Creating a secondary annuity market

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Introduction

The Government has published three consultations in connection with the proposed secondary market for annuities ("the New Market").

Key points

- Individuals will be permitted to assign or surrender annuities that are in their name and payable to them, including deferred annuities and those currently in payment which were bought before 6 April 2006. It is also intended that "schemes should be able to assign annuities in their name to members".
- The individual may take the proceeds of his or her annuity's sale as a lump sum, or arrange for the buyer to either designate the funds to a flexi-access drawdown fund ("FADF") or to use them to purchase a flexible annuity (under which the annual rate of payments can go down as well as up).
- The changes to the tax rules will not affect "short-term" annuities (those bought from drawdown funds that are paid for no more than five years) or "non-pension" annuities (those purchased with funds that did not originate from a registered pension scheme).
- The new tax rules will not override any other contractual or legal restrictions that prevent individuals from assigning or surrendering annuities which are not in their name.

Background

In the March Budget 2015 (see our Alert), the Government announced its intention to create a secondary annuity market for consumers. Under the proposals an individual will be able to assign or surrender their annuity income payable to them in respect of either DB or DC arrangements. Where reassignment is to a third party, the provider would then continue to hold the underlying assets and pay the annuity income to the third party for the lifetime of the original annuitant.

The proposals are designed to extend the new retirement freedoms and flexibilities to people who retired before 6 April 2015 and therefore had little choice but to buy an annuity with their DC benefits.

Authorisation and regulation

Retail investment in the New Market will be prohibited. Buyers and brokers will need to be FCA authorised and, as such, will be subject to conduct regulation by the FCA and, in certain circumstances, prudential regulation by the PRA.

Draft legislation has been published for consultation which will, among other matters, create three new specified regulated activities:

- entering into a regulated annuity assignment agreement as a purchaser
- entering into a regulated annuity "buy-back" agreement as an annuity provider
- regulated annuity broking.

Separating these activities is intended to make it easier for the FCA to identify the firms that are participating in the New Market and enable it to apply specific tailored rules to them.

Proposed rules

On 21 April 2016, the FCA issued a consultation on proposed rules and guidance for the New Market. These aim to balance the need to support the New Market with protecting consumers. For example, under the proposed rules:

- buyers and brokers making an offer for a seller's annuity income will be required to present their offer alongside the "replacement cost" of the annuity income, making it clear what it would be worth if it were to be bought new on the open market.
- firms will be required, at the earliest opportunity, to give those considering the sale of their annuity specific risk warnings and to recommend that they seek regulated financial advice or guidance from Pension Wise. Firms will also be required to recommend that sellers shop around.
- annuity providers will only be able to recover reasonable costs when charging to facilitate annuity income sale and the sale of the annuity will fall within the scope of both the Financial Ombudsman Service and the Financial Services Compensation Scheme.

The FCA is also considering whether it is necessary to put in place a requirement for an intermediary to facilitate an annuity buy-back and, if so, whether there should be a threshold below which annuity providers could buy back an annuity directly.

Financial promotions

The financial promotions regime restricts all types of financial promotion unless it is made or approved by an FCA authorised firm or under a relevant exemption. Unauthorised persons must not, in the course of business, communicate an invitation or inducement to engage in investment activity. Contravention of this restriction is a criminal offence.

The Government considers it important to help ensure that consumers are protected from unauthorised cold calling or other unwanted marketing in relation to their ability to sell their annuity income on the New Market. Communications of invitations or inducements to annuity holders to enter into transactions to assign or buy back annuities will therefore be subject to the financial promotions regime.

Tax changes

On 20 April 2016, HMRC published a consultation on the tax framework for the New Market.

Currently the assignment or surrender of an annuity gives rise to unauthorised payment tax charges under tax legislation, subject to certain exceptions (eg. pension sharing). To create the New Market new rules will, subject to certain conditions, permit individuals to:

- take the proceeds of the sale of their annuity as a lump sum
- arrange for the buyer to pay the proceeds into a FADF
- arrange for the buyer to use the proceeds to purchase the individual a flexible annuity.

Provided these conditions are met, individuals will not become liable to unauthorised payment charges and any lump sum or income drawdown will be taxed as pension income at the individual's marginal rate.

To ensure that the proceeds from an assignment / surrender are treated in the same way as the annuity income they replace, lump sum proceeds or income paid under a new annuity or out of a FADF to a dependant or beneficiary will be exempt from tax where the annuity being assigned / surrendered is itself exempt from tax.

Money purchase Annual Allowance

Individuals who flexibly access their retirement savings become subject to an AA of £10,000 for DC pension savings, known as the money purchase annual allowance ("the MPAA"). If the individual exceeds the MPAA, they then become subject to a reduced AA (of £30,000) in respect of any (DB) pension savings.

Individuals who surrender or assign their rights to an annuity (whether or not purchased before 6 April 2015) will be subject to the MPAA. However, the Government proposes that individuals surrendering / assigning low value annuities purchased before 6 April 2016 in return for a lump sum will not be subject to the MPAA. The definition of "low value" has yet to be determined and will be worked on in conjunction with the FCA.

Information requirements

New information requirements will be introduced for the:

- insurers who issued the annuities being assigned / surrendered
- individuals who assign / surrender their annuities
- entities which buy the annuities.

Next steps

The three consultations close in June 2016, with the New Market due to come into effect from 6 April 2017. However, there are clearly some practical issues outstanding. For example, how the process of notifying providers of the death of the original annuitant will work.

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