Consultation Response

Secondary annuity market: proposed rules and guidance, CP16/12

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About this consultation

This Financial Conduct Authority (FCA) consultation is for establishing the rules and regulations governing the new secondary market for annuities. It covers a range of behavioural and consumer protection issues that will apply to buyers (i.e. financial service companies) and brokers in the marketplace.

Key points and recommendations

- Age UK understands that some people may welcome the creation of the marketplace and is pleased with the continued acknowledgement of the significant consumer protection issues that may arise.
- Risk warnings should be clearly delivered at the outset of the process in all cases, including in any advertising and marketing.
- We agree that the regulations should oblige brokers and advisers to show a clear illustration of the costs likely to be incurred, similar to the diagram included in Annex 3 of the consultation paper.
- All potential sellers who are not paying for advice should be compelled to attend a Pension Wise guidance session before being allowed to complete their sale.
- We are concerned that a broker's panel might represent a problem for a seller, particularly if they would benefit from surrendering/re-selling their income, and believe the FCA should add a rule that all brokers must obtain a quote from the original provider, even if they are not on the panel.
- There is a major gap in the regulation on protection for 'contingent beneficiaries' (including dependents). We strongly urge the FCA to ensure that people to do not lose future income either unknowingly or against their best interests, particularly where there are mental capacity issues involved.
- At a minimum, buyers should carry out some form of check on beneficiaries' awareness and on existing conditions that may affect mental capacity.
- Firms involved in the secondary annuities marketplace may encounter a higher proportion of claimants with mental capacity issues than in other marketplaces, because they will be dealing exclusively with the over 55s. The FCA must ensure that they are behaving appropriately and treating customers fairly, and be prepared to intervene if this is not the case.
- If not already included on their panel, brokers and adviser-brokers should be compelled to seek out a quote from the seller's original provider. In some cases (for example where less underwriting is needed) it may deliver better value to the seller.

1. Introduction

Age UK understands that some individuals may welcome the introduction of the secondary market for annuities. However, it comes with significant risks for consumers – this is an irreversible decision that will have an impact on their income for the rest of their lives. It is essential that all government departments and agencies are committed to ensuring consumer protection is the top priority, and that any such measures are not watered down to generate a higher number of buyers.

During the development of the marketplace so far we are pleased that HM Treasury and the FCA are aware of the risks involved. We agree with the following sentiment, and urge the FCA to ensure that it remains at the heart of the marketplace:

> *"Academic research suggests that, under most circumstances, it is best for retirees to annuitise most, and in some cases all, of their retirement assets. This means that, even if the market for secondary annuities itself works well, there is a risk that many consumers make hasty decisions, which they might not have made with more thorough or better-informed consideration." (FCA, April 2016)*

Throughout this response we raise various concerns about issues connected with the marketplace. This introduction briefly summarises two other areas we feel should be included more explicitly, and we hope that future regulation will allow for this.

Compulsory guidance

We continue to believe that all consumers should, prior to completing their sale, undertake a guidance session with Pension Wise (if they are not using paid-for advice). We are concerned that many sellers may not be aware of the full implications, including tax and benefit eligibility and implications for contingent beneficiaries. As this is an irreversible decision, and often will be taken by people who are older and have been relying on their annuity income for several years, we believe that the risk warnings and other regulatory efforts are unlikely to be enough to ensure that people do not sell their annuity when it runs counter to their best interests.

In the recent polling by the Institute and Faculty of Actuaries, 67 per cent of people aged 55+ agreed that there should be a 'legal requirement for free, tailored information from public bodies such as Pension Wise'[i], indicating strong support for such an approach.

Advertising and marketing

There is a very real danger that inappropriate or aggressive promotional activities could lead people towards selling their income when not appropriate. The FCA must very carefully monitor all such activity and ensure that risk warnings are displayed prominently, and should consider extending existing rules to provide more stringent governance of the secondary annuity marketplace.

2. Questions

1. ***Do you agree with our proposal to require specific risk warnings to be given to consumers at first contact? Would you suggest any changes to the format and content of the risk warnings?***

Age UK fully supports the use of such risk warnings, and believe that they are of even greater significance in the secondary annuities market than under the pension flexibilities. They should be delivered alongside some clear signposting to Pension Wise.

The risk warnings should be delivered repeatedly throughout the process, including in any advertising and marketing (i.e. before the potential seller makes contact with a broker or adviser). Buyers and brokers should be required to talk through the risk warnings, and ensure that they are displayed prominently in written communications.

It is with some concern that we note the recent research on the pension flexibilities by Citizens Advice found that only 1.6 per cent of those surveyed had changed their behaviour because of the risk warnings.[ii] The research explains that this is largely because these risk warnings are delivered further downstream in the process, when consumers are suffering from a general ‘fatigue’, and that to maximise effectiveness they should be delivered as early as possible – this lesson should be borne firmly in mind as the secondary annuity process is developed.

Content
The risk warnings should be as engaging as possible, and that the FCA should conduct behavioural testing to determine the most effective ways of communicating with consumers in relation to this specific marketplace. Making sure people are able to access, understand, and apply the messages to their own situation is of paramount importance, and if they are delivered via a non-written means of communication such as during a telephone call, extra care must be taken to ensure consumers genuinely understand the issues – a ‘tick box’ approach will not be enough and buyers should use specialist staff who thoroughly understand the marketplace and the risks involved.

The eight broad topic areas proposed seem to cover most major issues and we agree that deluging consumers with too much information could be counter-productive. However, three additional topics that could be considered are ‘paying for long-term care’, ‘mental capacity and powers of attorney’, and ‘covering day-to-day expenditure’. These would, perhaps, fit under existing headings (for example the ‘risk of running out of money’) but could equally merit their own sections.

Finally, we welcome the acknowledgement that it will not be the right option for most people. The risk warnings should be prefaced by a statement along the lines of:

> *“For most people, keeping their annuity income will be the right decision – allowing them a stable and guaranteed retirement income.”*[iii] *(HM Treasury, March 2015)*

Age UK has always welcomed the Treasury’s willingness to express such a view, and believe such a statement would help set a behavioural norm where consumers approach this marketplace with caution.

2. ***Do you agree:***
    a. ***that at first contact all sellers should be informed about the compulsory advice requirement; given a recommendation to take advice and/or Pension Wise guidance; given a recommendation to shop around; and***
    b. ***that annuity providers should check that legally required ‘appropriate advice’ has been taken, by receiving confirmation in a durable medium, prior to proceeding with annuity income sale?***

We agree that all sellers should be informed about the compulsory advice requirement at the outset, and that consumers should be encouraged to shop around (bearing in mind understanding of the behavioural impact of the way in which ‘shopping around’ is communicated).

However we continue to believe that before selling their annuity income all consumers should either take paid advice or be required to attend a guidance session with Pension Wise. People who take the irreversible decision to sell their annuity could find themselves in a highly disadvantageous situation, the full impact of which is highly complex and difficult to understand, particularly on issues such as tax or welfare benefits. A session with Pension Wise would allow people the opportunity to discuss their options and the potential implications with an objective source, before committing to sell, and provide a route for referral to other sources of advice for those consumers who have wider advice needs.

3. ***Do you agree with our 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?***

We are concerned that a regulatory gap in the protection of dependent beneficiaries is emerging. Without sufficient safeguards, there are likely to be cases where the contingent beneficiary will unwittingly lose their future income.

In the secondary annuities market, both the primary annuity holder and the buyer are likely to have a role in ensuring that contingent beneficiaries are aware of the impact on their future incomes:

1) The primary annuity holder needs to be in a position to make the contingent beneficiary aware of any implications for their future income. However, this is not to say that it is the annuity holder's responsibility – in fact it is down to regulatory rules on risk warnings and advertising/marketing to ensure that both parties are aware of the potential implications, and to facilitate communication.

We believe the proposed risk warning on 'dependents' should be amended to reflect this substantial risk. Any advertising and marketing should carry risk warnings prominently.

The specific role of Pension Wise in communicating with contingent beneficiaries should be carefully considered.

2) We are concerned there is a gap in the regulatory framework governing the behaviour of buyers. There appears to be nothing built into the sales process to require them to perform even a rudimentary check on dependents or the contingent beneficiary's level of knowledge. We believe a regulatory stop-gap should place some onus on the buyer to discuss with the individual the implications for beneficiaries and ensure the beneficiary has mental capacity.

The FCA should also examine how contract law is affected by mental capacity and what this might mean for the secondary annuity marketplace. Given the irreversibility of some of the decisions, we have significant concerns that people could enter into an arrangement that they (or an attorney) later come to recognise as being made improperly, which could cause untold difficulty for buyers and sellers alike.

In particular, we are concerned especially where there is a possibility that the contingent beneficiary may be suffering from cognitive decline, whether general age-related or as a symptom of another illness, such as dementia.

While we accept there will sometimes be contractual issues with enforcing, for example, a sign-off process for contingent beneficiaries, we do feel that there should be some process in place to raise awareness and help people plan for theirs and their loved one's future.

4. ***Do you agree that, at first contact, all sellers should be informed about:***
    a. ***the ancillary costs the relevant firm reasonably believes it may charge for***
    b. ***the possibility that the relevant annuity provider may cover its costs, directly or indirectly, from the seller?***

Yes. All costs likely to be incurred by individuals throughout the process should be presented as transparently as possible, including administrative charges. A clear example including estimates of all known costs should be given to illustrate the impact these will have.

5. ***Do you agree with our proposals on panel disclosure rules?***

We are concerned that the panel process will not represent the best interests of consumers. Having to first choose a broker before obtaining a quote adds an extra layer of complexity and an additional choice into the process – which is not what many potential sellers will be expecting – while increasing the effort needed to get a quote and potentially delaying exposure to risk warnings. People are therefore likely to be far more invested in the process before they gain a fuller understanding of the risks involved, making them proportionately more likely to follow through with a sub-optimal purchase.

Panel size might also be an issue for consumers, if brokers do not offer a competitive range of potential buyers – the FCA should look into what additional measures can be taken to ensure competitive prices are offered in all circumstances.

In particular, it may be that lower value annuity holders may be more likely to benefit from 'surrendering' their annuity contract (i.e. selling their annuity income back to their providers). If the original provider does not appear on a panel this may be disadvantageous to the seller.

The FCA should introduce a rule saying that the broker or adviser-broker must also obtain a quote from the original provider, as a minimum in the case of sellers with lower value annuities and potentially for all sellers.

The panel approach is also likely to act as a barrier to entry for new buyers, which could affect competition within the marketplace.

6. ***Do you agree that firms providing quotes should be required to:***
    a. ***present quotes for annuity income in certain prescribed ways; and***
    b. ***provide the price comparator alongside their quotes for annuity income?***

Yes. Age UK feels a clear illustration of price differentials is an essential part of the communications with sellers, and without this diagram it will be difficult for many consumers to develop a clear understanding of real costs involved. We support the format included in the consultation paper – copied here for reference.

Quote presentation and price comparator form 1 – where an exact comparator can be found on the primary market.

Price comparator

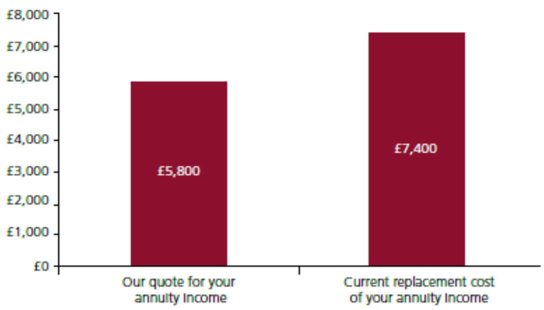
Our quote for your annuity income is:

£5,800

How does this compare with the amount it would cost you to buy your annuity today?

You would have to pay **£7,400** if you were to buy your annuity income today on the open market.

This means that you will get **£1,600** less for your annuity than it would cost you to buy that income today on the open market.



Please make sure you are comfortable with the difference between our quote for your annuity income and what it would cost to replace that income.

Don't forget that you can shop around for other quotes for your annuity income, and that you do not have to go through with the sale of your annuity income.

Notes:

1 *Our quote for your annuity income is net of any costs that we estimate we will cause you to incur prior to our agreeing to buy your income.*

2 *Other parties in the transaction, such as the annuity provider, may also require payments or recover costs from the proceeds of the annuity income sale.*

3 *The amount it would cost you to buy your annuity income again from an annuity provider includes the annuity provider's administration costs, underwriting costs, intermediation costs and profit margins.*

We agree with the FCA that the best comparator is the cost of buying a replacement income – as long as it is clear that actual costs may vary depending on what the individual does with their lump sum – as this approach automatically accounts for life expectancy and age, and puts the onus on the provider to find the best-priced comparator.

We also consider that it the comparison between the two ‘quotes’ is fair as it is intended as a guide only. From the consumer’s perspective, the fact that some of the ‘replacement of your annuity income’ cost is related to administrative and set-up costs is irrelevant. This is a tool designed to pass on knowledge of an indicative cost to the consumer, not to dictate the direction the consumer should take.

We hope the FCA maintains this or a close variant that clearly and succinctly illustrates the typical transaction cost. It should also monitor consumer understanding and behaviour and be prepared to adapt the illustration if it is not properly understood.

7. ***Do you agree that the 14 day stop period requirement should be extended to all secondary annuity market interactions?***

Yes, it is important that face-to-face transactions are included.

8. ***Do you agree with our proposals on broker incentives and charging?***

We agree that brokers should not receive commission. Any costs to the seller must be clear and upfront – along with the make-up of the broker’s panel.

It also must be made abundantly clear at the outset that just obtaining a quote from a broker does not incur a charge and there is no obligation for the consumer to continue. Once invested in the process many individuals may feel that they have no choice but to continue, and it is important that people realise they can back out.

Under both the customer journeys outlined in Annex 2 we believe that Pension Wise guidance should be built in as an integral part of the process. Seeking guidance is not specified at any point, whereas using a broker and seeking paid advice is. Pension Wise should be built into each and every customer journey, and the FCA should re-model its suggested pathways to place a far greater emphasis on this, with multiple ‘touch-points’ pointing towards Pension Wise.

9. ***Do you agree that the FCA should make rules requiring that an annuity provider can only cover reasonable costs when charging to help facilitate or execute an annuity income sale?***

Yes, although perhaps some clarification should be provided as to what a 'reasonable cost' entails upfront, in order for the seller to be aware, and these should be reflected in the price comparator diagram and the quote.

10. ***Do you agree with our proposals to continue to provide access to the ombudsman service in relation to the sale of annuity income on the secondary market?***

Yes.

11. ***Do you agree with our proposal to continue to provide access to the FSCS in relation to the sale of annuity income on the secondary market?***

Yes.

13. ***Do you agree that we should provide guidance reminding firms active in this market about their existing legal responsibilities in respect of sellers who may lack full mental capacity?***

This is a very important part of the regulatory structure. As all sellers will be aged at least 55, there might be a higher incidence of mental capacity issues than in other financial marketplaces. There is also a# risk of abuse from relatives wishing to gain access to a capital sum. Firms may not be used to dealing with such consumers, and so the emphasis here must be stronger.

Age UK recommends that brokers and buyers are carefully monitored to ensure they are recognising any issues with their customer's mental capacity and acting appropriately. It is vital that if an issue with firms' behaviour in the marketplace develops, the FCA will step in and create tighter guidance specifically for the secondary annuity market.

Similar issues may occur with individuals who may have full mental capacity, but may be 'vulnerable' in a different way, for example being recently bereaved. It is important the FCA considers carefully whether the regulations here will provide sufficient protection.

[i] Polling by YouGov for the Institute and Faculty of Actuaries, April 2016
[ii] Citizens Advice (2016), Drawing a pension: a consumer perspective on the first year of the pension freedoms
[iii] HM Treasury, Department for Work and Pensions (2015), Creating a secondary annuity market consultation paper