Financial Conduct Authority

Thematic Review TR14/20

Annuities sales practices

December 2014

Contents

Abbreviations used in this paper

ABI	Association of British Insurers
CEO	Chief Executive Officer
DB	Defined benefit
DC	Defined contribution
DWP	Department for Work and Pensions
GAR	Guaranteed Annuity Rate
HMT	Her Majesty’s Treasury
MAS	Money Advice Service
MVR	Market Value Reduction
OMO	Open Market Option
PS	Policy Statement
SRD	Selected Retirement Date
SERPS	State Earnings-Related Pension Scheme
TPAS	The Pensions Advisory Service

1 Executive summary

Why did we review firms' annuities sales practices?

In February 2014 we reported on our previous thematic review into annuities[1] following a concern that many consumers were buying an annuity from their current pension provider, and that they may be missing out on a higher income in retirement as a result. We found that some parts of the market were not working well for some consumers and specifically that many consumers do not shop around and switch provider, even when a high proportion of these would be better off doing so.

We found that 60% of consumers were not switching providers when they bought an annuity[2], despite the fact that around 80% of these consumers could get a higher income on the open market, many significantly so. For enhanced annuities specifically we estimated the proportion who could get a better deal on the open market as 91%.

As a result, we announced a package of work in February comprising this thematic review and the retirement income market study (the market study). This thematic review aimed to understand whether firms' sales and customer retention practices contributed to customers not shopping around and switching. It seeks to mitigate the risk that consumers have a reduced income in retirement as a result of buying the wrong type of annuity or not shopping around on the open market.

After we announced this package of work, the Budget 2014 proposed changes to the retirement income market.[3] This is the biggest reform to the market in a generation and opens up a wider range of choices for consumers. Our consumer research clearly suggests that consumers welcome this increased flexibility.

However, savers benefitting from a wider range of choices will experience a landscape that is more complex, and will need more support in making the right choices. To support the increased flexibility in the retirement market, the Government announced a 'guidance guarantee' [4], which entitles everyone with a Defined Contribution (DC) pension fund to access free (at the point of delivery), impartial guidance.

1 FCA's 'Thematic Review of Annuities TR14/2' published 14 February 2014 www.fca.org.uk/news/tr14-02-thematic-review-of-annuities.

2 We found that 60% of annuities were purchased from customers' existing pension providers or through a third party distribution arrangement. We are aware that other sources of research provide slightly different estimates (including the consumer research undertaken by GfK for the market study), with a lower proportion of consumers not shopping around. This difference may be explained by the fact that GfK's research also includes consumers buying annuities through a panel or a tied provider; hence GFK's finding (that 60% of consumers buy an annuity from a different provider) does not necessarily reflect the proportion of people that shop around and switch provider, by our definition.

3 *Freedom and choice in pensions* – HM Treasury, July 2014 www.gov.uk/government/consultations/freedom-and-choice-in-pensions

4 Freedom and choice in pensions – HM Treasury, July 2014 www.gov.uk/government/consultations/freedom-and-choice-in-pensions

The guidance guarantee will perform a vital role in helping consumers post-April 2015, but firms also need to step up and play their part. We wanted to take this opportunity to assess firms' sales practices now, as the quality of communications between firms and their customers about their wider retirement income options will be even more significant in the new retirement landscape.

What did we review?

We looked at the non-advised sales practices of pension providers offering annuities to their existing customers. Our sample of firms covered 70% of this market.[5] We conducted our review during the second and third quarters of 2014, looking at material relating to the period September 2013 to November 2013.

We reviewed customer literature provided by firms leading up to retirement, listened to telephone calls discussing retirement income options and reviewed potential drivers of risk in the firms' businesses.

We then assessed these against four consumer outcomes[6] to see if firms' sales practices enabled consumers to make informed decisions about their retirement options. We considered our Principles for Businesses, in particular those dealing with treating customers fairly and communications with clients, and connected Rules. We also considered the results of the thematic work on Open Market Options (OMO) which the Financial Services Authority (FSA) published in June 2008[7] and the principles and requirements of the ABI Code of Conduct on Retirement Choices[8] (the ABI Code), as it is an industry established code which is compulsory for members.

5 FCA Data, market share information from 'Thematic Review of Annuities TR14/2' published 14 February 2014

6 The four consumer outcomes were defined for the purposes of this thematic review and were developed having regard to our rules, Principles for Businesses and the ABI code, and considering the risks to consumers in this market. Our aim is for all firms to deliver the four consumer outcomes. More detail is provided in section 2.2.

7 Results of the FSA's thematic work on Open Market Options under maturing personal pension and stakeholder pension schemes: www.fsa.gov.uk/pages/Library/Other_publications/Pensions/2008/omo.shtml

8 Consumers in the Retirement Income Market: Code of Conduct on Retirement Choices was published by the Association of British Insurers in March 2012 with implementation from 1 March 2013 www.abi.org.uk/~/media/Files/Documents/Publications/Public/Migrated/Pensions/The%20ABI%20Code%20of%20Conduct%20on%20Retirement%20Choices.pdf

The four consumer outcomes are:

1 Consumers are actively encouraged (and not discouraged) to shop around, and can make informed decisions about how and when to buy annuities.

2 Consumers are provided with relevant and timely information about the potential benefits of any guaranteed annuity rate (GAR) or risks of a market value reduction (MVR) that exists in their existing pension contract.

3 Consumers are provided with appropriate and timely information about:

   A the benefits of enhanced annuities and their potential eligibility

   B an enhanced annuity being available on the open market (particularly, where their pension provider does not offer one)

   C the potential for variation between different providers' underwriting and its impact on the income offered

4 Consumers are provided with appropriate information about the different annuity options available to them (e.g. joint v single, level v escalating, and various guaranteed periods) and the implications of selecting different annuity types.

What did we find?

We found evidence indicating that firms' sales practices are contributing to consumers not shopping around and switching, and at times to consumers potentially buying the wrong type of annuity, in particular not purchasing an enhanced annuity when they may be eligible for one. This means consumers may be missing out on a potentially higher income in retirement as a result.

We found examples where the ABI Code is not being applied in practice, particularly where the requirements under the ABI Code are less prescriptive and require more judgement from firms to ensure customers are treated fairly as required by our rules.

Our key findings are as follows:

Outcome 1:

- Customers are generally told at some stage of the customer journey they can shop around but firms are in general not repeating and reinforcing the message at key points and are not explaining to customers how to shop around. As a result, firms are in general not doing enough to actively encourage customers to shop around.

- Our previous thematic review into annuities estimated that consumers buying standard annuities could, on average, **increase their annual income by £67 by shopping around and switching**.[9]

Outcome 2:

- Information given to customers with valuable guaranteed annuity rates (GARs) could be improved, although this does not appear to be leading to widespread poor customer outcomes.

Outcome 3:

- While the majority of customers are informed of enhanced annuities, many are not informed of shopping around for enhanced annuities or encouraged to do so to get a higher income, particularly during conversations with firms.

- The majority of customers are not told that other providers may offer enhanced annuities for medical conditions or lifestyle factors not covered by their existing provider.

- This is the area where we have the greatest concern in terms of the impact on customer outcomes and the prevalence of poor practice found as a general theme.

- Our previous thematic review of annuities estimated that consumers eligible for an enhanced annuity (either through their pension provider or the open market) but who purchased a standard annuity could, on average, **benefit from shopping around and switching by £110 to £175 annually**.[10]

Outcome 4:

- In general, firms' literature clearly described the different annuity options available to customers. However, in firms' conversations with their customers the picture was more varied and we found individual examples of good and poor practice.

What do we want to achieve?

Annuities have in the past been the most dominant retirement income product, but in future other products may increase in popularity relative to annuities. We want to see firms stepping up to meet the challenge of the new retirement market, while always keeping in mind their responsibility to treat their customers fairly. In order for the pension reforms to work, and for people to have trust and confidence in the products they are buying, firms need to act now.

9 As set out on page 14 of FCA's 'Thematic Review of Annuities TR14/2' published 14 February 2014. Based on the average fund size of £17,000 and average annual income from a standard pension of £1000

10 Based on the average fund size of £17,000 and annual income from a standard pension of £1000 set out on page 17 of FCA's 'Thematic Review of Annuities TR14/2' published 14 February 2014

What happens next?

Bearing in mind their individual circumstances, we are asking the majority of firms to do further work to determine if our findings in relation to enhanced annuities are indicative of a more widespread problem and/or have led to poor consumer outcomes. We will not apply new standards retrospectively but will look at the period since the FSA's previous thematic work on Open Market Options in 2008. The findings from this work clearly highlighted that firms needed to make improvements in relation to the way consumers were informed about shopping around for enhanced annuities. Given that individual feedback was provided to firms and the findings were published, we believe that from that time firms should have been in no doubt about their responsibilities to their customers in relation to enhanced annuities.

The further work we are asking firms to do is not a review of all relevant sales since May 2008, but for individual firms it may include gathering more evidence, on a statistically significant basis, to determine whether customers with certain medical conditions or lifestyle factors missed out on a higher income in retirement by:

- purchasing a standard annuity (rather than an enhanced annuity)
- not shopping around for an enhanced annuity and as a result purchasing an enhanced annuity from their current provider rather than on the open market

Once we have reviewed the additional evidence gathered by the affected firms, we will consider what further action, if any, to take.

Where our thematic review has identified poor practice we will also work with these firms to make improvements to their annuities sales practices now across all four outcomes. Where required, this will include:

- improvements to the training provided to call handlers and the call scripts/guidelines used to assist them in their conversations with customers
- improvements to customer literature such as improving completeness and clarity of messaging
- re-evaluation of strategies that present a risk to good consumer outcomes

In addition, we will be signposting the findings of our review more generally to the market through the publication of this report and the good and poor practice examples in Annex 1.

We believe annuities are an important product for the retirement market. Our market study published today suggests that, for people with average-sized pension pots, the right annuity purchased on the open market offers good value for money relative to alternative drawdown strategies and may therefore be a good option for those with low risk appetites. It is therefore important that the annuities market works well going forward. It is also important that at-retirement communications are effective in steering consumers towards the right product and there are important lessons for firms from this review.

2
Background, scope and approach

2.1 Background

Why have we reviewed annuity sales practices?

Our previous thematic review into annuities indicated that, while shopping around for an annuity would often provide consumers with a better deal, most consumers were buying an annuity from their existing pension provider. We estimated that each annual cohort of consumers annuitising would need to have saved between £115m to £230m extra in their pensions to make up for the income lost by not shopping around and switching provider by using the open market option, although we recognise this may not be realisable, as changes in switching behaviour may result in changes to the market.

The previous review concluded that, in part, consumers miss out on the benefits available from shopping around and switching due to:

- their lack of engagement in pensions and annuities
- the confusing trade-offs they face
- the impact of behavioural biases that make it difficult for consumers to make the right choices and that may result in them not shopping around effectively

The results also identified that some firms have active retention strategies that may reduce the propensity of customers to shop around.

In February we announced a package of work to investigate the root causes of these issues which included this thematic review to investigate how pension providers offer annuities to their existing customers. This report outlines the findings of this review. This package of work also included the market study which was published separately today and is explored in more detail below.

The regulatory landscape for annuities

In 2002, the FSA introduced rules requiring insurers to inform their existing pension customers that they could buy an annuity on the open market and to improve consistency between firms in the way this was done.[11]

In 2008 the FSA conducted a review of the wake-up packs sent by firms to their existing pension customers at the start of the retirement customer journey, measuring firms' literature against the OMO Rules and Principle 6 and 7.

That review found some good examples of literature which clearly set out customer's options, including explaining the potential benefits of exercising the OMO. However, it also found that almost 40% of firms had material for one or more products that failed to meet the requirements.

11 FSA Policy Statement 106 – Disclosure: Trading an endowment policy and buying a pension annuity April 2002 www.fsa.gov.uk/pubs/policy/ps106.pdf

It also noted that very few firms mentioned the advantages of shopping around for customers with health problems, who could be better off buying an annuity from providers offering impaired life or enhanced annuities.

Detailed feedback was provided to the firms in the sample and a statement of the overall results was also issued to the industry at the time.[12]

Following discussions with the Government-led Open Market Option Review Group, the Association of British Insurers (ABI) introduced its Code of Conduct on Retirement Choices[13] (the ABI Code), which was implemented in March 2013 and began the publication of annuity rates[14] in August 2013.

The ABI Code is compulsory for ABI members as a condition of membership and CEOs of ABI member firms sign an annual declaration of compliance. The ABI Code sets out the requirements that ABI members must follow throughout the retirement process, detailing the communications required by a firm to its customers as they approach retirement; this is known as the customer journey. The ABI Code seeks to ensure that customers are given information at various touch points in the lead-up to retirement, building on FCA rules. The approach is intended to engage customers earlier, to avoid over-burdening them with too much information at any one point, and to improve their knowledge and understanding and reinforce key points by repeating important information. It applies wherever an ABI member is communicating directly with a new or existing customer who can buy an annuity.

The introduction to the Code gives an overview of its aims before the rest of the Code goes into detail about the requirements.

The primary purpose of all customer communications is to help the customer understand the decisions he or she must make, and to support him or her through the retirement process. The provider must ensure that their communications take the customer through the following journey:

- **Understanding retirement** – the customer must be clearly informed about the decisions he/she will need to make before receiving a retirement income.
- **Understanding the different ways to take a retirement income** – firms must explain the range of ways retirement income can be taken, including those products they do not offer themselves. The firm must highlight the possibility of joint, escalating and enhanced annuities.
- **Understanding how to buy –** firms must encourage customers to gather comparative quotations from different providers. In order to do this, firms must clearly explain how this can be done, provide all the information needed and must not sell any product relying on the customer's inertia or ignorance.

Source: ABI Code of Conduct on Retirement Choices p2

12 www.fsa.gov.uk/pages/Library/Other_publications/Pensions/2008/omo.html

13 Consumers in the Retirement Income Market: Code of Conduct on Retirement Choices was published in March 2012 with implementation from 1 March 2013 www.abi.org.uk/~/media/Files/Documents/Publications/Public/Migrated/Pensions/The%20ABI%20Code%20of%20Conduct%20on%20Retirement%20Choices.pdf

14 ABI Annuity Window first rate publication was 21 August 2013 www.abi.org.uk/Insurance-and-savings/Products/Pensions/Retirement-and-your-pension/Annuity-rates

How does this thematic review relate to other activities in the annuities market?

Budget 2014

The Budget 2014 announced proposals for fundamental changes to the options consumers will have for accessing their DC pensions at retirement. In summary, from the age of 55 consumers will be able to:

- take their pension savings as cash
- buy an annuity (or other income generating guaranteed products that may emerge)
- use income drawdown, without any limits applied
- use a combination of these

To support the increased flexibility in the retirement market, the Government announced a 'guidance guarantee', which entitles everyone with a DC pension fund to access free (at the point of delivery), impartial guidance, including the option of a face-to-face conversation about their options when accessing their pension savings. The Government announced in July that HM Treasury would hold responsibility for overall service design and getting it up and running for April 2015. The objective of the guidance guarantee is to empower consumers to make informed and confident decisions on how they use their pension savings in retirement.

Alongside the guidance guarantee, there remains an important role for the sales and retention practices operated by pension providers with their existing pension customers; these sales and retention practices form the subject of this review.

We published 'near final' standards for the designated guidance providers delivering the guidance and 'near final' rules for firms in PS14/17 in November. The rules set out requirements on pension providers to signpost the availability of the pensions guidance service to consumers and to take account of the wider choices in retirement. Firms that operate personal and stakeholder pensions need to act to make the necessary changes to enable them to comply with these rules once they are made and come into force.

As stated in our Policy Statement on the retirement reforms and the guidance guarantee, published November 2014, we will be undertaking a thorough review of our rules in the pensions and retirement area, including at-retirement communications in 2015. This work will build on the standardisation work being undertaken with HM Treasury and industry. As part of this review, we propose to consult on replacing the ABI Code with our own rules. This will involve considering not only which aspects of the ABI Code should be incorporated into new FCA rules, but also where additional changes might be appropriate to extend our regulations in order to help consumers understand their options at retirement and enable them to shop around for the best retirement option for them.

Changes to provider business models

Before the Budget 2014 announcements, there was already evidence of changes to providers' strategies in the retirement income market, with a number of firms introducing new in-house enhanced annuity offerings to replace enhanced annuities provided through tied relationships.

As a result of the proposals announced in the Budget 2014, product development in relation to retirement income products outside of traditional annuities has already started. Distribution arrangements may also evolve, with firms enhancing existing propositions or developing new propositions to distribute existing and new products. Existing sales processes may be subject to change, for example firms may start to contact customers at an earlier stage in relation to their Selected Retirement Date (SRD).

The Market Study

The purpose of the market study is to understand what underlies the lack of shopping around in this market at present. It has assessed whether competition is currently working well for consumers, but also, in light of the Budget changes, sought to understand how consumers and firms are likely to behave in the new landscape.

The key provisional findings of the market study of most relevance to this report are listed below:

- Some consumers are fully aware of their right to shop around, consider alternatives and make a conscious decision to stick with their current provider. However, one in five of those who purchase an annuity with their existing pension provider are unaware that they have the option to switch provider. Others are deterred from engaging with their options by the length and complexity of the information contained within the wake-up packs sent out by providers, or because they do not believe that the sums involved make it worthwhile

- Analysis suggests that, for people with average-sized pension pots, the right annuity purchased on the open market offers good value for money relative to alternative drawdown strategies and may therefore be a good option for those with low risk appetites

- Pension savers display well known biases, such as a tendency to underestimate longevity, inflation and investment risk. We also found that the choices savers make are highly sensitive to how the options are presented (framing effects)

- Looking forward, we expect to see more "hybrid" products emerge, combining annuity and drawdown features

Where the above findings interact with our findings regarding firms' sales practices this is explored further in Chapter 3 of this report.

We are now consulting on the findings and proposed remedies in relation to the market study. The market study report sets out a number of proposed remedies that we believe will go some way in addressing the concerns identified in our provisional findings. We want to increase consumers' awareness of information and its relevance, increase the quality of information that consumers receive so that they can properly assess it, and facilitate consumers acting on that information.

In summary, this is a significant period for the retirement income market. The output from our review of rules in 2015 and a number of the proposed remedies from the market study may impact aspects of firms' sales practices in the future. However, we believe there is clear merit in taking this opportunity to use our findings to drive improvements by firms in this market now, considering the entire customer retirement journey. It is vitally important that the practices of pension providers support rather than prevent the achievement of good consumer outcomes in retirement in the new pension landscape.

What were our objectives?

This review was designed to assess the non-advised annuity sales practices of pension providers towards their existing pension customers, and to use the findings to help mitigate the risk that these customers have a reduced income from their annuity by:

- buying the wrong type of annuity e.g. a standard annuity rather than an enhanced annuity
- not shopping around and switching on the open market

The project sought to advance this through building a detailed understanding of:

- how firms were communicating with their customers in the lead-up to retirement and whether customers were being treated fairly
- how the manner of communications impact on customer decision making and behaviour
- whether this contributed to customers not shopping around and/or getting the right type of annuity

To investigate this we developed four consumer outcomes, having regard to our rules, principles and the ABI Code, and considering the risks to consumers in this market we identified above. We then assessed firms' sales practices against these four consumer outcomes to see if they adequately supported their delivery.

The four consumer outcomes are:

1. Consumers are actively encouraged (and not discouraged) to shop around, and can make informed decisions about how and when to buy annuities.
2. Consumers are provided with relevant and timely information about the potential benefits of any guaranteed annuity rate (GAR) or risks of a market value reduction (MVR) that exists in their existing pension contract.
3. Consumers are provided with appropriate and timely information about (a) the benefits of enhanced annuities and their potential eligibility (b) an enhanced annuity being available on the open market (particularly, where their pension provider does not offer one), (c) the potential for variation between different providers' underwriting and its impact on the income offered.
4. Consumers are provided with appropriate information about the different annuity options available to them (joint v single, level v escalating, and various guaranteed periods) and the implications of selecting different annuity types.

Our aim is for all firms to deliver the above four consumer outcomes. By delivering these outcomes, we can have greater confidence that consumers approaching retirement are given the right information at the right time to help them make informed decisions about their retirement choices.

Who will be interested in this report?

This report summarises the thematic work we conducted on the annuities sector – it is not general guidance on the operation of our rules.

This paper is directed at firms selling annuities and firms which have existing personal or stakeholder pension customers, their representatives and consumer representative groups.

Is this of interest to consumers?

The improvements to firms' sales practices will affect all consumers who have personal or stakeholder DC pension funds. The market study also published today has set out proposed remedies to improve consumer engagement through smarter disclosure and to help facilitate a well-functioning market.

2.2 The scope of our review

Firms in the review

Our review focused on firms which provide personal or stakeholder pensions schemes and offer annuities on a non-advised basis to their existing pension customers. We reviewed eight firms which between them comprise approximately 70% of this market. We selected a broad range of firms of varying size, type and business model to ensure a representative picture of the sector as a whole. The results outlined in this report are based on this sample.

We have not looked at trust-based occupational pension scheme providers as this is outside our regulatory remit.

2.3 Approach

Method of assessment

We conducted our review during the second and third quarters of 2014. Our review period was after implementation of the ABI Code and encompassed interactions with customers from September 2013 to November 2013.

We reviewed key stages of the customer journey: documentation, including wake-up packs, reminder letters, and all other firm literature provided to customers at retirement; and all retirement journey telephone calls for a sample of customer profiles. Due to the discovery nature of thematic work, the sample of customer profiles was not 'statistically significant' but was nevertheless sufficient to enable us to identify some themes and trends in firms' conversations with their customers. This does not mean that these themes and trends were evident in all the firms we sampled.

We also reviewed some potential drivers of poor consumer outcomes: firms' commercial and retention strategies; staff targets and incentives; staff training; and call scripts.

We assessed all of the above within the context of the four consumer outcomes outlined previously.

In developing our assessment framework our starting point was to consider our Principles for Businesses, in particular those dealing with treating customers fairly and communications with clients, and connected Rules.

We also considered the principles and requirements of the ABI Code, as it is an industry established compulsory code for members. The ABI Code sets the industry's own benchmark for members about communicating key information clearly and consistently, which member firms have implicitly publicly committed to and which CEOs of member firms attest to annually.

Throughout this report we refer to the findings and key statistics from our previous thematic review into annuities, as this was one of the significant drivers behind this thematic review being commissioned. For full details of the methodology used and the assumptions behind these findings, please see our Thematic Review of Annuities TR14/2. It should be noted that some of the data in the previous review was compiled before full implementation of the ABI code and therefore may not capture the full effect of changes to firms' sales processes as a result of the introduction of the ABI Code.

Shopping around vs switching

There is an important difference between shopping around and switching, as defined in our market study and included below.

- There is an important difference between shopping around and switching, and shopping around does not necessarily lead to switching.
- Shopping around is usually measured through consumer research whilst switching is a quantitative measure based on actual purchases.
- An individual may have switched without shopping around (for example, looking at one other provider, perhaps as a response to a direct offer financial promotion, which does not constitute, in our view, true shopping around).
- The Money Advice Service (MAS) promotes a four-step plan to shopping around for annuities:
  - Step 1 – Decide on type of annuity you want
  - Step 2 – Check what your pension provider is offering
  - Step 3 – Use the MAS annuity comparison table
  - Step 4 – Discuss your findings with a retirement income expert
- The MAS guide is equally applicable to other retirement income products as it is to annuities, though we recognise that Step 3 – the comparison of products - is more difficult for alternatives such as income drawdown where 'products' vary according to much more than just the headline price.
- We expect that an 'expert' source, as described in Step 4 will be easier for consumers to access with the introduction of the pensions guidance service.

Source: FCA's thematic review of annuities 2013 and Money Advice Service website

In the next section we focus on firms' sales practices and their appropriateness in informing customers how to shop around. The figures estimating how much financially better off the consumer would be by buying on the open market relate to the customer switching.

Our detailed findings are set out in Chapter 3.

3
Key findings

This chapter sets out our key findings from the analysis of the information provided by firms and is set out firstly to cover general findings and is then split by each of the four consumer outcomes previously mentioned. It includes good and poor practice identified in our review of the information and evidence provided by the firms in our sample.

We include tables with individual examples of good and poor practice in Annex 1.

3.1 General findings

Although our findings are set out by specific consumer outcome, there are a number of general themes emerging.

While some firms have better documentation than others, documentation mostly provides customers with information about shopping around. However, messages are not always consistent, even within an individual firm or throughout the entire customer journey. For example, we saw good practice in one piece of documentation and poor practice in another from the same firm. Some firms need to make significant improvements to their documentation.

We also saw good and poor practice across firms in telephone conversations with their customers, but in general the quality of information provided to customers in documentation was significantly higher than that provided during telephone calls. We found evidence indicating that significant and wholesale improvements may be required to enhance firms' conversations with their customers conducted by telephone.

This is particularly relevant as the findings from the market study show that although the respondents in the review, on balance, placed more weight on written communications, they preferred to speak to people to discuss options and clarify their understanding.[15] Therefore, improvements to the quality of conversations between firms and their customers over the telephone could significantly aid their customers' understanding and ability to make informed decisions.

We also found examples where both the firm's documentation and calls were poor. This was particularly so in relation to enhanced annuities and this needs significant improvement going forward. In particular, we found examples where, as a result of firms' actions, customers are not getting the right type of annuity, for example buying a standard annuity where they may qualify for an enhanced annuity. Even though our overall sample size is small, and we did not explicitly seek to identify and measure the harm caused, our findings are grounds for concern. This is explored in further detail under outcome 3.

15 'Ignition House: Exploring Consumer Decision Making and Behaviour in the At-Retirement Landscape' published 11 December 2014 P44: Respondents felt that calls with providers could be useful. They liked to make calls to clarify their understanding and felt that that such inquiries were dealt with more efficiently over the phone as they are able ask questions directly and probe if they required further information. That said, respondents do not always trust what is said to them.

Training and call scripts

From our analysis it would appear one of the root causes of the issues with the customer conversations on calls relates to the poor training of call handlers and the quality of the call scripts/guidelines. We found examples of training that did not cover:

- the need to highlight shopping around or how to shop around at all (including for enhanced annuities)
- the importance of highlighting GARs/MVRs
- the financial implication of each annuity option/choice available

Other retirement income options

We also identified from our select sample that, although the documentation signposted other retirement income options, such as income drawdown, the telephone calls for the majority of firms to discuss customers' retirement options currently focus on annuities alone rather than focusing on all the options at retirement. Annuities have in the past been the most dominant retirement income product. In the future, other products may increase in popularity relative to annuities. Therefore, the improvements needed by firms to have appropriate conversations with their customers about all their retirement income options will be even more significant from April 2015 onwards.

We set out our findings by specific consumer outcome below.

Outcome 1: Consumers are actively encouraged (and not discouraged) to shop around, and can make informed decisions about how and when to purchase annuities.

The previous annuities thematic review showed that customers could gain on average £67 of retirement income annually through shopping around to purchase their standard annuity[16], although this figure varies widely across firms. We found that customers of some firms will get the best rate from their existing pension provider, while others could increase their annual income by as much as £171 by shopping around and switching. It is important to consider not only the impact on annual income of not shopping around, but also the impact on total lifetime income. To assess the impact of switching over the lifetime of each annuitant in our previous review we estimated by how much they would have needed to increase their pension savings to achieve the annual income available on the open market from their existing pension provider.[17] For a customer with a standard annuity we estimated this as £1,429.

If customers are not made aware that they may benefit from shopping around to buy their annuity with another provider they may purchase an annuity with their current pension provider, potentially resulting in a lower income in retirement.

16 As set out on page 14 of FCA's 'Thematic Review of Annuities TR14/2' published 14 February 2014. Based on the average fund size of £17,000 and average annual income from a standard pension of £1000

17 As set out on page 17 of FCA's 'Thematic Review of Annuities TR14/2' published 14 February 2014. For example, if a customer is offered a 5% annuity rate from their existing pension provider for a fund size of £10,000 and a rate of 5.5% on the open market, they would need an extra £1000 in their pension fund to get the same income they could have got with £10,000 on the open market.

Findings from our review of firm sales practices

Generally, the documentation provided to customers covered the necessary information and we saw examples that were clear and informative and provided the customer with the information needed to shop around.

We saw some examples of good practice in this area. For example, clearly highlighting in illustrations that customers should use these illustrations to shop around and compare the retirement income quoted with the retirement income offered by other providers. Also, firms using bold language and highlighted headings in written documentation to draw the customer's attention to the shopping around message.

We did identify some inconsistencies in a number of firms in our sample, where written documentation did not include key messages for customers of certain parts of the business or at different stages of the customer journey. For example, one firm in our sample provided a leaflet with information on how to shop around which clearly directed the customer to compare quotes from different companies. However, this leaflet is only provided to customers in one part of the business and not to customers in other parts of the business. This presents the risk that some customers of this firm will not be made aware of how to shop around.

We have also seen examples where the information provided to customers is not balanced. For example, customers are informed that the cost of converting their pension fund into a retirement income may change if they delay retirement so that they may not get as much for their money (but it does not mention they may get more). This may prompt the customer to purchase an annuity more quickly. Or customers are told that to get the best income from shopping around they should seek financial advice when in fact they can shop around themselves to get a higher income. This poses a risk that even if customers are aware of the option to shop around, they may be discouraged to shop around and may miss out on a higher income in retirement.

We found that the primary area of risk to this outcome is in the conversations firms have with their customers on telephone calls. The majority of calls in our sample did not actively encourage customers to shop around, or repeat the shopping around message. We found examples where the 'shopping around' message was only given to the customer once during the phone call, for some firms right at the start of the conversation, rather than being repeated and reinforced to the customer at relevant times during the call. Some firms in our sample did not mention shopping around at all on calls to some customers.

The systemic issues with the calls could be driven in part by the poor training material we identified, which was not sufficient to ensure call handlers were prepared to have adequate conversations with customers. We found examples where training did not equip call handlers to actively encourage customers to shop around, nor inform customers how to shop around, and for some firms focused on areas other than annuities such as data protection.

For some firms this failing in training is compounded by there being an absence of call scripts to guide call handlers through retirement conversations with customers, or call scripts that fail to guide call handlers through conversations that would actively encourage customers to shop around or explain to customers how to shop around. The poor training and lack of appropriate call scripts may result in poor consumer outcomes as some call handlers are ill-equipped to provide customers with the right information.

The strategies of firms towards their existing pension customers across our sample also varied. Firms will always have a commercial imperative to retain customers, and this can be positive as long as retention strategies involve supplying customers with good services and products at competitive rates. But firms also need to ensure their customers fully understand their option to shop around and switch and the benefits of doing so. We found examples of strategies of providers to retain their existing pension customers but the link with consumer shopping around and switching was not always clear.

For example, one firm in our sample had a strategy that identified the introduction of the ABI Code as a threat to its business model. The firm responded to this perceived threat by instigating a programme that seeks to have regular touch points with customers to ease them through the retirement journey, and in so doing attempts to retain them as annuity customers of the firm. Of further concern, the head of the business line responsible for selling annuities to existing pension customers is, in part, remunerated by variable pay that is linked to the volume of sales of annuities to existing pension customers.

Other firms' strategies provided examples of good practice. One firm's stated strategy is to implement the ABI Code in full, in spirit as well as to the letter. Another firm's strategy stated that, since the introduction of the ABI Code, shopping around and the importance of customers understanding their options has been reinforced. However, we did not always find a clear link between seeing examples of good practice in a firm's strategy and the successful execution of this strategy.

Panel arrangements

Restricted panel arrangements offer consumers the opportunity to compare the products and prices of a selection of retirement income providers' annuity products. The market coverage of restricted panels varies from panel to panel, meaning the customer choosing from a panel may buy an annuity from a portion of the open market but not the full open market. We found examples where the disclosure to customers was not sufficiently clear that the panel service gives the customer access to a restricted portion of the open market and that the customer may still receive a higher income in retirement from shopping around on the full open market outside of the panel arrangement.

Findings from the market study relevant to this report

Consumer research undertaken as part of the market study found that 40% of consumers do not exercise their option to switch and instead purchase an annuity from their existing pension provider[18] The market study also found that only 45% of retirees[19] recall receiving information from their existing pension provider about their right to shop around when buying a retirement income product. This supports our findings from our review of sales practices set out above. Although the message to shop around is being disclosed by firms, it is not being repeated and reinforced during relevant stages of the consumer journey, particularly during telephone calls to effectively increase consumer awareness.

Once consumers have identified a provider for their at-retirement product, it appears that it is relatively straightforward to purchase the product, even when they are using multiple pots (either individually or consolidated). This process can take some time, typically a few weeks but should not materially affect consumers' decision-making.

18 *GFK: At Retirement Consumer research – exploring changes in the retirement landscape* p5 published 11 December 2014. The consumer research that GfK carried out for the FCA found that 40% of consumers who recall purchasing an annuity bought their annuity from their pension provider, while 60% bought from a different provider. Other sources (the FCA Thematic Review of Annuities 2014 and ABI research) paint a slightly different picture, with a higher proportion of consumers staying with their existing provider (60% and 68% respectively). This difference may be explained by the fact that GfK's research also includes consumers buying annuities through a panel or a tied provider; hence GFK's finding (that 60% of consumers buy an annuity from a different provider) does not necessarily reflect the proportion of people that shop around and switch provider, by our definition. Nevertheless, all sources consistently point to there being a significant proportion that do not switch who could get a better deal by doing so.

19 Defined as: people over 55 years old who have either started drawing down from/accessing their pension savings or have made a decision to 'defer' i.e. put off accessing such pension savings. This includes people who may still be in full-time or part-time employment. GfK Consumer Research p52

Perceived barriers to shopping around facing consumers purchasing retirement income products include[20]:

- Difficulty understanding where to start with the process or how to go about finding out about it (particularly those with limited confidence using the internet)
- Reluctance to commit to the time/effort involved. This is particularly true for consumers whose DC pension pot accounts for a relatively small proportion of their overall retirement income
- Unfamiliar terminology putting people off and adding to complexity of decision making. Pensions are described as 'jargon-filled'
- An unwillingness to provide detailed personal information, particularly online and where they had not heard of a site or used it before
- Trust 'expert' to do it for them. If, for example, employers were involved in the process, consumers typically had more limited knowledge of their options and did not shop around. This is usually because the consumer trusts the person they speak to who they treat as an 'expert' and feel little need to carry out any follow-up research. The same is true for those who delegate their decision to an IFA
- Major life events, which result in urgent need to turn pension into income (for example health, redundancy). For these consumers, time is the key factor in decision making

The poor practice we found in firms' sales practices, particularly not informing customers of how to shop around and repeating the message at relevant stages in the journey, may be reinforcing the barriers to shopping around listed above and in this way contributing to consumer decisions not to shop around and/or switch. For example, if customers are not aware of the method for shopping around, they may choose not to do so because they assume it will be costly and time-consuming. We observed one particular example of poor practice of a firm in our sample not dispelling during a telephone call a customer's notion that shopping around would be costly and difficult.

Outcome 2: Consumers are provided with relevant and timely information about the potential benefits of any guaranteed annuity rate (GAR) or risks of a market value reduction (MVR) that exists in their existing pension contract.

Guaranteed Annuity Rate (GAR)

Some pension contracts include a provision called a Guaranteed Annuity Rate (GAR), which can be very valuable to the customer and can significantly increase the income the customer receives in retirement for a given pot size. However, individual policies can have specific clauses for taking a GAR, for example, that the annuity must be taken at the SRD, or can only be applied to certain annuity options, for example if a single life annuity is taken rather than a joint life annuity. Therefore it is important for good customer outcomes that the customer is not only made aware that they qualify for this valuable GAR and the benefit of having it, but also that they understand how and when to take their annuity in order to benefit from the GAR. If the customer is not made fully aware of these factors, they may lose a significant proportion of their potential income in retirement.

20 Evidence from FSCP consumer research and FCA consumer research

We saw some examples of good practice in relation to this outcome in written correspondence. Some firms clearly highlighted to customers that they have a GAR, that it is valuable, and in some cases included separate leaflets that provide worked examples to illustrate the significant benefit to the customer of taking their GAR. One firm in our sample illustrated clearly to the customer how their retirement income would change depending on the age at which the GAR annuity is purchased.

However, we also identified instances in the written documentation of firms not stating clearly the key terms and conditions of the customer taking their GAR, for example not informing the customer of the impact of delaying their retirement on their ability to take their GAR. We also identified one firm where, although the benefits and risks of losing a GAR were clearly explained to the customer in the accompanying leaflet, the wake up pack letter itself did not clearly inform the customer that they had a GAR.

During telephone calls, the quality of the conversation between the firms and the customers regarding their GARs varied. We found evidence that firms were not always explaining clearly to customers on phone calls the potential benefits of taking their GAR and the risk to the customer's income in retirement of not taking their GAR.

However, we also found evidence of good practice in conversations with customers in relation to this outcome. For example, some firms compared the GAR annuity rate with any enhanced annuity rate available, for customers for whom it was relevant, to ensure the customer received the higher income of the two options. It should be noted that our sample sizes for customer profiles with GARs were very small.

To provide further insight into this section of the market, we requested from firms information on the proportion of their customers with a GAR provision in their pension policy that ultimately took an annuity with a GAR. The GAR conversion rates for all the firms in our sample were high, so although we note the evidence of poor practice in firms' sales processes identified above, we have not seen evidence of this leading to poor consumer outcomes.

In addition to the results above, as a result of the Budget reforms we have already consulted on changes and published 'near final' rules in this area. We have made our expectations on firms explicit in the changed rules by specifying the information that should be provided to consumers about the existing pension scheme.[21] This information must include:

- The sum of money that will be available to exercise open market options
- whether any guarantees apply and, if so, information about how the guarantees work
- any other relevant special features, restrictions, or conditions that apply, such as (for with-profit funds) any market value reduction conditions in place
- any other information relevant to the exercise of the retail client's open market options

Market Value Reduction (MVR)

Some with-profits pensions can apply MVRs. MVRs reduce the fund value that can be withdrawn by the customer if they withdraw their funds early at a time when the market value of the fund has reduced. This is to ensure that the payout reflects the value of the fund in a manner that is fair to all investors. Many providers guarantee that they will not apply an MVR at certain times,

21 COBS 19.4.1A R (3) in 'near final instrument' published in PS14/17 /www.fca.org.uk/your-fca/documents/policy-statements/ps14-17

for example at the customer's SRD. If the customer is not made aware of when they may access their pension fund without an MVR applying, they may incur the MVR, reducing their fund value and ultimately reducing their income in retirement.

Similarly to the evidence for GARs, we found mixed results on the clarity of disclosure regarding MVRs across the firms in our sample. Some good practice was identified, for example written documentation clearly detailing and explaining MVRs and explaining MVRs clearly on calls, with one firm providing a helpful Q&A sheet on MVRs.

However, there were also examples of poor practice, with one firm not making it clear to customers on calls whether they have an MVR applied to their pension policies and other examples of key information regarding MVRs being positioned toward the back of the retirement packs, reducing its impact on customers.

For both GARs and MVRs we saw evidence of inadequate training and call scripts to equip call handlers to have informative conversations with customers on the importance and impact of GARs/MVRs. The evidence varied from insufficient training that would only enable the call handler to have a high level conversation with the customer to a lack of training on this topic entirely.

Outcome 3: Consumers are provided with appropriate and timely information about:

a. the benefits of enhanced annuities and their potential eligibility

b. an enhanced annuity being available on the open market (particularly, where their pension provider does not offer one)

c. the potential variation between different providers' underwriting and its impact on the income offered.

Enhanced annuities work on the basis that, if a customer has a medical condition or a lifestyle factor, such as smoking, they will have a shorter life expectancy than someone in a better state of health. Firms expect to pay these customers their retirement income for less time, so compensate by giving them a higher income, essentially using up their pension fund more quickly by giving them access to more money each year. As a result, in the vast majority of cases, a customer taking an enhanced annuity will receive a higher income in retirement than a customer taking a standard annuity.

Our previous thematic review into annuities estimated that consumers who would be eligible for an enhanced annuity (either from their pension provider or using the open market), but who purchased a standard annuity from their pension provider could, on average, benefit from shopping around and switching by £110 to £175 annually.[22] However, the true range of additional income to the individual will depend on the nature of the individual's health and lifestyle factors.

The review also identified that only 5% of annuities sold by providers to their existing pension customers were enhanced, compared to 50% of annuities sold on the open market. This may be because consumers who are obtaining an enhancement are the very consumers who have identified their eligibility for an enhanced annuity and are choosing to use the open market to shop around. However, it is also possible that a significant number of consumers

22 Based on the average fund size of £17,000 and annual income from a standard pension of £1000 set out on page 17 of FCA's 'Thematic Review of Annuities TR14/2' published 14 February 2014

buying standard annuities from their existing provider may be eligible for an enhanced annuity. To explore this issue further we looked closely at what providers tell their customers about enhanced annuities as part of this review.

From our review of firms' sales practices, this is the area where we have the greatest concern. Our findings show that while the majority of customers are generally informed of enhanced annuities, many are not informed about shopping around for an enhanced annuity or encouraged to do so to get a higher income, particularly during conversations with firms. Similarly, the majority are not told that other providers may offer enhanced annuities for medical conditions or lifestyle factors not covered by their existing provider.

The market study has found concerning evidence of consumer awareness in this area. It has found that a large proportion (43%) of people in bad health were not aware that annuity income varies with life expectancy.[23] If firms do not support these consumers to get good outcomes, they could be missing out on a significant income in retirement as a result.

The detailed findings are set out below, split by each component of the outcome.

a. the benefits of enhanced annuities and their potential eligibility

This captures the risk to good consumer outcomes of the consumer not being made appropriately aware of the features, benefits and their potential eligibility for an enhanced annuity. If the consumer is not made appropriately aware of enhanced annuities, they may buy a standard annuity rather than an enhanced annuity, which is likely to result in a lower income in retirement.

In general, the customer literature provided appropriately informs customers about enhanced annuities and the criteria for qualifying for one using the standard ABI wording as follows:

> **'Do you smoke? Are you on any medication or do you have a medical condition?**
>
> If so, you may be eligible for an enhanced annuity, which could pay you a much higher level of income.'
>
> *Source: ABI Code of Conduct on Retirement Choices p11*

In written correspondence, firms are also making it clear to customers that the benefit of an enhanced annuity is potentially a higher income in retirement. This is important in ensuring customers explore their potential eligibility for an enhanced annuity, as in other financial products customers may be aware of, for example term assurance or whole of life assurance, pre-existing medical conditions are likely to lead to higher costs for consumers rather than resulting in a higher income.

23 *GFK: At Retirement Consumer research – exploring changes in the retirement landscape* p6 published 11 December 2014. Base: 78 consumers. At a total sample level, 38% of consumes didn't know that smokers or those in poor health could get a higher income (base size 1000).

The majority of firms in our sample are also explaining the features and benefits of enhanced annuities to customers on calls and actively having conversations with their customers regarding the health and lifestyle factors that may make them eligible. There were a number of individual examples that were exceptions to this; where the conversations with customers regarding enhanced annuities were insufficient to explore the customers' eligibility.

There was evidence from one firm where conversations regarding enhanced annuities did not always lead to good customer outcomes due to the way in which the information was framed and presented to the customer. By the firm presenting the information to the customer in a way that highlighted the time it would take for the customer to access their tax-free cash lump sum, the customer purchased a standard annuity rather than applying for an enhanced annuity which requires a longer process for the customer to access their tax-free cash.

The quality of training to equip call handlers to have conversations to explain clearly the features and benefits of an enhanced annuity varied across firms in our sample. We found examples of adequate training programmes, whilst some firms had no training in place on this particular topic.

b. an enhanced annuity being available on the open market (particularly where their pension provider does not offer one),

This captures the risk to good consumer outcomes resulting from consumers not being made appropriately aware that they can shop around on the open market for enhanced annuities. If consumers are not appropriately informed their **retirement income may be reduced in one of two ways**:

i. they may **buy an enhanced annuity with their provider rather than an enhanced annuity on the open market,** or

ii. if their provider does not offer enhanced annuities, they may buy **a standard annuity with their current provider rather than an enhanced annuity on the open market.**

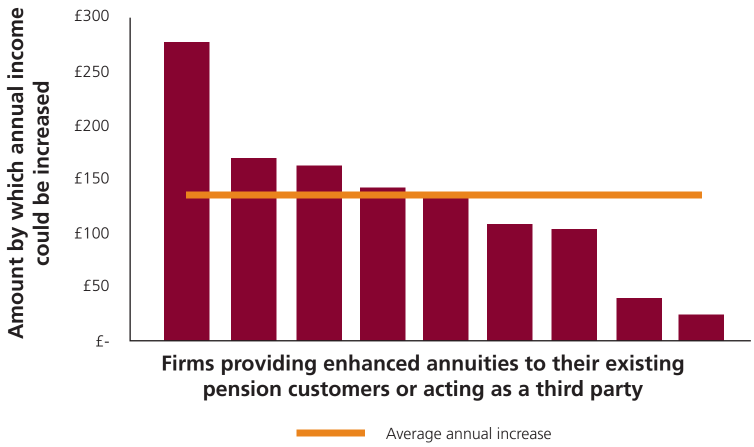
Focusing on option i), our previous thematic review into annuities estimated that consumers buying enhanced annuities could increase their annual income by £135 by purchasing an annuity on the open market[24], again, with wide variation in the gains consumers could make depending on their pension provider and their personal circumstances. We estimated that customers of some firms could increase their annual income by as much as £278 by buying their enhanced annuity on the open market.[25] We estimated that consumers would have needed to increase their pension savings by £2,428 to achieve the equivalent enhanced annuity annual income available on the open market from their existing pension provider.

To illustrate this point, Figure 1 below, taken from our previous review into annuities, shows nine providers who either offer enhanced annuities to their pension customers or act as a third party to a provider who does not offer its own enhanced annuity (there was a tenth firm in the sample whose existing pension customers, on average, received a good deal from their existing provider and were excluded from the chart).

24 Based on the average fund size of £26,800 and annual income from a standard pension of £1630 as set out on page 14 of FCA's 'Thematic Review of Annuities TR14/2' published 14 February 2014

25 As set out on page 16 of FCA's 'Thematic Review of Annuities TR14/2' published 14 February 2014, one lifestyle factor was used in our analysis, and the valuation may be different for other lifestyle or health factors.

Figure 1: Average estimated amount by which consumers purchasing enhanced annuities could increase their annual income by shopping around and switching provider



As the results show, it is very important that firms clearly inform customers that they may shop around for enhanced annuities as they may receive a higher income in retirement as a result.

We found that the quality of customer literature in this area varied. Some firms do not inform customers in the letters that form part of their wake up packs and reminder letters that they could shop around for enhanced annuities, for other firms this was the case for customers of only certain parts of the business. For customers this means that they may buy an enhanced annuity from their current provider when they might have been able to receive a higher income in retirement from an enhanced annuity from another provider.

This was exacerbated by poor disclosure on calls; the majority of calls listened to in relation to enhanced annuities did not encourage customers to shop around. Again, this reinforces the likelihood that a customer who might have received a higher income in retirement from another provider will receive a lower income in retirement by buying an enhanced annuity with their current provider.

A likely driver of the poor disclosure on calls is the evidence of insufficient training and call scripts in this area. We found a general theme that training programmes did not sufficiently equip call handlers to have informed conversations with consumers regarding shopping around for enhanced annuities.

There are a number of firms in our sample that do not themselves underwrite enhanced annuities but use a third party to whom they refer customers who disclose health and lifestyle factors that may qualify them for an enhanced annuity. We again found limited shopping around messages in this scenario, i.e. customers not being made aware that they may shop around for enhanced annuities with providers other than the third party.

Focusing on option ii) we saw one firm that does not offer enhanced annuities providing clear examples of good practice. This firm's documentation highlighted clearly the features and benefits of an enhanced annuity, including the health and lifestyle factors that may result in a customer qualifying, and informed the customer that they should shop around for the chance of a higher income in retirement as the firm itself does not offer an enhanced annuity.

However, we also found a clear example of poor practice. One firm in our sample has a strategy to not highlight enhanced annuities in conversations unless the customer raises it proactively. This practice presents a high risk that consumers with health or lifestyle factors could miss out on a higher income in retirement from an enhanced annuity by taking a standard annuity instead.

c. the potential variation between different providers' underwriting and its impact on the income offered

The underwriting criteria for enhanced annuities vary between providers and a given condition may make a customer eligible for an enhanced annuity with one provider and not another. So, if a customer does not qualify for a firm's enhanced annuity offering, it is important that the firm makes the customer aware that other providers may cover their health or lifestyle factor. This third component of outcome 3 captures the risk that the customer **may take out a standard annuity with their current provider when they would have been better off taking an enhanced annuity with another provider.**

Disclosure in this area was generally poor, with the majority of firms in our sample not informing customers in written documentation that underwriting criteria may vary between providers or the potential impact of this on customers' income in retirement. The majority of calls that we listened to in relation to enhanced annuities did not tell customers that other providers may offer enhanced annuities based on medical conditions or lifestyle factors not covered by the firm. In combination with poor documentation this presents a significant risk to customers with medical conditions or lifestyle factors who may have taken out a standard annuity with their current pension provider when they would have been better off shopping around for an enhanced annuity on the open market. Again, this appears to be driven by the quality of training and call scripts, which as a general theme were insufficient.

We found individual examples in our sample where customers disclosed medical conditions to the firm that were not covered by their enhanced underwriting criteria but were not informed by the firms in question that these medical conditions might be covered elsewhere.

Outcome 4: Consumers are provided with appropriate information about the different annuity options available to them (joint v single, level v escalating, and various guaranteed periods) and the risk associated with not taking these options.

There are a number of annuity options available to customers that impact their income in retirement and how it varies over time. The most common annuity options for customers are listed below:

- **Single vs joint life annuity:** The payments for a single life annuity end with the customer's death, whereas a joint life annuity will continue to make a payment to the surviving spouse/dependent until their death.

- **Level vs escalating annuity:** The payments for a level annuity are fixed over time whereas in an escalating annuity payments will rise over time, either at a pre-agreed rate or linked to the rate of inflation (e.g. CPI, RPI).

- **Guarantee annuity vs no guarantee annuity:** A guarantee period is set by the customer when buying an annuity, for example five years. If the customer dies within the first five years annuity payments will continue to be made up until five years; if the customer dies after the five years the annuity payments will end upon their death (for a single life annuity).

The annuity option chosen by the customer is vitally important to the customer's retirement income. For example, if a customer buys a single life annuity without fully understanding the implications, upon their death their spouse may not be provided for, depending on other retirement income available.

Findings from firms' sales practices

In general, we found customer literature clearly described the different annuity options available to the customer. Most firms include and also signpost the MAS guide in their pre-retirement communications, which extensively outlines the range of options available.

In firms' conversations with their customers, the picture was more varied. We saw examples of good practice, with some firms in our sample clearly explaining the options and the financial impact on customers, engaging customers in active discussions about their options and taking practical steps to aid customers' understanding.

However, we also saw examples of poor practice. Some firms in our sample asked customers to choose their annuity option before fully explaining the features and implications of that option, or failed to offer the customer comparison quotes for the options on which the customer was undecided to allow the customer to compare the impact on their retirement income. We also saw the use of jargon and complex terminology in call scripts to describe options for some firms and in others we saw examples where firms did not fully explain the financial impact of choosing certain options.

Generally, there was evidence that call handlers were reading from an agreed script and were not able to amend this to plainer language in appropriate circumstances, for example, when plainer language may help the customer's understanding. This is an issue with script design but may also be reflective of insufficient training in this area. We saw evidence of insufficient call handler training on annuity options for a number of firms meaning that call handlers may not be sufficiently informed and empowered to tailor conversations to the information needs of the customer.

Other retirement income options

Our findings above focus on annuity options, as do the majority of phone calls with customers. Although the written documentation provided to customers includes details of other retirement income options, such as income drawdown, these are not covered regularly on the calls by the majority of firms in our sample. This will need to improve after April 2015 when the choices available to customers will widen significantly.

Findings from the market study relative to this report

Qualitative consumer research shows that although there is a high awareness of the risk that inflation poses in 'eating away' at income, the majority of retirees are unwilling to pay the price today (in the form of lower initial payments) to inflation proof their income for tomorrow. When asked to estimate what impact inflation proofing would have on initial income from an annuity purchased with a £100,000 pot, consumers heavily under-estimate the costs involved, or even think that the initial payment will be higher than the income that would be generated through buying a level annuity. Joint life contracts and guarantee periods work in a very similar way; when faced with the trade-off above, a preference or need for more money today prevails.

The low propensity to inflation-proof future income could have a greater impact on future cohorts of retirees. The current generation of retirees often have an underpin of inflation-proofed income from other sources including, Defined Benefit (DB) pensions and State Earnings-Related Pension Schemes (SERPS), although these sources will decline in importance over time. Therefore the importance of firms having high quality conversations with customers regarding their annuity options is only set to increase in the future.

4
Conclusions and next steps

Conclusions

It is clear from our review that firms' behaviour is contributing to consumers not shopping around on the open market and potentially missing out on a higher income in retirement. Customers are not always getting all the information they need from their pension provider to make informed decisions about their retirement options. This is particularly concerning as, currently, these decisions are irreversible and consumers are locked into their annuities for the rest of their lives.

A particular area of concern is the enhanced annuities market, and we have seen evidence that this market in particular is not working well for consumers. We have found examples where firms are not providing customers with sufficient information about shopping around for enhanced annuities or informing the customer that the firm might not offer the annuity that best meets the customer's needs. The results of the market study also highlight that the general awareness of enhanced annuities amongst consumers who may be eligible is low.

Analysis undertaken as part of the market study suggests that the right annuity purchased on the open market offers good value for money relative to alternative drawdown strategies and may therefore be a good option for those with low risk appetites. It is really important that those consumers who still wish to annuitise in the future, or take other retirement income options, are given sufficient information with which to make an informed decision as they approach retirement.

Next steps

Bearing in mind their individual circumstances, we are asking the majority of firms to do further work to determine if our findings in relation to enhanced annuities are indicative of a more widespread problem and/or have led to poor consumer outcomes. We will not apply new standards retrospectively but will look at the period since the FSA's previous thematic work on Open Market Options in 2008. The findings from this work clearly highlighted that firms needed to make improvements in relation to the way consumers were informed about shopping around for enhanced annuities. Given that individual feedback was provided to firms and the findings were published, we believe that from that time firms should have been in no doubt about their responsibilities to their customers in relation to enhanced annuities.

The further work we are asking firms to do is not a review of all relevant sales since May 2008, but for individual firms it may include gathering more evidence, on a statistically significant basis, to determine whether customers with certain medical conditions or lifestyle factors missed out on a higher income in retirement by:

- purchasing a standard annuity (rather than an enhanced annuity)
- not shopping around for an enhanced annuity and as a result purchasing an enhanced annuity from their current provider rather than on the open market

Once we have reviewed the additional evidence gathered by the affected firms, we will consider what further action, if any, to take.

Where our thematic review has identified poor practice we will also work with these firms to make improvements to their annuities sales practices now across all four outcomes. Where required, this will include:

- improvements to the training provided to call handlers and the call scripts/guidelines used to assist them in their conversations with customers
- improvements to customer literature such as improving completeness and clarity of messaging
- re-evaluation of strategies that present a risk to good consumer outcomes

In addition, we will be signposting the findings of our review more generally to the market through the publication of the good and poor practice examples in this report.

As stated in our Policy Statement on the retirement reforms and the guidance guarantee, published November 2014, we will be undertaking a thorough review of our rules in the pensions and retirement area, including at-retirement communications, in 2015. This work will build on the standardisation work being undertaken with HM Treasury and industry. As part of this review, we propose to consult on replacing the ABI Code with our own rules. This will involve considering not only which aspects of the ABI Code should be incorporated into new FCA rules, but also where additional changes might be appropriate to extend our regulationsin order to help consumers understand their options at retirement and enable them to shop around for the best retirement option for them.

Annex 1
Good and poor practice tables

Some specific examples of good and poor practice identified in our review are identified below:

Table 1: Good practice identified in our review

Outcome 1: Consumers are actively encouraged (and not discouraged) to shop around, and can make informed decisions about how and when to purchase annuities.		
Good practice	Customer documentation	• Highlighting clearly to customers that they can use the quotations provided to them to compare retirement income when shopping around on the open market. • Additional leaflets adding value to the retirement pack documentation, either through including a separate shopping around guide highlighting prominently the advantages of shopping around or signposting clearly to the standard MAS guide, particularly with reference to how to shop around. • Using highlighted text and boxes to draw customers' attention to the shopping around message and separate 'key contacts' pages containing numerous sources of useful advice for customers.
	Telephone calls	• Actively dispelling the customer's notion that shopping around is costly by emphasising that shopping around is easy, outlining the benefits and explaining to the customer how to shop around.
	Strategy, training and incentives	• Training programmes that train call handlers to promote shopping around by outlining an appropriate indicative increased income the consumer could receive as a result of shopping around. • Introducing a new internal programme to put communications and supporting processes in place to help every customer make an informed decision and understand their retirement choices.

Outcome 2: Consumers are provided with relevant and timely information about the potential benefits of any guaranteed annuity rate (GAR) or risks of a market value reduction (MVR) that exists in their existing pension contract.		
Good practice	Customer documentation	• Signposting to customers that they have a GAR through a clear table on the first page of the retirement pack informing the customer that they have a valuable GAR. • Using highlighted and emboldened headings stating 'guaranteed higher income' to capture the customer's attention. • Inclusion in the retirement pack of signposted leaflets outlining how valuable GARs are, including illustrated examples of GAR incomes versus standard annuity incomes and drawing customers' attention to the circumstances in which a GAR may be lost.
	Telephone calls	• Providing comparative GAR rates and enhanced annuity rates, where relevant, to ensure the customer receives the higher retirement income.
	Strategy, training and incentives	• Allowing customers to 're-shape' or 're-time' GARs in most cases, to give the customer more flexibility in taking their higher GAR income. • Monitoring GAR MI to ensure any concerns over trends in GAR conversion rates are identified.

Outcome 3: Consumers are provided with appropriate and timely information about (a) their potential eligibility for and the benefits of enhanced annuities (b) an enhanced annuity being available on the open market (particularly, where their pension provider does not offer one), (c) the potential for variation between different providers' underwriting and its impact on the income offered.		
Good practice	Customer documentation	• A firm in our sample that does not offer enhanced annuities actively highlighting that their customers could shop around for an enhanced annuity for the chance of a higher income in retirement. • Inclusion within the retirement documentation of a "step-by-step guide to taking your pension income" clearly setting out pertinent information associated with enhanced annuities.
	Telephone calls	• Conversations with customers that ensure the customer has received a standard annuity quote prior to their enhanced annuity quote to allow the customer to make a comparison with the value of their enhanced annuity quote

Outcome 4: Consumers are provided with appropriate information about the different annuity options available to them (e.g. joint v single, level v escalating, and various guaranteed periods) and the implications of selecting different annuity types.		
Good practice	Customer documentation	• Using tables to outline a diverse range of annuity options which provide clear visual presentations and draw the customer's attention to the variety of options. • Providing a diverse range of options to the customer including some that the firm do not offer themselves.
	Telephone calls	• Clearly explaining the various options available to the customer (including the financial impact of these options) and actively engaging the customer in a discussion to reinforce the customer's understanding, for example, by asking the customer to explain their understanding in their own words. • Using practical techniques to aid the customer's understanding while discussing the different annuity options such as ensuring the customer has a pen and paper to make a note of the conversation or ensuring the customer has the wake up pack during the call so the customer can see the differences in income from the available options. • Call scripts that suggest a pause after talking through the annuity options and a call back following a break to allow the customer time to reflect on the conversation, re-read the written documentation and consider their options.

Table 2: Poor practice identified in our review

Outcome 1: Consumers are actively encouraged (and not discouraged) to shop around, and can make informed decisions about how and when to purchase annuities.		
Poor practice	Customer documentation	• Evidence of practices that may discourage shopping around. For example, highlighting to customers in an unbalanced way that there may be an additional charge when exercising their open market option. • Customer literature presenting imbalanced messages to customers. For example informing customers that delaying their retirement decision may result in a lower income in retirement, due to higher charges, but not also informing customers that delaying retirement could also result in a higher income. • Using less clear and impactful language to describe shopping around. For example, disclosing that other providers may provide better annuity rates or other annuity options rather than focusing on the chance of a higher income in retirement.
	Telephone calls	• Conversations with customers that do not repeat and reinforce the shopping around message at relevant points throughout the conversation. Not actively encouraging customers to shop around through gathering comparative quotations, nor informing the customer how to go about doing so. • Referring customers to a firm's restricted panel as a means of shopping around without clearly explaining to the customer that they can shop around outside of the panel for the chance of a higher income in retirement.
	Strategy, training and incentives	• No clear training structure in place to ensure call handlers receive adequate training on actively encouraging customers to shop around and explaining clearly how to do so. • No call scripts in place for call handlers to guide customers through the retirement conversation. • The Head of the Business Line responsible for selling annuities to existing pension customers is, in part, remunerated by variable pay that is linked to the volume of sales of annuities to existing pension customers.

Outcome 2: Consumers are provided with relevant and timely information about the potential benefits of any guaranteed annuity rate (GAR) or risks of a market value reduction (MVR) that exists in their existing pension contract.		
Poor practice	Customer documentation	• Written documentation does not communicate clearly to the customer that they have a GAR. • Specific GAR information is not included, such as the value/financial implications of the GAR or key terms and conditions of the GAR such as when the annuity must be bought in order to benefit from the GAR. • GARs and MVRs are not prominently highlighted at the appropriate place in relevant customer literature.
	Telephone calls	• Conversations with customers disclose the basic principles of GARs/MVRs. However, call handlers are not consistent in emphasising the importance of these or bringing to life the potential impact for customers.
	Strategy, training and incentives	• Evidence of limited call handler training on the features of GARs/MVRs and their impact on the customer's income in retirement

Outcome 3: : Consumers are provided with appropriate and timely information about (a) their potential eligibility for and the benefits of enhanced annuities (b) an enhanced annuity being available on the open market (particularly, where their pension provider does not offer one), (c) the potential for variation between different providers' underwriting and its impact on the income offered.		
Poor practice	Customer documentation	• Wake-up pack letters and reminder letters do not mention shopping around for enhanced annuities.. • Written correspondence does not inform customers that other providers may underwrite enhanced annuities for other health and lifestyle factors and that as a result an enhanced annuity income may be available to the customer by shopping around.
	Telephone calls	• Despite the firm being aware of the customer's medical condition, the firm does not dispel the customer's own notion that they will not qualify for an enhanced annuity. • Despite the firm being aware that the customer is not in work due to long term sickness and has a pot size that qualifies for an enhanced annuity, the firm does not explore the customer's eligibility for an enhanced annuity before a customer taking triviality. • Despite the firm being aware of the customer's serious medical condition, the retirement options are framed to the customer in such a way that exploits the customer's behavioural biases (to access their tax-free cash lump sum quickly) and results in the customer buying a standard annuity rather than an enhanced annuity. • Conversations with customers with specific health and lifestyle factors that are not covered by the firm do not inform customers that other providers might underwrite for different health and lifestyle factors, and that as a result an enhanced annuity income may be available to the customer by shopping around.
	Strategy, training and incentives	• Training materials do not cover encouraging customers to shop around for enhanced annuities to obtain a higher income and do not outline the impact on the customer's income of other providers' differing underwriting criteria. • Training materials do not promote shopping around for enhanced annuities with training focussed on referring customers to the third party for enhanced annuities.

Outcome 4: Consumers are provided with appropriate information about the different annuity options available to them (e.g. joint v single, level v escalating, and various guaranteed periods) and the implications of selecting different annuity types.		
Poor practice	Customer documentation	• An accompanying leaflet is provided in the wake-up pack but the leaflet does not include a comparison table to show the different annuity options and the impact of these annuity options on retirement income.
	Telephone calls	• Asking the customer for a decision on annuity type prior to fully explaining the range of options and their impact on customer income. • Not providing comparison quotes to help the customer understand the impact of their choices on their retirement income to help them to make an informed choice. • Use of jargon and complex terminology in call handler scripts, for example, reference to complex products such as 'LPI' without a full explanation.
	Strategy, training and incentives	• Evidence of insufficient training to equip call handlers to discuss different annuity options and the impact on income with customers.

Annex 2
Glossary

This glossary sets out the key terms we use and how we have defined them for this report.

Annuitant – A customer who has purchased an annuity.

Annuity – an insurance contract that provides a customer with a guaranteed income for life in return for a lump sum premium paid from a pension policy.

Annuity rate – the first year's annual payment received by a customer expressed as a percentage of the premium paid for the annuity.

Defined benefit pension – an occupational pension where the income at retirement is based on the number of years in the scheme and the individual's earnings.

Defined contribution pension – a pension scheme where a fund is built up through contributions and investments which results in a pot of money to be converted into an income at retirement.

Enhanced annuity – an annuity where the rate is increased due to the customer's health or lifestyle factors that the insurer has knowledge of. This includes the whole spectrum of enhancements from smoking to fully medically underwritten annuities (often called 'impaired life' annuities) on the basis of specific health conditions. The customer will have to disclose their state of health to the provider on their application form, and may have to be medically examined for impaired life annuities.

Escalating annuity – an annuity where the annual payment rises over time. The most common escalation is for the annuity payment to rise by a fixed percentage such as three or five percent per year, however it may also be linked to the Retail Price Index (e.g. RPI-linked or indexed annuity).

Guaranteed annuity rate (GAR) – GARs are included in some existing pension contracts, allowing the customer to convert their pension fund to an annuity at a rate defined within the pension contract (in some cases only available on a specified retirement date).

Income drawdown – income drawdown allows the customer to take an income from their pension fund, while the remainder of the fund remains invested. Unlike an annuity the customer continues to bear investment risk and longevity risk (the risk that they outlive their money). There are also different tax rules for annuities and income drawdown arrangements and differences in what happens when the customer dies.

Investment-linked annuity – an annuity where the income paid to the customer is linked to the performance of an underlying investment. This includes with-profits and unit-linked annuities.

Level annuity – an annuity whose payments remain the same, in monetary terms, for the duration of the contract. This can be contrasted with an escalating annuity.

Market value reduction (MVR) – a deduction which pension providers may make on certain withdrawals or switches from, or between, with-profits funds.

Standard annuity – an annuity where the rate is not underwritten on the basis of the health or lifestyle factors of the customer (other than their age or fund size).

Third-party arrangement – an arrangement between pension and annuity providers where one provider has an agreement to provide annuities for all or a subset of the other's existing pension customers.

Wake-up pack – the information sent to members of contract-based and trust-based pension schemes before they make a decision regarding taking benefits from their pension savings.

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