

Mrs Sue Baker  
Savings and Pensions Policy Team  
Room 133a, New Wing  
Somerset House  
London  
WC2R 1LB

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Dear Mrs Baker

## **Modernising Annuities**

I am responding on behalf of the Financial Services Consumer Panel to the Consultative Document issued jointly by the Department for Work and Pensions and the Inland Revenue in February. As I am sure you are aware, the Panel is an independent body established by the Financial Services Authority (FSA) under the Financial Services and Markets Act 2000 to represent the interests of consumers. The main purpose of the Panel is to provide advice to the FSA, but we also look at the impact on consumers of activities outside but related to the FSA's remit.

### *Overall Approach*

While the Panel welcomes the opportunity to comment on your ideas for modernising annuities, our sense is that annuities are just one aspect of a much larger debate that needs to take place on pensions more generally. Pension savings are hugely important for everyone and we would encourage you to initiate a wider all-embracing review rather than restricting your focus to annuities. Furthermore, in the interests of clarity (consumer understanding of what is meant by 'annuities' is very low), we suggest that it would be better to use the terms 'pension income' instead of 'annuity' and 'pension savings' for funds paid into a pension plan. These would be more readily understandable by consumers in general.

### *Informed Choice*

The Consumer Panel is very supportive of the work carried out by the FSA to promote public understanding of the financial system and to secure appropriate consumer protection. We welcomed the launch last year of the on-line comparative tables and we are pleased that coverage is to be extended to include more products, including annuities. The Panel was consulted on the FSA's choice of theme projects for 2001-02 and expressed strong support for the Ageing Population Theme. We

were particularly keen for the FSA to examine the effects of demographic change on different categories of consumer and to include issues such as healthcare, vulnerable and excluded consumers and ethnicity. We are delighted that, as a result of this work, the FSA plans to focus more of its effort on helping people prepare for retirement, as well as helping people in retirement, so that they can better understand the choices open to them when managing their financial affairs.

That said, as your Consultation Document demonstrates, the subject of pensions - and the purchase of annuities in particular - is complex and many people with pension savings are not aware of the process they will need to go through in order to convert their savings into pension income. Many people do not even know that they will need to buy an annuity and there is little awareness of the open market option or, indeed, of the different types of annuity that are available (eg joint life or impaired life). It is also evident that consumers do not understand the factors that affect annuity rates and may be opting for income drawdown products in the belief that annuity rates will improve but without appreciating the effects of a low inflation environment and improvements in life expectancy on the annuity market. Failure to shop around or to purchase the most appropriate product at the right time means that large numbers of consumers are not making the most of their pension savings; on the contrary they may be locking into 'losses' and, the longer they live, the greater those losses become.

We believe that the importance of the decision about which type of annuity to buy and from which company, together with the wide range of options now available to people reaching retirement, mean that it is essential that people seek independent advice on what is the best course of action for them. Our understanding is that, in any event, insurance companies typically make a deduction from pension 'pots' to pay commission irrespective of whether or not advice is provided. However, if as you imply on page 36 of your Consultation Document, people are not aware of the deduction of commission and insurance companies are not taking positive steps to alert them to this, then they are missing out on vital advice that they have in fact paid for. As things stand at present, there would seem to be a strong case for 'unbundling' the cost of advice from these products with a view to making the position more transparent.

The Consumer Panel is very keen to ensure that people have access to independent financial advice in general. We believe that the easy availability of free independent advice makes even more sense in the case of pension savings because of the importance put on them by governments and the substantial income tax subsidies given. The benefit of these subsidies can be whittled away by poor choice of annuity purchase in the absence of advice - surely not a good use of public funds. The FSA is already aware of our views on the need to fill the 'advice gap' more generally and our response to its proposals for reforming polarisation will reflect our strongly held view that pro-active steps need to be taken in this area.

In the light of your Consultation Document, we have thought carefully about the steps that might usefully be taken specifically to ensure delivery of the independent

advice that people need if they are to put their pension savings to best use. We have come to the conclusion that all pension savers should receive free independent financial advice before they make any decisions about turning their pension savings into pension income. One possible way of delivering this would be to raise a levy on all pension providers to fund some form of voucher or 'green form' scheme (as is available with legal advice) that would encourage pension savers to seek advice and give them some flexibility as to who they obtained advice from. Alternatively, the money raised from the levy could be used to fund the establishment of an independent charitable trust charged with making free advice available to consumers at the time they have to make important decisions in respect of their pension savings. If the free advice cannot be funded from existing built-in commissions, we would suggest that the Government should be prepared to make a contribution with a view to ensuring that its earlier income tax subsidies are of maximum benefit to consumers (rather than ending up in the hands of insurance companies).

Naturally, we are very supportive of the changes to rules and guidance put forward by the FSA in CP106. It is essential that pension savers understand that they have an option to purchase an annuity from a different pension provider and are encouraged to shop around. We would like to reach a position whereby firms would be required, not only to make pension savers aware of their option to purchase an annuity from a different pension provider, but also to inform them of their right to free independent financial advice and how to go about obtaining it.

### *Capital Protection*

One of the biggest concerns of pension savers who are considering the purchase of an annuity must be the risk that they may die early and that, in consequence, their pension savings are lost to the pension provider. We note what you say on page 48 of the Consultation Document about insuring pension savings and we understand that a number of pension providers are happy to offer a lifetime capital guarantee at a reasonable premium. We would welcome steps to encourage providers to offer options of this nature to pension savers and to make consumers aware of their ability to protect their capital in this way.

### *CAT Standards*

The Panel agrees with the view expressed on page 35 of the Consultation Document that CAT standards will not necessarily help every part of the retail financial savings market. In a heavily segmented market such as the credit card market, for example, a standardised product is less likely to be widely suitable. However, in the case of annuities, we feel that it would be beneficial to adopt a CAT standard for a straightforward annuity. It seems to us that, although providers need to be given greater flexibility and encouragement to develop a wider range of annuity products, there is a sufficiently high demand from pension savers for a basic standard annuity to make a CAT standard beneficial. The development of a CAT standard for annuities would also encourage pension savers to shop around in that they would be able to compare prices of a standardised product. We do not accept your argument

that the creation of a CAT standard annuity might encourage providers to promote traditional annuities at the expense of devoting their energy to the development of new kinds of annuity. Is there any evidence of this in relation to other CAT-marked products?

I hope these comments are helpful. We have not used the questions raised in the Consultation Document as a structure for this response, mainly because we feel that our preferred solution to many of the questions is to ensure that pension savers obtain independent financial advice. We did examine the ideas put forward in the Document for the possible introduction of limited period annuities. Whilst we were attracted by the concept, we did not see what advantages limited period annuities would have for the consumer over income drawdown. On this and other more technical aspects, the Panel will itself be interested in seeing the responses from pension providers.

Yours sincerely



**Colin Brown**  
Chairman

cc. John Tiner,  
Christine Farnish  
Mick Folger  
Clare Boyle

FS Consumer Panel can be contacted  
c/o Consumer Panel Secretariat at the FSA  
Tel: 020 7676 0720 Fax: 0207 676 0911

Email: [enquiries@fs-cp.org.uk](mailto:enquiries@fs-cp.org.uk)  
Website: <http://www.fs-cp.org.uk>