capacity should be protected by an application to the court.
- 4.4.6 Question 16: The same standard of guidance from PensionWise should be in place as for those cashing in their pensions. The complexities of the interaction of benefits and taxation are normally way beyond the understanding of the population who are likely to be involved with benefits and it must be impressed upon them that any change in capital and/or income may well have an impact on their benefits.
- 4.4.7 Question 17: Provided that they are alerted to any likely impact as noted above to Q16, there can be no excuse for treating them as second class citizens unable to make their own decisions about their lives. If they are aware that they may lose benefits by pursuing a particular route, that is their responsibility. It is not the job of Government to tell people how to live, merely to make the consequences of their actions clear to them.
- 4.4.8 Question 18: No comment.