

Thematic Review

TR16/7

Review of annuity sales practices



October 2016

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Abbreviations used in this paper

ABI Association of British Insurers

COBS Conduct of Business Sourcebook

FSA Financial Services Authority

FCA Financial Conduct Authority

MAS Money Advice Service

OMO Open Market Option

1.

Executive summary

Context

- 1.1 The introduction of Pension Freedoms in April 2015 presented consumers with a broader range of choices around how they access their pension savings from age 55 and onwards. Annuities are no longer the 'default' position for most customers.
- 1.2 Despite this, annuities remain an important option for pension customers who are considering how best to use their retirement savings. The continued availability of annuities provides an important choice for those customers who are likely to value the certainty of income which they provide, and the provisions they can offer for surviving partners and other dependents.
- 1.3 It remains imperative that customers who are approaching a crucial decision point in their lives are provided with timely, relevant and adequate information sufficient to be able to make an informed decision about whether to exercise, or decline to exercise, an open market option (OMO). This applies to all options which are available to them, and we have recently provided our guidance and rule changes to support this via PS16/12.¹ In all cases, including where the decision is to purchase an annuity, the decision is an important one which may define the customer's standard of living for many years to come. It is a crucial decision to get right.
- 1.4 The focus of this piece of work, which forms part of the FCA's ongoing pensions strategy, has been on one important element of this provision – specifically, the extent to which firms conducting non-advised sales have informed existing customers about the availability of, and their potential eligibility for, enhanced annuities² and the fact that customers could potentially get a higher income from an enhanced annuity with another provider.

Why did we undertake the review?

- 1.5 Enhanced annuities are an important part of retirement provision for those who may be eligible for them. By definition, many such customers are of advancing years and are potentially vulnerable in that their health conditions may constrain their activities or place additional financial demands on them. Many of the customers in our sample had small pension pots, the average being c. £25,000.

1 www.fca.org.uk/your-fca/documents/policy-statements/ps16-12

2 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 typically provide them with a higher income.

- 1.6** It is important that these customers are given sufficient information to enable them to make an informed choice about enhanced annuities; this has the potential to enable them to increase their retirement income, and thus ease their financial burden at a crucial point in their lives.
- 1.7** Our first Thematic Review into annuities (TR14/2³) reported in February 2014 that many consumers were buying an annuity from their current pension provider without considering what might be available to them on the open market, and that they may be missing out on a higher income in retirement as a result. Our second review (TR14/20) considered whether 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 due to poor sales practices by providers of non-advised annuities.
- 1.8** In December 2014 we published the results of TR14/20.⁴ While that review highlighted several areas in which firms could improve their overall practices, the primary concern we identified in that thematic report regarded information provided to customers about enhanced annuities when sold through a non-advised sales process.
- 1.9** As a result, we asked the majority of firms from our original sample to review a random sample that was representative of the underlying population and sufficiently robust for our intended analysis of historic annuity sales to determine whether the weaknesses and failings we identified in relation to sales of enhanced annuities in TR14/20 were indicative of a more widespread problem and/or have led to poor consumer outcomes. The firms who participated in the review accounted for approximately two-thirds⁵ of the non-advised annuity market.

What did we review?

- 1.10** Our work focused on non-advised sales of annuities made by pension providers to their own customers between May 2008 and April 2015. Specifically, we looked at the information provided regarding enhanced (sometimes called impaired life) annuities.
- 1.11** In undertaking this work, it was our intention to establish whether firms, during their non-advised sales communications with customers (both written and oral), provided their customers with sufficient information about enhanced annuities. Specifically, we wanted to understand whether firms made customers aware of their potential eligibility for enhanced annuities and explained that by shopping around for annuities they could potentially get a higher income with another provider.
- 1.12** We asked firms to assess whether they had ensured that, throughout the chain of information provided to the customer, there was a clear, fair and not misleading explanation of enhanced annuities which would enable the customer to understand whether they were potentially eligible for one and make an informed decision about shopping around.

³ www.fca.org.uk/news/tr14-02-thematic-review-of-annuities

⁴ www.fca.org.uk/news/tr14-20-annuities-sales-practice

⁵ The proportion of the market (based on policy count) for individual non-profit and with-profits annuities covered by all firms in our sample averages c.64% between 2008 and 2014. However, the market data includes annuities sold on the open market and advised sales, so the true coverage of the non-advised internal vesting market in our sample is likely to be higher (Source: firms' PRA returns supplemented by additional firm data).

What baseline standards did we apply?

- 1.13** The specific rules against which each case was assessed are described in Annex 1 of this paper. In summary, firms must conform to the specific standards in COBS 19.4 (open market options) which specifies the information that should be provided to customers in writing in the run up to retirement (including providing the FSA/MAS Factsheet) and when they are making choices about how to access their pension savings. Any communications with customers must be clear, fair and not misleading (COBS 4.2.1R) and the firm must act honestly, fairly and professionally in accordance with the best interests of its client (COBS 2.1.1R).
- 1.14** As a minimum, we expect that firms communicating orally or in writing about the options available in relation to the types of annuity which a customer might buy (whether from the firm, or on the open market) would ordinarily provide to the client, or ensure that the client has, sufficient information about all of the client's options. This is so that the client is able to make an informed decision about whether to shop around for, and buy, an enhanced annuity and to reiterate those messages, as appropriate, throughout the retirement journey.

How did we conduct the review?

- 1.15** The review was conducted by suitably skilled and experienced staff within the firms in the sample who used a comprehensive set of review instructions which were developed by the FCA. These instructions clearly laid out the criteria against which each sale should be reviewed (the baseline standards), and specified the FCA rules against which each communication should be assessed.
- 1.16** The review was conducted by selecting a random sample that was representative of the underlying population and sufficiently robust for our intended analysis, with a sample of more than 1200 sales across the firms in the sample group. The approach for identifying the review populations and for selecting the sample cases was validated by an external consultant statistician.
- 1.17** To ensure that firms complied with FCA instructions we validated a minimum of 10% of the cases reviewed by each firm. We were pleased that the participating firms conducted the review in accordance with our instructions and timescales. On any occasions where our findings differed from those of the firm we provided detailed oral and written feedback and asked them to revisit any similar cases. This approach has given us confidence in the rigour and accuracy of the findings.⁶

Estimate of detriment

- 1.18** The exercise did not involve contacting customers as we felt that to do this at this stage would have been disruptive to those individuals and may have caused undue concern among customer groups before we were able to finalise our conclusions; therefore the firms/FCA could not know whether any individual customer was eligible for an enhanced annuity. So, in order to estimate potential customer detriment, we:
- i. estimated the likelihood of customers in our sample group being eligible for an enhanced annuity, and

⁶ The method of assessment used in this review is set out in Annex 1.

- ii. calculated the likely aggregate arising from this by using indicative 'uplift rates' i.e. the increase a customer may have received for an illness or lifestyle issue when compared to a standard annuity

Both i. and ii. above allowed for different broad categories of lifestyle/health impairment.

- 1.19** For a proportion of customers our review methodology led us to conclude that the firm's conduct may have caused them a financial loss. The results suggest that it is more likely than not that these customers would have bought an enhanced annuity rather than a standard annuity had they been given sufficient information, and would have been eligible to do so because of a health condition or lifestyle factor. In these cases, we have estimated a plausible range of lost annuity income to an average customer as being between £120 to £240 p.a.⁷ This is dependent on a number of factors which we explain in paragraphs 14 – 17 of Annex 1.
- 1.20** It is important to stress that this part of the exercise was intended to arrive at an aggregated estimate of the possible range of customer detriment across the firms in our sample, using market level assumptions combined with the rates of non-compliance from the review exercise. The approach was not designed to assess actual detriment arising from individual customer circumstances.

What did we find?

- 1.21** We concluded that, based on our review sample, there is no evidence that there is an industry-wide or systemic failure to provide customers with sufficient information about enhanced annuities through non-advised sales, which is resulting in actual loss.
- 1.22** We identified two types of non-compliance:
- 'Type 1' - a failure of the process and therefore a breach of our rules.
 - 'Type 2' – where the firm concluded that a 'Type 1' fail was likely to have changed the customer's behaviour in a way which may have caused the customer actual loss i.e. as a result of the poor communication, the customer bought a standard rather than an enhanced annuity and/or failed to shop around.
- 1.23** There was a relatively high incidence of 'Type 1' fails across the firms in the sample. However, despite these 'Type 1' fails the impacted customers typically still received sufficient information throughout the sale. In fact, the majority of firms in the sample returned relatively low 'Type 2' fail rates. Generally, most firms from our sample provided customers with adequate information about enhanced annuities (and the open market option) throughout the non-advised sales process to enable them to make an informed decision about their potential eligibility and the benefits these annuities could provide.
- 1.24** However, a small number of the firms in the sample returned a high 'Type 2' failure rate. In the case of these firms it is probable that many of their customers would not have been given sufficient information to understand the options available to them, the benefits of buying an enhanced annuity and their right to buy one on the open market.

⁷ To illustrate this further - for an annuitant who lives for five years this equates to £600 to £1200 in lost income; over ten years it equates to £1200 to £2400; over 15 years it equates to £1800 to £3600.

- 1.25** Finally, our work on detriment found that throughout the relevant period approximately 39% to 48% of customers who bought a standard annuity from their current pension provider may have had qualifying health or lifestyle conditions which would have made them eligible for an enhanced annuity. Therefore, we estimate that in fewer than half the sales where we found 'Type 2' fails there is evidence that customers may have suffered actual financial loss.

What was underlying these failures?

- 1.26** We observed that 'Type 2' failures were typically caused by a firm's poor handling of telephone conversations with their customer. These usually took place after the initial written wake-up packs were issued. Often, these conversations only reacted to customers' questions and the firm took no steps to reiterate key messages about customers' potential eligibility for enhanced annuities. In such cases, there was over-reliance on the messages given in the wake-up packs even though considerable time may have passed since they were received by the customer.
- 1.27** In addition, we observed that firms often failed to repeat key messages about enhanced annuities in one or more individual communications, either written or oral, throughout the sales process ('Type 1' fails). However, in the majority of cases firms provided sufficient information overall to enable the customer to make an informed choice. For this reason, many 'Type 1' fails did not become 'Type 2' fails.
- 1.28** Nonetheless, this still suggests that all firms within our sample can improve elements of their sales processes and customer communications, especially when it comes to repeating key messages about enhanced annuities.

What do we want to achieve?

- 1.29** In our planned set of actions we wish to focus on four areas:
- **Having confidence in the wider sector**
We want to be certain that there are no more 'outlier' firms in the market, i.e. firms who are likely to have extensively failed to provide sufficient information to customers. We have identified the larger firms (by market share) who sold annuities to their existing customer base of pension policyholders and who did not fall within our original sample. We will ask these firms to conduct a review exercise to ensure that they do not have any concerns about their sales. This exercise will be overseen by the FCA and the firms' senior management will be asked formally to attest to the outcome of their review.
 - **Appropriate compensation to be paid where due**
We will ask the small number of firms who have repeatedly failed to provide customers with the information they require regarding enhanced annuities to review all non-advised annuity sales from July 2008⁸ to identify customers who are likely to be eligible for redress. We will ask them to quantify that redress and compensate the customers accordingly.

⁸ This date takes account of the point in time at which firms received formal feedback on the FSA's 2008 thematic review on the open market option and the FSA made its public statement on the results www.fsa.gov.uk/pages/Library/Other_publications/Pensions/2008/omo.shtml

- **Customers' options**

We encourage any customers who feel they were given insufficient information about enhanced annuities at the time they chose their annuity to contact their firm. Firms are obliged to deal with complaints promptly and fairly.⁹ Such customers also have recourse to the Financial Ombudsman Service in the event they disagree with the way the firm deals with their complaint.

- **Greater awareness among firms of conduct standards**

Incorporated within this thematic report is a detailed explanation of the findings from our Thematic Review.

What happens next?

- 1.30** Based on our review we conclude that there is no evidence to support general industry-wide remedial action.
- 1.31** However, because a small number of firms returned a high 'Type 2' fail rate, we will be asking those firms to conduct a formal review of their past sales. Under the FCA's formal powers within FSMA¹⁰, we will ask these firms to appoint skilled persons who will ensure that the review is conducted rigorously and effectively. The FCA will also provide these firms with a mechanism through which redress can be calculated consistently.
- 1.32** In addition, because we want to have confidence across the entire sector, we will contact the largest firms by market share outside our sample group to discuss the detail of the review exercise we want them to undertake and the process they should apply. We will also write to the Chief Executives of the remaining firms in this sector that fell outside our sample to draw their attention to our findings.
- 1.33** **All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 706 60790 or email publications_graphics@fca.org.uk or write to Editorial and Digital Department, Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.**

⁹ Under the standards of the FCA's DISP sourcebook which describes firms' obligations regarding dispute resolution.

¹⁰ The Financial Services and Markets Act 2000, which is the primary legislation that provides powers to the FCA.

2. Background, scope and approach

Background

- 2.1** Our first Thematic Review into annuities (TR14/2¹¹) was published in February 2014. We found that some parts of the market were not working well for some consumers. In particular, our results suggested that many consumers were buying an annuity from their current pension provider without shopping around and switching providers, even when a high proportion would be better off doing so. As a result, they may be missing out on a higher income in retirement.
- 2.2** We wanted to reduce 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 as a direct result of their annuity provider's actions. As a result, we announced a review that aimed to understand whether firms' sales and customer retention practices contributed to customers not shopping around and switching.
- 2.3** In December 2014 we published the results of our Thematic Review, TR14/20¹², into annuity sales practices. Our primary concern in that report was with non-advised sales of enhanced annuities.¹³ Specifically, TR14/20 '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'. More specifically we found examples where the ABI code¹⁴ (more detail can be found in Annex 3) was 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. We were concerned that consumers may be missing out on a higher income in retirement because firms were not informing consumers of key information from the FSA/MAS factsheets¹⁵ on annuities about:
- a.** the benefits of enhanced annuities and the consumers' potential for them;
 - b.** an enhanced annuity being available on the open market (particularly, where their provider does not offer one), and
 - c.** the potential variation between different providers' underwriting and its impact on the income offered.

¹¹ www.fca.org.uk/news/tr14-02-thematic-review-of-annuities

¹² www.fca.org.uk/news/tr14-20-annuities-sales-practice

¹³ 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 provide them with a higher income.

¹⁴ The ABI Code of Conduct on Retirement Choices (in force from 1 March 2013) which must be followed by its members in addition to any FCA requirements.

¹⁵ A document developed by the FSA and the Money Advice Service which was introduced from 2008 and which outlines for customers their options at retirement. It has been a mandatory element of COBS 19.4 that this (or an equivalent statement) must be sent by firms to customers as part of their retirement wake-up pack.

- 2.4** Based on our findings we decided that the majority of firms that took part in the initial review (for TR14/20) should conduct a further review of a random sample that was representative of the underlying population and sufficiently robust for our intended analysis of annuity sales. This review aimed to determine whether the weaknesses and failings identified in relation to enhanced annuities indicated a more widespread problem and/or led to poor customer outcomes. The review was conducted by these firms during 2015 and their results were validated by the FCA. The results and conclusions form the primary content of this paper.

How did this review differ from the sampling work undertaken for TR14/20?

- 2.5** The results published in TR14/20 were based on a limited sampling approach and assessed the sales of annuities against the FCA's Principles for Business, the relevant COBS rules (set out in paragraph 2 of Annex 1) and the ABI Code of Conduct on Retirement Choices. This limited sample identified potential concerns regarding the communication of enhanced annuities. In order to determine with greater accuracy whether our concerns indicated a more widespread problem, we decided to conduct a more detailed and extensive review. This review used a random sample that was representative of the underlying population and sufficiently robust for our intended analysis and focused on firms' adherence to our COBS rule standards. Therefore, the nature and scope of the review was more rigorous and extensive, and enabled us to arrive at more definitive conclusions regarding firms' practices.

What did we want to achieve?

- 2.6** Our review intended to establish whether firms, during their non-advised sales communications (both written and oral), provided their existing customers with sufficient information about enhanced annuities. Specifically, we wanted to identify whether firms made customers aware of their potential eligibility for enhanced annuities, and explained that customers could shop around for them and potentially get a higher income from an enhanced annuity with another provider.

Who will be interested?

- 2.7** This report summarises the thematic work we conducted on non-advised annuity sales made between May 2008 and April 2015 – it is not general guidance on the operation of our rules.
- 2.8** It will be of interest to annuity providers and customers in receipt of annuity payments or approaching their retirement.
- 2.9** The results set out in section 3 of this paper indicate that some customers, when vesting their pensions, may not have been provided with timely, relevant and adequate information sufficient to enable them to make an informed decision regarding their potential eligibility for enhanced annuities or their option to shop around for one. Such customers are encouraged to raise the matter with their provider, who is bound by the FCA's complaint handling rules and the jurisdiction of the Financial Ombudsman Service.

Scope

- 2.10** The scope¹⁶ of our review¹⁷ was limited to all non-advised sales of pension annuities (both standard and enhanced/impaired life) sold to the firms' existing contract-based defined contribution pension customers during the relevant period, including customers who have subsequently died during the relevant period.

¹⁶ The full range of products defined as in-scope and out of scope are set out in Annex 2.

¹⁷ The scope of this review is the same as in earlier phases of the FCA's work on annuities published in TR14/2 and TR14/20.

3. Results

Overview

- 3.1** The objective of our work, as outlined in TR14/20, was to establish if the concerns identified in that report regarding enhanced annuities indicated a more widespread issue.
- 3.2** For the majority of firms in our sample our findings suggest they made a relatively low number of sales through which customers may have suffered financial loss. This tells us that, in the majority of cases, the information firms have given customers about enhanced annuities across the entire non-advised sales process has been timely, relevant and adequate. As such, the information has enabled these customers to make informed decisions about their potential eligibility for, and the benefits they might derive from, enhanced annuities.
- 3.3** Therefore, we found no evidence to suggest that there is an industry-wide failing, as many of the firms in our sample demonstrated that they provide clear and comprehensive information to customers. However, a small number of firms in the sample returned a high number of sales where consumers may have suffered loss. Of these consumers a significant number may have received insufficient information regarding enhanced annuities. Many customers of these firms will not have understood enhanced annuities fully, and may not have been in a position to make an informed choice about them, including whether to shop around on the open market.
- 3.4** The findings described in this section, whilst relatively widespread failures of process, have thus generally not led to significant changes in customer behaviour in a way which may have caused the customer actual loss. Any actual customer loss is, as previously described, largely limited to those of a small number of firms in the sample.
- 3.5** Across our sample written communications tended to meet our standards as they provided sufficient information regarding enhanced annuities. This supports the findings of the review conducted by the Financial Services Authority in 2008¹⁸ and TR14/20. The majority of our concerns arising from the review published here relate to significant oral communications (usually in the form of a telephone conversation) in which firms discussed with customers their annuity options, but did not mention enhanced annuities or the customer's option to shop around on the open market for a higher income.
- 3.6** Our key findings are described in more detail below.

¹⁸ www.fsa.gov.uk/pages/Library/Other_publications/Pensions/2008/omo.shtml

Detailed findings

- 3.7** The following section describes the main findings and examples of failure identified in the review.

Overview of non-compliance with the relevant COBS rules

- One third of firms reported gaps in the information they provided to customers. (This was more likely to be during significant oral communications, i.e. telephone conversations.)
- The impact of information gaps was likely to be reduced when more information was provided in subsequent communications.
- Poor call handling was likely to have caused some customers to purchase a standard annuity when they may have been eligible for an enhanced annuity.

- 3.8** Greater detail is given below.

Overview where non-compliance may have caused loss

- This was usually attributable to poor handling of telephone conversations. In these conversations firms reacted to customers' questions rather than taking the initiative to make sure customers were aware of key information about enhanced annuities.
- These calls gave customers little or no information about enhanced annuities on which to base their decision-making.
- In such cases, firms relied on the written message provided in the wake-up pack, which customers may have received many weeks or months before making their decision. This failure to reiterate important messages about annuities was the main cause of non-compliance with our standards.

Wake-up and follow-up packs

- In the majority of cases, written communications provided customers with the relevant information required by COBS 19.4. This was usually because the FSA/MAS leaflet was included within wake-up packs. In instances where it was not, firms generally provided some explanation to customers about enhanced annuities which met the standards of our rule.
- Follow-up packs also met the standards of COBS 19.4.3 by reminding customers generally of their option to shop around on the open market.
- The firms in our sample usually provided both packs to customers in a timely fashion and in line with the standards of COBS 19.4.
- In a limited number of instances we observed fails in some written communications. These tended to be isolated and did not generally lead to a 'Type 2' fail as firms usually provided sufficient information to the customer elsewhere in the process.

Examples included:

- In some cases wake-up packs and/or follow-up packs were not sent within the timeframes set out in COBS 19.4. These packs tended to be fully compliant in all other respects and in none of these cases did the failure to send the pack within the specified timeframe directly lead to potential customer detriment. Nonetheless, the timeframes exist within

our rules to ensure that customers' information needs are met in a timely manner. In particular they ensure that information is provided to customers in good time to allow them to consider their options fully and raise questions with the firm if necessary.

- We also identified instances where firms could not confirm that they had sent wake-up packs to a customer. This was not widespread in our findings and we did not see it as directly contributing to poor customer outcomes. However, while there was no evidence to suggest that the packs were not provided, it was not possible to confirm this. This poses the question of whether a firm's systems and controls would be sufficient if they were presented with a complaint and/or a legal challenge.
- We also saw examples across all firms where the wording of messages regarding enhanced annuities could have been clearer and/or better positioned within the documents. Usually this related to the clarity of the message or the extent of the information provided – for example, in some cases firms explained what an enhanced annuity is but gave very few examples of what a lifestyle factor might be, often using 'smoking' as a proxy. In other cases, information regarding enhanced annuities was split between different documents in the pack, which could cause a customer to absorb only part of the message. We also saw some instances of wording that suggested an enhanced annuity is available only to customers with critical illnesses which affect life expectancy. This may have led customers with less serious medical conditions or lifestyle factors to believe that their condition did not make them eligible to apply for an enhancement.
- However, in these examples of poor wording and/or positioning of key messages we saw no evidence that customers were inadequately informed, or that they would have reached a different decision had the wording been clearer. We therefore concluded that, while improvements could be made in the interest of clarity, the poor wording we saw is unlikely to have changed customers' behaviour in a way which may have caused actual loss. In such instances we have fed back to the firms in our sample where their written documentation could be improved to give greater clarity to customers.

Significant oral communications

- 3.9** Most examples we found in the sample of non-compliance related to significant oral communications where customers' annuity options were discussed but with little or no reference to enhanced annuities.
- 3.10** In a number of the telephone conversations we reviewed it was clear that customers had a limited understanding of the subject matter, even when they had received the wake-up and/or follow-up packs. Firms did not recognise that customers are not experts in insurance products and also failed to understand that the eligibility criteria and benefits of enhanced annuities are not well known by the ordinary customer. The information requirements set out in our rules seek to ensure that customers have timely, relevant and adequate information about their retirement options.
- 3.11** We identified some instances where call handlers recognised a customer's limited understanding and tailored their responses and language effectively towards addressing their customers' needs. However, we also found evidence of telephone conversations where call handlers did not appear to respond effectively to their customer's apparent lack of understanding. In several cases this was demonstrated by the call handler failing to explain about enhanced annuities,

even when it was evident that the customer may have benefitted from this subject being reiterated during the telephone conversation.

3.12 Examples of the concerns we identified include:

- In telephone conversations call handlers sometimes failed to repeat key messages regarding enhanced annuities. In such cases, customers would have been reliant on recalling the information from wake-up packs which they may have received many weeks or months previously. This created a risk that they may have taken out a standard annuity because they had forgotten or overlooked the information about enhanced annuities.
- Call handlers were sometimes heavily reliant on call scripts when talking to clients. Where clients had specific questions or misunderstandings about the options presented to them, call handlers were often unable to respond to the client's specific needs, engage in useful discussions about retirement options or, in some instances, clarify areas of client misunderstanding.
- Firms did not explain that enhanced annuities were available where lifestyle factors (e.g. smoking status, being over or underweight) may contribute to a reduced life expectancy. Often call handlers focused solely on serious medical conditions (heart disease, cancer) and did not mention that enhanced annuities may be available to those with illnesses or lifestyle choices that affect longevity.
- Firms may have discussed enhanced annuities, but not made customers aware that they could obtain a higher income by shopping around for an enhanced annuity on the open market.
- In some instances call handlers informed clients that they would not qualify for an enhanced annuity based on certain medical conditions or lifestyle factors, such as high blood pressure or smoking, even though other firms offered enhanced annuities for these conditions at the time.
- The firm may have reminded the customer of their option to shop around for an annuity, but not made it clear to the customer that this option also applies to enhanced annuities.
- Although firms often made it clear that a customer might obtain an enhanced annuity, they did not also explain that, because of firms' differing underwriting practices, another firm may cover the customer for a condition that they themselves would not.
- Where firms did not sell enhanced annuities, they did not always inform customers of this and some did not mention enhanced annuities at all when speaking to the customer. Therefore, customers may have thought that they had no alternative other than to take out a standard annuity.
- In some cases firms gave customers clear messages about enhanced annuities that they later undermined by comments which contradicted their earlier statements or made them unclear. Typical instances of this included:
 - call handlers under-playing the level of increase which a customer may obtain by shopping around
 - call handlers putting a strong emphasis on the speed at which tax free cash payments could be made if the customer does not shop around

- Instances of a firm undermining information which had already been provided sometimes took the form of failing to correct a customer's obvious misunderstanding about enhanced annuities. For example, we saw instances where a customer stated that there would be no point in shopping around because it would make little difference, and the call handler did not correct or challenge the customer.
- Call handlers wrongly gave the impression that a referral to a connected annuity provider (where a relationship existed) is the same as shopping around and could offer the same benefits.

3.13 It is not possible to identify a definitive underlying cause for the non-compliance we identified regarding telephone calls. As described above, there were instances where the required information about enhanced annuities was not provided to customers. This suggests that firms are relying heavily on wake-up packs and as a result are not repeating or reinforcing key messages at appropriate points in their later significant communications with customers.

3.14 We listened to telephone conversations where call handlers responded in a purely reactive manner to the customer's questions. Consequently they did not actively introduce the subject of enhanced annuities even when the conversation clearly focused on the range of annuity options available to the customer. This created a risk that customers might consider the 'shape' of their annuity without considering their potential eligibility for an enhanced rate and could therefore be losing out on a higher income.

3.15 We also listened to telephone conversations where little or no consideration was given to linking other key information. For example, the shopping around message was given at the start of the call, in an apparently scripted manner, but was not repeated at a later point when enhanced annuities were discussed. Often there was an extensive passage of time between the two parts of the message. This created a risk that the customer may not connect the information about shopping around with their eligibility for an enhanced annuity. As a result, even though the customer may become aware that they could be eligible for an enhancement they may not realise or remember that they could achieve a higher income by shopping around.

Significant written communications

3.16 The majority of significant communications which took place after issuing wake-up packs tended to be in the form of telephone calls. However, we observed that some firms issued quotation packs containing an updated annuity projection and a selection of supporting documents which varied in content.

3.17 In a number of cases, these packs appeared to improve the customer's understanding. They were often issued as a follow-up to a telephone conversation in which the customer's annuity options were discussed. In such cases, provided there was no indication from the call or any other interactions with the customer that the customer would not understand the content of the pack, issuing the pack is likely to have aided the customer's overall understanding of their options.

3.18 In certain cases we concluded that, even where there was evidence that one or more telephone conversations may not have complied with our review standards, the subsequent issue of a pack may well have resolved this by providing the customer with full information about enhanced annuities in line with the information provided in wake-up packs.

- 3.19** In other cases we observed that firms only included information about standard annuities (omitting key information from the FSA/MAS leaflet). This would leave those customers with only a partial set of information on which to make their decision about their annuity options.
- 3.20** Usually the customer would have received these packs a considerable time after their wake-up packs, potentially weeks and even months later, and therefore could well have used this documentation rather than the original pack to make their final decision. This created a risk that the later pack could leave the customer poorly informed about enhanced annuities, even where the original wake-up pack was fully compliant.

Non-recording of calls

- 3.21** Two of the firms did not have call recordings for some, or all, of the sales in the review sample. One firm retained call recordings for three years, meaning that they deleted call records beyond that point. The other had no call recordings at all as it was not their practice to keep them.
- 3.22** The specifics of call recording methods were not within the scope of this review. Nonetheless, it is appropriate to observe that, in instances where calls were unavailable for review, it was not possible to make a clear and unequivocal judgement about the information which was provided to customers. In some cases, call notes made by call handlers on customer servicing records were provided as a proxy for the call recordings. However, these tended to be brief and lacked enough information to draw definitive conclusions.
- 3.23** From a Systems and Controls perspective, this may present a challenge for those firms in dealing with customer complaints or any other claims on the product which may arise. In such cases these firms could have difficulty in demonstrating that the information they provided to customers was sufficiently extensive and timely to have enabled them to have made an informed decision.
- 3.24** For one of these firms we concluded that we have obtained sufficient statistical evidence to form a definitive view of their sales.
- 3.25** For the other firm, which recorded no calls for the bulk of the relevant period, we have not yet been able to make a final assessment of their sales. Therefore we have asked them to conduct a customer contact exercise in order to obtain the necessary information to assess the sales fully. This firm comprised less than 7% of our sample population and its written communications met the required standards.

Impact of detriment calculation

- 3.26** As a result of our review we have concluded that, for a proportion of customers, the firm's conduct may have caused a customer loss. This is because if these customers had been given sufficient information it is more likely than not that they would have bought an enhanced annuity rather than a standard annuity and would have been eligible to do so because of a health condition or lifestyle factor. In these cases, we have estimated a plausible range of lost annuity income to an average customer as being between £120 to £240 p.a. The actual lost income of any individual customer depends on:
- their individual eligibility for an enhanced annuity at the time of initial sale

- the health condition or lifestyle factor making them eligible, and
- the type of annuity purchase (level or escalating, joint life or single life, the size of their pension pot, whether the annuity bought was a standard annuity, guaranteed annuity or internal enhanced annuity, etc.).

3.27 Where an individual customer is still receiving an income from their (standard) annuity, the total value of the loss they have incurred will be the accumulated value of the lost regular income between the initial date of sale of the annuity and the current time, and the cost of purchasing an equivalent amount of additional income for the remainder of their life. Where a customer is deceased, the total value of the loss they have incurred (and attributable to their estate) would be the accumulated value of the lost regular income between the initial date of sale of the annuity and the date the customer died (allowing also for any guaranteed period and for a second life under a joint life annuity).

Actions we intend to take

3.28 As there is no evidence to suggest an industry-wide failing, we do not consider it necessary to initiate general industry-wide remedial action. There is, however, evidence that firms have not repeated key messages about the availability of, and customers' eligibility for, enhanced annuities in customer communications. As a result, some customers (whether within or outside our sample) may have suffered loss. It is important that those customers are given the opportunity to have their sales reviewed.

3.29 We therefore intend to take the following actions.

1. Firms outside our sample

A third of the sector falls outside our sample group. In order to take a rigorous and comprehensive approach we propose to initiate further sampling within that population of firms.

The mechanism through which we will do this will be similar to the approach described in Annex 1 of this paper i.e. the firms will lead this review themselves with some degree of oversight from the FCA. However, given that the majority of firms in this population had relatively small market shares the approach will differ in that we will ask them to revert to the FCA using our process of attestation¹⁹ rather than by formally reporting detailed findings to us.

Given that the firms in this group are typically smaller than the firms in our original sample, we do not consider it proportionate to ask all firms to complete this exercise and we will therefore focus on the top four by market share.

We are confident that this approach, combined with the wide-ranging and detailed sampling already completed, will provide us with a comprehensive view of any risks that might exist for customers who have taken out annuities across the relevant period.

We will also write to the Chief Executives of the remaining firms in this sector, who fell outside our sample, to draw their attention to our findings.

¹⁹ When we use an attestation, we do so to gain personal commitment from an approved person at a regulated firm that specific action has been taken or will be taken. The aim of an attestation is to ensure that there is clear accountability and senior management focus on those specific issues where we would like to see change within firms, often without on-going regulatory involvement.

2. Call to action

We encourage firms to consider our feedback and, where appropriate, explore how their communications and/or sales processes may be strengthened to address the points we have made.

We encourage any consumers who have taken out annuities (or their families) who may feel that they were given insufficient information regarding enhanced annuities when they made their annuity choice to contact their annuity provider. Firms are obliged to deal with complaints promptly and fairly.²⁰ All such consumers have recourse to the firm and, ultimately, to the Financial Ombudsman Service should they feel that, had they been provided with the necessary information, they would have potentially made a different decision.

3. Action in respect of the firms with the highest rates of non-compliance from the Thematic Review

The firms identified by the review reported here as having the highest rates of non-compliance will be asked to review all in-scope non-advised sales from July 2008 to the present time. These firms will be asked to apply the methodology which the FCA developed for the purposes of this review to ensure consistency of approach. As part of this, the FCA will work with these firms to determine a suitable mechanism for identifying and calculating any customer redress which may be due. This will also take into account the payment mechanics.

Our sample-based review identified that the large majority of customers who may have been given insufficient information about enhanced annuities, and therefore may be eligible for redress, are customers of these firms. By focusing our attention on these firms we are confident that the majority of customers who may have been disadvantaged as a result of firms' historic actions will be identified and redressed accordingly.

Customers of other firms in the sample or customers of firms outside of the sample may approach their firm directly if they feel that redress may be due, as described above.

²⁰ Under the standards of the FCA's DISP sourcebook which describes firms' obligations in respect of dispute resolution.

Annex 1

Method of assessment

1. We conducted our review during the second and third quarters of 2015. The review focused on three types of communication – the wake-up pack and follow-up pack (both sent in response to COBS 19.4, open market option standards) and other ‘significant communications’ which usually comprised one or more telephone conversations. A significant communication is concerned (in whole or in part) with the customer’s options regarding the type(s) of annuity which they might buy (whether from the firm or any provider with which the firm has an arrangement and/or on the open market).

The review standards

2. We assessed firms’ communications against the following standards for non-advised sales of annuities, from May 2008 to April 2015:
 - COBS 19.4 (provision of a written open market option statement/‘wake-up pack’) requires the following:
 - a. A ‘wake-up pack’ (the open market option statement) should be sent between four to six months before retirement, except where the wake-up pack has been sent in the past 12 months.²¹ The wake-up pack should contain information about the value of the pension pot, the different annuity types available and the benefits of shopping around rather than taking the annuity offered by the provider.²² The statement should consist of the FSAMAS factsheet or materially the same information.
 - b. A ‘reminder’ or ‘follow-up pack’²³ should be sent to customers about their open market options at least six weeks before their intended retirement date. The firm must remind their customers of their open market option statement and provide them with information about the sum of money they have available to buy an annuity on the open market.²⁴
 - COBS 2.1.1R (the ‘client’s best interests rule’) requires a firm to act honestly, fairly and professionally in accordance with the best interests of its client.
 - COBS 4.2.1R (the ‘fair, clear and not misleading information rule’) requires a firm to take reasonable steps to ensure that a communication is fair, clear and not misleading.

21 COBS 19.4.2R(1).

22 COBS 19.4.1R(3) and COBS 19.4.3R.

23 The reminder required under COBS 19.4.3R is generally referred to as the ‘follow-up pack’.

24 COBS 19.4.4R.

3. Principles 6²⁵ and 7²⁶ are relevant to a firm meeting the above obligations, but in this instance they do not add materially to what is required by the COBS rules.
4. As a minimum, we expect that firms communicating orally or in writing about the options available in relation to the types of annuity which a customer might buy (whether from the firm, or on the open market) would ordinarily provide to the client, or ensure that the client has, sufficient information about all of the client's options and to reiterate those messages, as appropriate, throughout the retirement journey. This is so that the client is able to make an informed decision about whether to shop around for, and buy, an enhanced annuity.

Review process

Assessing communications

5. We asked firms to review a sample of their annuity sales that fell within the scope of our review to determine whether they complied with the above standards. Firms were asked to review each customer communication (excluding those communications that were purely administrative in nature) to assess if it complied with the standards. This involved reviewing the:
 - wake-up pack
 - 6-week reminder letter, and
 - any other significant communications
6. If there was evidence that the firm had not complied with the standards (for example, the firm did not repeat a key message about the availability of enhanced annuities), the overall sale was then assessed. The assessment used a number of assumptions about customer behaviour to determine what effect the failure to provide information may have had on the customer's decision to purchase an annuity. Firms were asked to conclude whether a customer would still have purchased the same annuity from the firm or whether they would instead have been likely to consider an enhanced annuity from the firm or on the open market (regardless of whether or not they were eligible for one).
7. To ensure a consistent approach across firms the FCA designed an assessment template with accompanying instructions. We asked firms to consider whether there were breaches of any, or all, of the relevant COBS rules.

The review sample

8. The seven sample firms that participated in our review were selected to provide a broad representation of the vesting annuity market. Based on figures taken from the firms' regulatory returns, we estimate that collectively these firms represented approximately two-thirds of the individual annuity market over the period of the review. As such, the review incorporates some of the most significant firms in the market by way of market share. We are therefore confident that our review was sufficiently extensive to identify any specific areas of major firm failure in providing information about enhanced annuities to customers.

²⁵ A firm must pay due regard to the interests of its customers and treat them fairly.

²⁶ A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

9. We selected a random sample that was representative of the underlying population and sufficiently robust for our intended analysis. This allowed us to draw inferences about each firm's underlying population. The approach was designed by the FCA's actuaries and validated by an external consultant statistician.²⁷

The relevant period

10. The relevant period was defined as beginning on 1 May 2008 and ending on 5 April 2015, which is the date that the pension freedoms were implemented.

Stratification

11. To ensure that each firm's sample reflected their book of business for the relevant period, we asked each firm within the sample to provide us with a stratification plan. This stratification plan included sufficient factors to ensure that their sample for the relevant period represented their underlying population of non-advised annuity business. The FCA assessed each firm's proposed stratification plans to ensure that their approaches were robust, consistent and met the minimum criteria.

Selection of cases

12. Sample cases were selected by the FCA from the in-scope stratified population by using an automated random selection technique.

Validation approach

13. To ensure that firms participating in the review were completing the analysis consistently and in accordance with our instructions we validated approximately 10% of each firm's case reviews and provided written and oral feedback to firms to correct any errors. Where we identified serious errors in the firm's submission, e.g. where they reached the wrong decision regarding a 'Type 1 or 2' fail, we validated an additional 5 cases.

How we estimated aggregate customer detriment

14. To estimate the potential aggregate detriment by customers for whom the firm's non-advised sales process did not comply with the standards, we assumed that such customers would have bought an enhanced annuity if they were eligible for one.
15. The methodology for estimating detriment was structured to produce an aggregate. As such, it required no assumptions related to customers' individual circumstances, instead it was based on the average impact across the market. The FCA engaged external specialist support from Willis Towers Watson²⁸ to assist our in-house actuaries in developing this methodology and the key assumptions within it. Two of the key assumptions required to estimate aggregate detriment were:
- a. the proportion of vesting customers potentially eligible for an enhanced annuity, split by broad categories of lifestyle/health impairment factor, and

²⁷ Dr Susan Purdon, Bryson Purdon Social Research.

²⁸ Willis Towers Watson is a global advisory, broking and solutions company. It has an established actuarial consulting team that was engaged for this project. They were selected for this work through FCA's standard tender process. They were not involved in the assessment of compliance of the sales process nor in the calculation of the estimated aggregate customer detriment.

- b.** the range of percentage uplifts to annuity income available in an enhanced annuity relative to an internal vesting standard annuity, split by broad categories of lifestyle/health impairment factor.
- 16.** The assumption for both of these factors varied throughout the investigation period to reflect the development of the enhanced annuity market.
- 17.** Aggregate customer detriment across the seven firms in the sample was then estimated by applying these percentage factors to the amount of the annuity premium related to sales processes that were judged to not comply with the standards. The detriment was the total amount (at a point in time) by which customers potentially overpaid for the level of annuity payments they received from outset of their annuity, or the total value (at a point in time) of all the additional annual annuity payments customers have potentially lost out on already plus those they will lose out on over the remainder of their lives.

Annex 2

Glossary

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

Annuitant – a client who has purchased an annuity.

Annuity – an insurance contract that provides a client 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 client expressed as a percentage of the premium paid for the annuity.

Customer/client/consumer – these terms are interchangeable for the purpose of this report.

Enhanced annuity – an annuity where the rate is increased due to the client's medical condition or lifestyle factors of which the insurer is aware. 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 client will have to disclose their state of health to the provider, and may have to be medically examined for impaired life annuities.

Open market option (OMO) – defined in COBS 19.4.1R(2) as the option to use the proceeds of a personal pension scheme, stakeholder pension scheme, Free Standing Additional Voluntary Contribution, retirement annuity contract or pension buy-out contract to buy an annuity on the open market.

Scope – 'in scope sales' means all non-advised sales of pension annuities (both standard and enhanced/impaired life) sold to the firm's existing contract-based defined-contribution pension policyholders during the relevant period. This includes customers who have subsequently died during the relevant period.

In scope sales include:

- pension annuities purchased at rates that were guaranteed within the pension savings product (GARs)
- with-profits annuities and property-linked or index-linked annuities
- auto-vesting pensions

Sales that are out of scope include:

- advised sales of pension annuities
- purchased life annuities
- pension annuities sold to customers using their open market option (OMO), including

- customers from another firm choosing to exercise their OMO with the firm, and
- the firm's own customers choosing to exercise their OMO with another firm
- pension annuities purchased by existing customers with their pension funds, the amount of which on the date of sale was less than the minimum amount the firm would accept from a new customer through their exercising of an open market option

Relevant period – defined as beginning in May 2008 and ending in April 2015 when pension freedoms were implemented.

Significant communication – any communication where a firm discusses or describes, in whole or in part, the client's annuity options.

Standard annuity – an annuity where the rate is not underwritten based on the medical conditions or lifestyle factors of the client (other than their age or fund size).

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.

Annex 3

The Association of British Insurers Code

1. The ABI Code was compulsory²⁹ for ABI members as a condition of membership and CEOs of ABI member firms signed an annual declaration of compliance. The ABI Code set out the requirements that ABI members should 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 sought to ensure that customers were given information at various touch points in the lead-up to retirement, building on FCA rules. The approach was 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 applied wherever an ABI member was communicating directly with a new or existing customer who can buy an annuity.
2. The introduction to the Code gave an overview of its aims before the rest of the Code went into detail about the requirements.
3. 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

²⁹ In developing our proposals set out in [CP15/30](#) we considered the requirements of the ABI Code. We set out changes to our Handbook in [PS16/12](#).

Annex 4

Conduct of Business Sourcebook rules in place during the relevant period

COBS 2.1.1R The client's best interests rule

- (1) A firm must act honestly, fairly and professionally in accordance with the best interests of its client (the client's best interests rule).
- (2) This rule applies in relation to designated investment business carried on:
 - (a) for a retail client; and
 - (b) in relation to MiFID or equivalent third country business, for any other client.
- (3) For a management company, this rule applies in relation to any UCITS scheme or EEA UCITS scheme the firm manages.

[Note: article 19(1) of MiFID] and article 14(1)(a) and (b) of the UCITS Directive]

COBS 4.2 Fair, clear and not misleading communications

The fair, clear and not misleading rule

COBS 4.2.1R

- (1) A firm must ensure that a communication or a financial promotion is fair, clear and not misleading.
- (2) This rule applies in relation to:
 - (a) a communication by the firm to a client in relation to designated investment business other than a third party prospectus;
 - (b) a financial promotion communicated by the firm that is not:
 - (i) an excluded communication;
 - (ii) a non-retail communication;
 - (iii) a third party prospectus; and
 - (c) a financial promotion approved by the firm.

[Note: article 19(2) of MiFID, recital 52 to the MiFID implementing Directive and article 77 of the UCITS Directive]

COBS 4.2.2G

- (1) The fair, clear and not misleading rule applies in a way that is appropriate and proportionate taking into account the means of communication and the information the communication is intended to convey. So a communication addressed to a professional client may not need to include the same information, or be presented in the same way, as a communication addressed to a retail client.
- (2) COBS 4.2.1R(2)(b) does not limit the application of the fair, clear and not misleading rule under COBS 4.2.1R (2) (a). So, for example, a communication in relation to designated investment business that is both a communication to a professional client and a financial promotion, will still be subject to the fair, clear and not misleading rule.

The reasonable steps defence to an action for damages**COBS 4.2.6R**

If, in relation to a particular communication or financial promotion, a firm takes reasonable steps to ensure it complies with the fair, clear and not misleading rule, a contravention of that rule does not give rise to a right of action under section 138D of the Act.

COBS 19.4 Open market options**COBS 19.4.1R**

In this section:

- (1) 'intended retirement date' means:
 - (a) the date (according to the most recent recorded information available to the provider) when the scheme member intends to retire, or to bring the benefits in the scheme into payment, whichever is the earlier; or
 - (b) if there is no such date, the scheme member's state pension age;
- (2) 'open market option' means the option to use the proceeds of a personal pension scheme, stakeholder pension scheme, FSAVC, retirement annuity contract or pension buy-out contract to purchase an annuity on the open market; and
- (3) 'open market option statement' means:
 - (a) the fact sheet "Your pension: it's time to choose" available on www.moneyadviceservice.org.uk, together with a written summary of the retail client's open market option, which is sufficient for the client to be able to make an informed decision about whether to exercise, or to decline to exercise, an open market option; or
 - (b) a written statement that gives materially the same information.

When to send open market options statement and six-week reminder

COBS 19.4.2R

- (1) If a retail client asks a firm for a retirement quotation more than four months before the client's intended retirement date, the firm must give the client an open market option statement with or as part of its reply, unless the firm has given the client such a statement in the last 12 months.
- (2) If a firm does not receive such a request, it must provide a retail client with an open market option statement between four and six months before the client's intended retirement date.

COBS 19.4.3R

The firm must:

- (1) remind the retail client about the open market option statement; and (2) tell the client what sum of money will be available to buy an annuity on the open market; at least six weeks before the client's intended retirement date.

COBS 19.4.4R

If a retail client with an open market option tells a firm that he is considering, or has decided:

- (1) to discontinue an income withdrawal arrangement; or
- (2) to take a further sum of money from his pension to purchase an annuity as part of a phased retirement,

the firm must give the client an open market option statement, unless the firm has given the client such a statement in the last 12 months.

Financial Conduct Authority



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