Response to proposals to create a secondary annuity market

The Money Charity is the UK's leading financial capability charity.

We believe that being on top of your money means you are more in control of your life, your finances and your debts, reducing stress and hardship, and that this increases your wellbeing, helps you achieve your goals and live a happier more positive life as a result.

Our vision is for everyone to be on top of their money as a part of everyday life. So we empower people across the UK to build the skills, knowledge, attitudes and behaviours, to make the most of their money throughout their lives.

We believe financially capable people are on top of and make the most of their money in five key areas:

- Planning (including budgeting)
- Saving
- Debt
- Financial services products
- Everyday money (including wages, cash, bank accounts)

Introduction

1. We welcome the opportunity to respond to the proposals for the creation of a secondary annuity market, and the period of consultation that has been undertaken in order to mitigate the risks of consumer detriment.

2. Our fears of *'severe risk of widespread consumer detriment'*[1] were outlined in our response to the initial proposals in June 2015. With pension reforms promoting choice and allowing bad, as well as good decisions, significant work has to be done to ensure consumers understand and evaluate their options. Without services to help build financial capability and processes designed to ensure that decisions are made with due consideration, extending freedom to annuity holders could bring with it severe risks.

3. Consumers who withdraw as a lump sum a proportion of their defined contribution pension pot will make decisions that may leave them in a worse position than if they had bought an annuity, but the flexibility of the lump sum will allow many others to be better off in retirement. By contrast, consumers who choose to assign their annuity will have been charged fees twice and will be in a worse financial position on average.

4. We understand that the secondary annuity market is the logical extension of pension freedom to those who have already acquired an annuity. But the fact that assigning an annuity will not be a good choice for the vast majority or consumers means that, even with disclosures and safeguards, the likelihood of significant detriment is high.

5. In practice we believe there are relatively few circumstances in which a decision by an annuity holder to assign their rights to a third party would be an appropriate one:

    - Where an annuity-holder is in urgent need of funds, for example if they are facing problem debt.
    - Where an annuity-holder's current annuity income is small and does not contribute to their general financial wellbeing, but the amount they could receive by assigning their rights is more significant.
    - Where an annuity-holder is in receipt of multiple annuities and wishes to convert one or more annuities pass on wealth.

6. In all of these circumstances, there is significant risk of detriment or vulnerable people being taken advantage of – for all, there is a danger that the immediate reward in cash or passing on money to children will be chosen to the likely expense of long term financial security.

7. Many older people spend long years of their later life in dependency or semi-dependency, and many more will be vulnerable. Historically this group have had the

[1] The Money Charity response to proposals to create a secondary annuity market

financial certainties that come with annuities, defined benefit pensions, and the state pension. Even in situations of declining mental capacity or dependency, financial management has been reasonably simple and secure. Exposing older people to profoundly consequential financial decisions that will leave most worse off in the long term is risky, both for individuals and for society which may need to step in to help pensioners who have exhausted the pot they traded their income in for.

8. **For these reasons we do not support the creation of a secondary annuity market.**

9. However, if this policy is to be introduced, the rules and guidance consulted on in the questions below are a creditable attempt to lessen and mitigate the associated risks. The only significant feature we would add to the proposed rules and guidance is a clear up front warning that sellers will be worse off unless they die earlier than expected. We recognise that the risk warnings attempt to make a similar point, but we do not believe this is made in clear enough a way. We respond to the specific proposals for rules and guidance, including this point, below.

Q1: 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?

10. We agree with the requirement to present risk warnings at first contact with the consumer. It should be made clear up front for consumers that assigning their annuity is likely not to be in their best interests. Seven of the eight risk warnings outlined capture effectively what consumers will face, but we have concerns that the presentation and wording of risk five does not highlight clearly enough the probability of loss that sellers will face.

11. We explore fully our reservations and offer clearer wording and format for this risk warning in our answer to question 4.

12. As this probable loss of income is the key risk, it should be listed most prominently at the top of the risk warnings, not as the fifth of eight risks.

Q2: Do you agree 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**

• 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?

13. We agree with the scope of this measure. Informing prospective sellers of the compulsory advice requirement up-front will be helpful in ensuring that people understand the gravity of the financial decisions that they are making.

Q3: 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?

14. It is vital that contingent beneficiaries be part of any decision to assign an annuity. But simply requiring consent from the beneficiaries does not go far enough, the consent needs to be informed. So we would recommend that the FCA make rules that guarantee the contingent beneficiary advice in the same model as the annuity holder.

Q4: Do you agree that, at first contact, all sellers should be informed about:

- **the ancillary costs the relevant firm reasonably believes it may charge for**
- **the possibility that the relevant annuity provider may cover its costs, directly or indirectly, from the seller?**

15. Annuity holders need to be able to see the fees and other costs of assigning their annuity, so we agree sellers should be informed about this issue.

Q5: Do you agree with our proposals on panel disclosure rules?

16. It is vital that sellers are able to understand choices offered to them by brokers, and that brokers are incentivised to reach the largest panel of buyers available. So we support these rules to increase clarity.

Q6: Do you agree that firms providing quotes should be required to:

- **present quotes for annuity income in certain prescribed ways; and**
- **provide the price comparator alongside their quotes for annuity income?**

17. It is important that annuitants are able to understand choices offered to them. Standardisation of quotes and price comparison is necessary for this process. But we do not believe that the format and wording set out in Annex 3 is adequate to help sellers understand the probability that they will lose money from assigning their annuity.

18. We know from behavioural studies of financial capability that hyperbolic discounting[2] takes place, particularly with the less financially capable. The only effective safeguard against this that could be built in to the selling process is a clear and up front description of the likely loss that consumers will incur. Although juxtaposing the quote and the current replacement cost does attempt to show consumers this, it is not clear or stark enough.

19. When we at The Money Charity tested the graphs and wording with staff members who were not familiar with the consultation, we found that the meaning was not clear. Our colleagues did not understand why the quote was being compared to buying an

[2] Financial Services Authority - Financial Capability: A Behavioural Economics Perspective

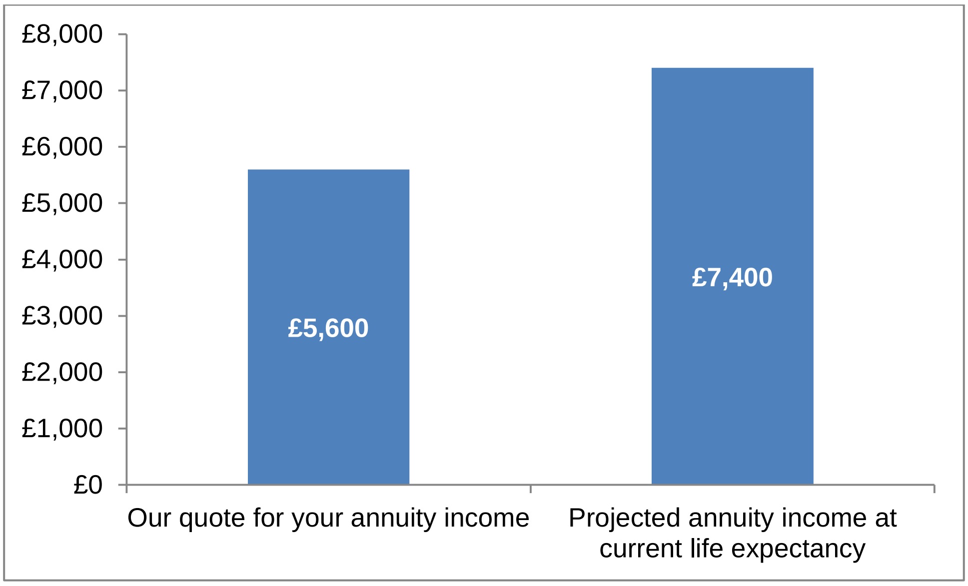
annuity, something that they would not be trying to do. This then obscured the reality of the probably loss a seller would face.

20. Once you are familiar with the language of '*current replacement costs*' it appears to be very intuitive. Certainly the writer of this response did not blink seeing the comparison table. But the vast majority of consumers will not be familiar with this hypothetical concept. And if even our staff who are relatively financially capable struggle to understand it, it is too complicated. The FCAS should propose a simpler formulation.

21. The use of current replacement costs is clearly an attempt to show that there is a probable loss, but it is too abstract a concept to show it clearly. We would prefer a formulation of language that expressed the difference in terms of years of lost income or likely absolute loss:

    'If you sell your annuity and live for as long as you are expected to, you will lose £1,600, or X years worth of income'

    'Unless you die at XX years old, selling your annuity will leave you worse off.'



This formulation would not rely on a comparison to a hypothetical annuity purchase that sellers would not be considering, but would lay out starkly the sum that they could expect from retaining their annuity versus the up-front sum they get. This is a far more intuitive and common sense comparison that lays out clearly the likely two options an annuitant has.

Q7: Do you agree that the 14 day stop period requirement should be extended to all secondary annuity market interactions?

22. We support the 14 day stop requirement at the very least. When likely reasons an annuitant would look sell their annuity are under pressure from a creditor or as part of a scam, any delay in the process serves as a safeguard against hastily made and long regretted decisions.

Q8: Do you agree with our proposals on broker incentives and charging?

23. Brokers should not have conflicts of interest, nor should they be seen to have them. Fees should be charged to the seller in a transparent and consistent way, so we support these proposals.

Q9: 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?

24. Particularly given the context where annuitants have historically got poor deals from providers, there would be no justification for allowing anything more than 'reasonable costs' to be charged. These costs must me disclosed clearly to sellers.

Q10: 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?

25. As previously discussed, many annuitants will look to sell their guaranteed income as a result of financial difficulties or scams. The rules and guidance outlined in this consultation hopefully will go some way towards mitigating the ill effects of this. But these rules will only have integrity if sellers are given access to the Financial Ombudsman Service.

Q11: 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?

26. We support the proposal to provide sellers with access to the FSCS.

Q12: Do you agree with our proposal to continue to apply IPRU (INV) Chapter 13 to firms when these new regulated activities are their principal business?

27. We support this proposal for prudential regulation.

Q13: 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?

28. With the original pension freedoms of 2014, the people making the decision to convert some of all of their DC pension pot to a lump sum were between the ages for 55 and 65. Significant numbers of people older than that are in dependency or semi dependency, and many more are in vulnerable situations.

29. When an annuitant of any age can sell their annuity the proportion with low financial capability or who lack mental capacity will be much greater than for the cohort who the original freedoms were set up for. The Mental Capacity Act 2005 and the Mental Health Act 2007 do provide an established legal framework and Treating Customer Fairly does provide the FCA with the grounds to take action in the case of detriment. But opening a secondary annuity market will be unprecedented, opening up more older people to profoundly consequential financial decisions that ever before. So we would expect The FCA to be active in monitoring the situation and stepping in with new rules and guidelines if detriment does arise.

30. In the case of pensioners who have given power of attorney to a third party, we do not think it is appropriate to allow sale of annuities except in order to pay off a debt. Pensioners who have become dependent need the guarantee of income that an annuity provides, and allowing a third party to make decisions that benefit the short term or self-interest over long term financial security opens up conflicts of interest that cannot be adequately regulated.

31. We would recommend that attorneys should only be able to sell a donor's annuity with the involvement of a regulated debt advisor.

Q14: Do you have any comments on our proposed amendments to FEES?

32. The proposed amendments seem reasonable.

33. We also welcome the commitment to consult on the Pension Wise Levy. The introduction of the secondary annuity market will require advice and guidance for an older, and considerably larger group, so will require significant growth in funding for bodies providing this.