



Institute and Faculty of Actuaries

Best Practice in the Retirement Sector: Avoiding Pitfalls

Adam J. Levitt



45992859

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Annuities – FSA background

- “Thematic work on Open Market Options” announced October 2007
- “We found it difficult to draw simple conclusions about what is the “right” level of OMO transfers”
- Examples of “poor practice”
 - failing to explain OMO can result in higher pension
 - insufficient inclusion of most important information (OMO, GAR ...)
 - confusing best rate with best type of annuity
- 40% of material not good enough



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Financial Conduct Authority ("FCA") 

- TCF: "We expect firms to base their business models, their culture and how they run their businesses on the principle of treating customers fairly ..." (July 2013)
- "Operational objectives" - Financial Services and Markets Act 2000
- Consumer protection objective
 - "... securing an appropriate degree of protection for consumers"
 - depends on kinds of investment, differing consumer expectations/expertise

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Financial Conduct Authority ("FCA") cont.d 

- Competition objective
 - differing consumer information needs
 - new market entrants
- "Competition is a process of rivalry between the firms seeking to win customers' business over time ... what matters are the outcomes that competition delivers the consumers"
- Problems in the FCA's eyes
 - low switching rates
 - "problems in the way consumers ... make decisions"
- Nuclear option: OIVOP

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Thematic review of annuities (TR14/2)

- FCA:
 - OMO rules introduced by FSA in 2002
 - 2012: 60% of annuities purchased from existing provider or through third-party arrangements
 - annuity purchasers "could increase their income by £67 per year" (before tax) - £135 for enhanced annuities
- "Overall standard annuities offered to existing pension customers were expected to be more profitable than annuities written in the open market"
 - ➔ competition **market study**, to identify how to improve shopping around

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HMT: Freedom and choice in pensions

➔ Opportunities + Risks

 



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FCA: Framing of retirement income options (December 2014) 

- "... consumers seem to associate the term "annuity" with poor value products ... even though consumers appear to value the underlying characteristics of the annuity"
- "Consumers in households with less than £30,000 [household income] appear to respond more strongly to the framing of retirement choices"



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Annuities sales practices: FCA thematic review (TR14/20)

- ABI Code not working, in FCA's view
- "The majority ... did not actively encourage customers to shop around, or repeat the shopping around message"
- "Poor" training/inappropriate call scripts



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Annuities sales practices: FCA thematic review (TR14/20) cont.d

- Evidence of OMO/ABI Code being circumvented by:
 - regular contact through the "retirement journey"
 - incentivisation of rollover sales
 - not explaining significance of GAR
 - not explaining when an MVR will apply on a with-profits product
 - not explaining the advantage of enhanced annuities: FCA's greatest concern



- OMO thematic work in 2008: "... firms should have been in no doubt about their responsibilities ... in relation to enhanced annuities"



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Behavioural economics: FCA's approach

- PPI an example of irrational consumer behaviour
- BE → rules + enforcement
- BE influences FCA's view of "appropriate degree of consumer protection" (FSMA objective) and consumer responsibility for own actions
- "Correcting consumers' behavioural errors may at times be crucial if the FCA is to achieve its **consumer protection objective**"



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Behavioural economics: FCA's approach cont.d

- "Framing" (presenting) information can undermine competition
 - "Because of biases, consumers tend to stick with their existing products ..."
- Cross-subsidies between consumer groups
 - risk of regressive impact



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Behavioural economics: FCA's approach cont.d

- BE: help identify risks via "business model and strategy analysis"
 - rip offs : uncompetitively high margins
 - suckers: concentrated profits from a small group of consumers
 - bargains: innovative products that appear very cheap
 - traps: contract features that often target behavioural biases
 - regret: reported or potential regret
 - folly: choices out of line with common sense
 - confusion: observed or likely confusion



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Behavioural economics: FCA's approach cont.d

- FCA →
 - more/different information
 - distribution controls
 - product bans



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Market study on retirement income (final report March 2015)

- "... the market is not working well for consumers"
 - not enough shopping around
 - framing effects
 - pension freedom risks exacerbating lack of shopping around
- FCA accepts brand loyalty need not indicate market failure
- Remedy 1: annuity quote comparison → consultation (rules 2016)



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Market study on retirement income cont.d

- Remedy 2: comms "framing effects" to be trialled
 - complicated by pension freedoms
- Remedy 3: wake-up comms and ABI Code → consultation (CP15/30 below)
- Remedy 4: "pensions dashboard" → HMG
 - to govern all pension savings, including state
 - NL and DK's DP solution
- Remedy 5: market monitoring
 - roll-over proportion
 - proportion giving up GAR



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Guidance guarantee: retirement risk warnings (PS15/4)



- COBS 19.7 introduced on 6 April 2015
- Triggered by accessing pension funds
- Insurer must "encourage" use of pensions guidance/regulated advice
- Must ask questions to establish existence of "risk factors" (e.g. health status; whether customer has shopped around; debt) – but see CP15/30 re small pots
- Must give "appropriate risk warnings" **before sale**
- Record keeping in relation to risk warnings



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FCA (CP15/30): proposed rule changes

- January: consultation closed
- To replace ABI Code by COBS rules
- Early 2016: another review of retirement income market
- OMO options statement (and reminder) must not include **application** for decumulation product
- Every comm about cash withdrawal from pension product
 - information when fund may be exhausted
 - at least annually



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FCA (CP15/30): proposed rule changes cont.d

- Every communication about annuity options must include information about **factors** affecting payments 
- Every communication concerning access to pension pot should
 - “not emphasise any potential benefits of the firm’s own products and services in a way that disguises, diminishes or obscures important information ...” contained in the Money Advice Service fact sheet
 - “prominently highlight the ability to **shop around ...**” and state that other providers may offer greater income 
- Projections must reflect **GARs**



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FCA (CP15/30): proposed rule changes cont.d



- “Pension freedoms offer greater choice which in turn increases the need to shop around ...”
- FCA recognises the danger of running out of money, but will regular projections help?
 - transferee firms may end up giving risk warnings, undermining impact
- Non-advised annuity purchase
 - price comparison website commission (now disclosable) can exceed advice  remedy?



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FCA (CP15/30): proposed rule changes cont.d

- “Lifestyling”
 - complicated by new freedoms
 - comms to allow informed decisions, based on: best interest rule; fair, clear and not misleading rule; and Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD)
- FSCS
 - FCA asks whether compensation should be the same (no limit for life insurance contracts now, but non-insurance capped at £50,000)



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Secondary annuity market (HMT, December)



- Providers will be able to buy-back their own annuities (through a regulated intermediary) – subject to a new regulatory permission – with ability to buy-back low-value annuities direct
- Annuities as pension scheme assets: in the name of an individual
- Tax: Spring 2016 consultation?
- Provider can veto assignment – incentivised to do so, given over-payment risk associated with transfer?



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Secondary annuity market cont.d

- Consumer protection: tension with new pension freedoms
 - ➔ Advice requirement to be legislated for (subject to a “threshold”
- new FSMA section 137 FBA FCA)
- FCA to consider risk warnings
- Fair value: FCA on-line tool to provide estimate, but would this address ancillary costs (advice; admin costs of provider)?



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Secondary annuity market cont.d



- Dependants:
 - contracts (Rights of Third Parties) Act 1999
 - dependant consent for assignment – only relevant if entire income stream is assigned : can/should dependant’s pension continue post-assignment of main rights?
 - pricing/fairness issue if dependant rights effectively end (akin to loss of GAR)



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Secondary annuity market cont.d



- Pricing focus on buy-backs: price to reflect administrative savings?
- Risk of dependant harm
- FCA consultation 2016



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Mis-selling: Lessons from the past

- No detailed assessment of how product was being sold and to whom
- No MI about performance of the product
- Incentive scheme mis-match with consumer interests
- Low claim rates and no analysis why



PPI and Card Protection spectre

Insurance add-ons: from 1 April, consumer must "actively elect" for product



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Avoiding mis-selling: Practical steps

- Identify target market
 - what does market need?
 - stress test products
- Consumer comms
 - appropriate type/level of information for target market?
- Product approval process
 - structured products guidance, FSA March 2012
 - executive sign-off and stress testing



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Avoiding mis-selling: Practical steps cont.d

- Distribution
 - to be appropriate for product and target market
- Monitoring
 - MI e.g. covering split of existing/new customer sales; profitability; complaints



HM Treasury (October 2015): Financial advice market review



- Post-RDR recognition of advice gaps
- Recognition of diversity of income/education/tech ability/age
- "... retail investment products (which includes pensions, retirement income products, and investments) sold without advice has increased from around 40% in 2011/12 to around two-thirds in 2014/15"
- Recognition of regulatory cost of providing advice and liability risk (including no FOS longstop)
- Development of automated advice encouraged



HM Treasury: Financial advice market review cont.d

- HM Treasury's initial focus on pension saving and taking an income on retirement
 - FCA Retirement Income Market Data July – September 2015 showed 42% go into drawdown without adviser; 68% GARs not taken up
- Trust issue: FCA consumer spotlight – "around half of people do not trust financial services firms at all" – irony of market failure



Appendix: PRIIPs Regulation – Key terms

- **PRIP** – packaged retail and insurance based investment products
 - Definition includes: investment product which offers a maturity or surrender value and where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations"
- **KID** – key information document (a new pan-European disclosure document that all retail investors should receive prior to investing in a PRIP)
- PRIIPs Regulation comes into force on 31 December 2016



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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.



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