New research from the Financial Services Consumer Panel (FSCP) has attacked the operation of the annuity market.

Given the current demographics of newspaper readership, it was perhaps inevitable that research showing that 'Annuities are increasingly complex and may not offer good value for money' would produce some lurid front page headlines. And so it was: the online version of the Daily Mail was a classic example 'Elderly savers being fleeced by pension sharks when they retire: Middlemen are making a fortune on transfer fees for annuities.'

So what exactly did the FSCP say and do?

- It undertook a 'literature review' over the last year, primarily the work of Dr Debbie Harrison, examining papers published on the annuity market 'between 2002 and 2013'. Thus much of material pre-dated the introduction of RDR and virtually all captured a market of declining rates.
- It commissioned three 'original qualitative studies' examining:
    - consumers' annuity purchasing experience;
    - the adequacy of annuity quotation and annuity purchase websites; and
    - experts' views on market developments.
- All this research was put together to help 'inform…key recommendations for regulatory and structural reform'

The FSCP's main findings are what would be expected from trawling over such familiar ground:

1. **Consumers poorly placed to drive effective competition** This echoes the comments of the Office of Fair Trading's recent report. The FSCP says consumers face a multitude of barriers including 'low financial capability; fear of product complexity and of making an irreversible, high-cost mistake; general distrust of professional advisers, and inability to find appropriate advice at acceptable cost.'

The FSCP found would-be annuity purchasers 'may 'shop but stop', put off by complexity, information overload and the perceived cost of a full-scale search.'

2. **Distribution market confusing and a lottery for consumers** This is basically a criticism of the growth of execution-only annuity websites. The FSCP found that purchasers 'do not understand the ramifications' of non-advised sales, eg loss of recourse to the Financial Ombudsman Service (FOS). There was also 'commission invisibility' and it was usually unclear whether a whole-of-market search was being offered – of 15 websites the FSCP examined, only two clearly said they offered a whole-of-market service.

It founds firms acting as introducers, noting 'their regulatory status and true identity is frequently unclear, as is their location (some are based offshore).' Some sites resulted in 'persistent unsolicited emails and telephone calls,' effectively encouraging people to give up shopping around.

The FSCP acknowledges that a 'significant shift to non-advice in the mass market for annuities [was] partly driven by reforms to charging structures introduced by the retail distribution review (RDR)' and goes on to suggest 'There is a danger that this shift in distribution channels will undermine the intentions of the RDR, leaving most customers with no choice but to use commission-based, non-advice service.'

The FSCP's comments on commission have drawn the most attention: 'Non-advice services are often more profitable than advice services because they have lower delivery costs, yet can often charge more, especially for enhanced annuities. Some enjoy very high commissions (5% to 6% as compared with an average of 1.5% to 3%) from providers keen to secure high-volume distribution channels. The higher profit margins for non-advice mean that although advice is theoretically economic for pots worth about £25,000, in practice it is rarely offered for pots worth less than £100,000…'

***3.* Annuities are increasingly complex and may not offer good value for money** The FSCP found that that enhanced annuities are 'now taking half or more of annuities purchased by consumers when switching from their existing pension provider …' However, the corollary is a more complex product and the 'compressing [of] annuity rates offered to healthy retirees.'

The FSCP says 'There is an emerging concern that insurers' profits on their rollover annuities might be excessive.' It suggests that 'The conventional wisdom that annuities provide value for money is open to question, not least because the relevant academic research into 'money's worth' is based on open market rates and does not take account of rollover rates, which appear to be significantly lower in certain cases.' Anyone looking at the recently issued ABI example rates tables can see the point.

***4.* Need for regulatory and structural reform** The FSCP says that there is 'an increasingly complex and confusing marketplace' for annuities and that some initiatives, such as the ABI's Code of Conduct, 'may overload consumers with information.'. In the FSCP's view, 'The chances of mass consumer detriment are…too high to trust to current market-driven solutions alone: hence our recommendations for further regulatory and government-led structural reform.'

The FSCP's recommendations are

- A 'rigorous market study' by the FCA 'to examine (a) possible exploitative pricing of 'rollover' annuities sold by insurance companies to their DC customers who have saved with them for a pension and (b) the distorting impact of embedded and opaque charges and regulatory arbitrage that may well seriously impede informed consumer choice between rollover and OMO providers and between non-advice and professional advice distribution channels.'
- Strengthening the operation of the OMO by a variety of measures, including banning tied annuity sales from its definition.
- Embodying in regulations the equivalent of a code of conduct for the non-advice market.
- Investigating the role of 'introducers'.

- The Money Advice Service (MAS) should fully develop its proposed annuity advisers directory and associated guidance.
- The Government should actively consider reforms to:

    - Amend tax rules that prevent those with several small pension pots, together worth more than £18,000, from taking their pension as a lump sum;
    - Introduce a national default annuities service that meets the enhanced OMO standards proposed; and
    - Require employers and trustees to establish a non-advice service that meets the enhanced OMO standards proposed for members of workplace schemes.

COMMENT

The FSCP report has certainly grabbed the headlines. Whether it will have any greater impact than all the other research into the annuity market remains to be seen. What can be seen is the value of true whole of market advice which will ensure full transparency of advice charges

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