

Consultation Paper

CP16/12\*\*\*

# Secondary Annuity Market – proposed rules and guidance



April 2016



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We are asking for comments on this Consultation Paper by 21 June 2016.

You can send them to us using the form on our website at:  
[www.the-fca.org.uk/cp16-12-response-form](http://www.the-fca.org.uk/cp16-12-response-form).

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## Abbreviations used in this paper

<b>BIPRU</b>	Prudential sourcebook for Banks, Building Societies and Investment Firms
<b>CASS</b>	Client Assets Sourcebook
<b>CBA</b>	Cost benefit analysis
<b>COMP</b>	Compensation sourcebook
<b>COBS</b>	Conduct of Business sourcebook
<b>CONC</b>	Consumer Credit sourcebook
<b>COND</b>	Threshold Conditions
<b>CP</b>	Consultation Paper
<b>DB</b>	Defined benefit
<b>DC</b>	Defined contribution
<b>DISP</b>	Dispute sourcebook
<b>DMD</b>	Distance Marketing of Consumer Financial Services Directive
<b>DWP</b>	Department for Work and Pensions
<b>EU</b>	European Union
<b>FCA</b>	Financial Conduct Authority
<b>FSCS</b>	Financial Services Compensation Scheme
<b>FSMA</b>	Financial Services and Markets Act 2000
<b>ICOBS</b>	Insurance Conduct of Business sourcebook
<b>IFPRU</b>	Prudential sourcebook for Investment Firms
<b>IMD</b>	Insurance Mediation Directive

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<b>IPRU (INV)</b>	Interim Prudential sourcebook for Investment Business
<b>MiFID</b>	Markets in Financial Instruments Directive
<b>NMPI</b>	Non-Mainstream Pooled Investment
<b>Ombudsman service</b>	Financial Ombudsman Service
<b>PII</b>	Professional Indemnity Insurance
<b>PPP</b>	Policyholder Protection Part
<b>PS</b>	Policy statement
<b>PRIN</b>	Principles for Business
<b>RDR</b>	Retail Distribution Review
<b>SYSC</b>	Senior Management Arrangements, Systems and Controls
<b>T&amp;C</b>	Training and Competency
<b>The Treasury</b>	Her Majesty's Treasury
<b>UK</b>	United Kingdom

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# 1. Overview

## Introduction

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- 1.1** This Consultation Paper (CP) seeks views on our proposed new rules and guidance for the secondary annuity market, which is due to start in April 2017. It sets out our expectations regarding the existing rules that apply to this market, and brings forward proposals to change our Handbook.

### Who does this consultation affect?

- 1.2** This consultation will be relevant to everyone with an interest in pensions and retirement issues, including:

- providers of annuities
- providers of retirement income products and other financial services products that play a role in consumers' retirement planning
- sponsors of occupational Defined Benefit (DB) and Defined Contribution (DC) schemes, both trust and contract based
- individuals and firms providing advice and information in this area
- distributors of financial products, in particular retirement income products
- asset management firms
- trade bodies representing financial services firms
- consumer bodies
- charities and other organisations with a particular interest in the ageing population and/or financial services more generally
- individual consumers

### Is this of interest to consumers?

- 1.3** The changes proposed in this CP will affect consumers who hold, or will hold, annuities in their name and contingent beneficiaries with an interest in such annuities. The proposals will play a key role in determining how consumers will be able to sell their annuity incomes on the secondary market.

### Context

- 1.4** In April 2015 the Government introduced new pension freedoms extending choices for individuals accessing their pension savings. In March 2015 the Government announced that it was consulting on extending similar freedoms to those who already had an annuity in payment.<sup>1</sup> This would allow individuals to sell their annuity income, as long as their annuity provider agreed, without the tax restrictions that currently apply. While technically annuity income sale is currently possible, few, if any, transactions are currently made. We expect the Government's tax changes to result in the market growing significantly.
- 1.5** The Government published its response to this consultation in December 2015. It confirmed that the tax changes would come into effect from April 2017. The changes would allow individuals to: receive all of the proceeds as a taxable lump sum; arrange for the buyer to pay all of the proceeds into a flexi-access drawdown fund; or arrange for the proceeds to be used to buy a new 'flexible' annuity.<sup>2</sup> Money withdrawn as a lump sum will be taxed at the consumer's marginal rate of income tax while tax will be deferred until withdrawal if monies are placed in a drawdown product.
- 1.6** The activities involved in selling an annuity income are already regulated by the FCA within our regulation of designated investment business. The Treasury announced, in April 2016, its intention to create three new dedicated regulated activities for the secondary annuity market. These are:
- buying annuity incomes
  - buying back annuity incomes (by the relevant annuity providers), and
  - acting as a market intermediary

Firms will need to obtain these new regulatory permissions in advance of undertaking the activities.<sup>3</sup>

- 1.7** The proposals in this CP set out the rules we will apply to these regulated activities. We believe that there is a significant risk of poor outcomes for consumers in the secondary annuity market. Annuities are inherently difficult for consumers to value, and consumers who will be able to participate in this market will include a higher proportion of older, more vulnerable consumers. Therefore our rules are designed to help provide appropriate consumer protection while promoting effective competition in the interests of the consumer, in accordance with our objectives. Some of our proposals will only come into effect once the Government has made the legislative changes required.

### Key definitions

- 1.8** This paper will refer to individuals 'selling' their annuity income, unless otherwise indicated. The term 'selling' covers two scenarios. The first is one in which the seller's rights to the annuity income are assigned to a third party for a lump sum.<sup>4</sup> The second is one in which the seller's

<sup>1</sup> 'Creating a secondary annuity market', The Treasury, March 2015.

<sup>2</sup> Individuals who want some cash and some income drawdown can achieve this by arranging for the transfer of all of the sale proceeds to a flexi-access drawdown fund, from which lump sums/drawdown income/annuity income can be taken as the individual chooses.

<sup>3</sup> An annuity provider facilitating the sale of an annuity to a third party would also currently be carrying out a regulated activity, and the Treasury has confirmed its intention for this to continue.

<sup>4</sup> Whether taken as cash or otherwise used as set out in paragraph 1.5 above.

rights to the annuity income are terminated in return for the annuity provider paying them a lump sum,<sup>5</sup> which we will refer to as 'buy back'.

**1.9** The secondary annuity market will involve a number of participants. Throughout this CP we refer to them as follows:

- **Seller** – the prospective annuity income seller (i.e. the consumer)
- **Annuity provider** – the insurer paying the annuity. This refers to their role as the provider facilitating assignment to a third party. In certain circumstances, the annuity provider may also buy-back the annuity income, in which case they are referred to as a buyer
- **Adviser** – a firm giving a personal recommendation, which does not act as a broker between a buyer and the seller
- **Broker** – a firm which acts as the broker between the buyer and the seller but that does not give a personal recommendation
- **Adviser-broker** – a firm giving a personal recommendation, which also acts as the broker between the buyer and the seller
- **Buyer** – a firm buying annuity incomes for their own account on the secondary market – this includes an annuity provider carrying out buy back. This will include direct buyers (where there is no broker or adviser-broker between the buyer and the seller) and indirect buyers (where there is a broker or adviser-broker between the buyer and the seller)
- **Firms** – the annuity provider, buyer, broker and adviser-brokers will be referred to collectively as firms if the proposed rules apply to all of these parties

#### Assessment of risks

**1.10** The Government has stated that it wants as many people as possible to be able to access their pensions flexibly. It believes that consumers should be free to make their own choices about what to do with their annuity incomes. The Government's consultation response acknowledges that for most people retaining their annuity will be the best choice as it provides a regular, guaranteed, income for life.<sup>6</sup>

**1.11** We recognise that a secondary market in annuities may deliver flexibility for some consumers. However, we believe consumers selling their annuity income could be exposed to significant risks. Over the course of 2015/2016, we have undertaken assessments of the risks to good consumer outcomes in the secondary annuity market. We have identified the following risks for sellers in the secondary annuity market:

- *longevity risk* – a consumer selling an annuity income is giving up some or all of their income and insurance against longevity risk, depending on the other income (including other annuities) they have. They may therefore face an increased risk of running out of money in retirement
- *value for money* – some consumers may struggle to value their annuity incomes in respect of the benefits being forgone. Consumers will need to be helped in making an informed choice about whether to sell, and at what price

<sup>5</sup> Again, whether taken as cash or used as set out in paragraph 1.5 above.

<sup>6</sup> 'Creating a secondary annuity market: response to the call for evidence', The Treasury, December 2015

- *consumer inertia* – if consumers do not shop around they may not find the best price for their annuity income
- *vulnerability* – there is a higher incidence of reduced mental capacity among potential annuity income sellers. Individuals who have debts may come under pressure to sell their annuity income in order to pay off those debts, although this may not be in their best interests. Sellers who are, or may become, reliant on means tested benefits may also be vulnerable
- *potential conflicts of interest* – conflicts of interest exist that have the potential to cause detriment to sellers, for example, in respect of relationships between brokers and buyers
- *potential risk of investment scams and fraud* – the FCA has a key role in seeking to reduce investment scams and fraud, this includes monies released from pensions and obtained via annuity income sale on the secondary annuity market
- *market depth* – it is impossible to know in advance how many buyers will seek to participate in the secondary annuity market. If insufficient buyers participate, this may reduce the price offered to consumers for their annuity income

**1.12** This CP focuses on our policy interventions to address these risks and consults on proposed changes to our Handbook.

### Summary of proposals

**1.13** The Government announced in its December 2015 consultation response that it would legislate to provide a number of protections for sellers in the secondary annuity market:

- a seller looking to sell an annuity income stream above a certain value will be required to seek appropriate financial advice before proceeding with the sale
- access to Pension Wise<sup>7</sup> will be extended to sellers and contingent beneficiaries<sup>8</sup> in the secondary annuity market. We will consult on standards for this extended Pension Wise service later in 2016
- there will be new dedicated regulated activities for the secondary annuity market. These will replace the general Financial Services and Markets Act 2000 (FSMA) regulated activities that currently apply<sup>9</sup>
- FCA regulation of the so-called tertiary market will be retained under the existing pre-existing FSMA regulated activities<sup>10</sup>

**1.14** The proposals in this CP are designed to introduce additional protections to support the seller throughout the consumer journey. The paper is divided into five sections:

<sup>7</sup> Pension Wise is a free at the point of use pensions guidance service set up by the Government.

<sup>8</sup> Many annuity contracts provide for benefits to be paid to someone other than the main annuity holder in certain circumstances. For example, 'joint life' annuities will pay an income for life to the primary annuity holder, and then, assuming the primary holder dies first, will then pay all or a proportion of that income to another person until their death. The other person is therefore a beneficiary under the contract, but only if certain conditions are met. We refer to such persons as contingent beneficiaries. See the 'contingent beneficiaries' section in the main paper below.

<sup>9</sup> As part of introducing these new regulated activities, the Government is also consulting on changes that would require *all* buyers of annuity income in the secondary market to be authorised – even if a person was not buying annuity incomes 'by way of business'. In practice this would mean that retail investors will not be able to invest directly in this market.

<sup>10</sup> The term 'tertiary market' refers to 're-assignments'. A re-assignment is a transaction in which a firm that has purchased an annuity income from a consumer in turn sells (re-assigns) that annuity income to a third party. The rest of this paper deals only with the secondary market, except for a section on the tertiary market and related issues in Chapter 6.

- disclosure
- presentation of offers
- restrictions on charging
- compensation and prudential arrangements
- other regulatory requirements

**1.15** A summary of proposals in each of the five sections is set out below. The proposed new rules and guidance aim to deliver, among others, the protections set out below:

- sellers should, at least once, and as early in the process as possible:
  - receive the relevant risk warnings (see 1.16 below)
  - be made aware of the possible existence, and where possible the likely amount, of charges and costs they may bear in selling their annuity income
  - be made aware of the possibility of taking advice, or using the Pension Wise guidance service, and be encouraged to use such services
  - be made aware of the possible legal requirement for them to take advice and the possible need to obtain consent from contingent beneficiaries
  - be encouraged to shop around for better quotes for their annuity income
- all quotes made for a seller's annuity income should be presented net of the firm's estimated forthcoming costs where possible. This should also be accompanied by a quote of the replacement cost of the annuity income were it to be bought new on the open market
- broker remuneration must not introduce conflicts of interest
- sellers will be able to complain to the Financial Ombudsman Service (ombudsman service) and, if necessary, seek redress from the Financial Services Compensation Scheme (FSCS), subject to all the appropriate eligibility criteria being satisfied

#### **Disclosure**

**1.16** *Risk warnings:* We propose that firms contacted for the first time by a seller must ensure the seller receives information about the risks in the form of a series of specified warnings.

**1.17** *Advice and guidance:*

- *recommendation to take advice:* We propose to require that firms contacted for the first time by a seller must recommend that the seller takes advice, if not already taken, even if taking advice is not required by legislation (see below)
- *recommendation to use guidance:* The Government is legislating to extend access to Pension Wise to those considering the sale of their annuity incomes and to contingent beneficiaries. We propose to require firms contacted for the first time by a seller to recommend that the seller seeks guidance. The FCA will consult on the standards for extending Pensions Wise later in 2016

- *advice requirement check*: The Government is legislating to require sellers to take ‘appropriate advice’ where the value of their annuity income is above a certain threshold, and to place a duty on the FCA to make rules determining which firms should check that this has been done prior to sale. We propose that in most cases annuity providers will carry out this check. The Government will set the compulsory advice threshold, and the definition of ‘appropriate advice’, in secondary legislation. We propose to require that firms contacted for the first time by a seller must inform the seller about the existence of the compulsory advice requirement
- 1.18** *Recommendation to shop around*: We propose to require that firms contacted for the first time by a seller must recommend that the seller shops around to ensure that they get the best value when selling their annuity income.
- 1.19** *Contingent beneficiary consent requirements*: We propose that firms contacted for the first time by a seller must tell the seller that consent from contingent beneficiaries may be required before they can sell their annuity income. Under our proposed rules, annuity providers will (where legally required) need to make reasonable efforts to obtain consent from relevant contingent beneficiaries prior to facilitating an annuity income sale.
- 1.20** *Disclosure of other costs*: We propose to require a buyer, broker or adviser-broker, at first contact, to inform the seller of the types and estimated amount of other costs that it may levy. These may, for example, include charges for a medical examination (brokerage fees and their disclosure are covered separately). A buyer, broker or adviser-broker will also be required to inform the seller that an annuity provider may cover its reasonable costs, directly or indirectly, from the seller.
- 1.21** *Panel disclosure*: Brokers and adviser-brokers will be required to disclose the number of buyers on their panel and their relationships with buyers upfront to potential sellers.
- Presentation of offers**
- 1.22** *Quote presentation*: We propose that quotes for a seller’s annuity income must be presented in all cases in pounds sterling. Quotes for annuity incomes must not be conditional on some other event occurring, such as the seller committing to put the proceeds into a particular drawdown product. All quotes, even indicative quotes provided prior to any required health assessments, should be presented net of any additional costs charged by the firm (these costs should also have been disclosed at first contact as set out above). Brokers or adviser-brokers must present multiple quotes for an annuity income in a descending order of price.
- 1.23** *Price comparator*: We propose to require buyers, brokers and adviser-brokers to, in most cases, provide a quote of the current replacement cost of the annuity income the consumer is looking to sell, if it was to be bought new on the open market. This must be presented in a standardised format alongside the firm’s quote for the annuity income.
- 1.24** *14 day cancellation or ‘stop’ period*: The Distance Marketing of Consumer Financial Services Directive 2002/65/EC (DMD), as implemented by existing FCA rules, will allow consumers to change their mind and cancel any decision to sell their annuity income for 14 calendar days after they have agreed a sale, for ‘distance contracts’.<sup>11</sup> In practice annuity sales are likely to be irreversible so firms will most likely choose to put in place a ‘stop period’ during which the firm and the seller cannot proceed to complete the sale of the annuity income. This will give the

<sup>11</sup> A ‘Distance contract’ is defined in the Handbook: [www.handbook.fca.org.uk/handbook/glossary/?starts-with=D](http://www.handbook.fca.org.uk/handbook/glossary/?starts-with=D) and may be broadly summarised as a transaction carried out through the exclusive use (directly or through an intermediary) of one or more means of distance communication (any means which do not involve the simultaneous physical presence of the supplier or intermediary and the consumer). Examples could include the internet, phone, or post.

customer a chance to reconsider their decision. We propose to extend this DMD requirement so that it covers all annuity income sale transactions, whether distance contracts or non-distance contracts (e.g. face-to-face transactions).<sup>12</sup>

### **Restrictions on charging**

- 1.25** *Broker incentives and charging:* We will require brokers and adviser-broker firms to set out their charges up-front, in writing, and agree them with the seller, rather than being paid potentially variable commissions set by buyers.
- 1.26** *Annuity provider costs:* We propose to make a rule stating that an annuity provider can only cover reasonable costs when charging to help facilitate annuity income assignment to a third party, or charging for tasks that need to be carried out when buying back.

### **Compensation and prudential arrangements**

- 1.27** *Ombudsman service protection:* The sale of an annuity income will continue to fall within the scope of the ombudsman service, providing a mechanism to settle disputes between sellers and authorised firms and between contingent beneficiaries and annuity providers involved in the sale of the annuity income.
- 1.28** *FSCS:* The sale of annuity income will continue to fall within scope of the FSCS. Under FCA rules, a seller could make a claim for the acts or omissions of authorised firms involved in the sale, if those firms are in default.
- 1.29** *Prudential requirements:* Firms authorised to participate in the secondary annuity market will continue to be required to meet minimum capital resource requirements and, in some cases, to hold a minimum level of professional indemnity insurance.

### **Record keeping and other regulatory requirements**

- 1.30** *Mental capacity guidance:* We will provide guidance in our Handbook to remind firms active in this market about their existing legal obligations when dealing with sellers who may be vulnerable due to a possible lack of full mental capacity. Our guidance will echo similar guidance found in our consumer credit rules (CONC). Our guidance will not change the existing law relevant for this area, including the laws governing powers of attorney, etc.
- 1.31** *Record keeping requirements:* Firms must ensure that they are fully compliant with the SYSC record keeping requirements. In accordance with SYSC 9, firms will be required to ensure that these records are retrievable and capable of being reproduced if necessary. We will issue data requests and undertake supervisory work in accordance with our duties under FSMA. Due to the risks in the secondary annuity market, data requests are likely to be more frequent in the initial years of its operation.
- 1.32** *Other regulatory requirements:* Existing FCA rules applying to firms undertaking designated investment business will apply to firms undertaking the new regulated activities of purchasing, intermediating and buying-back annuity incomes on the secondary market. Firms who undertake these activities will need to pay fees towards the funding of the FCA, and other bodies such as the ombudsman service, the FSCS and the Money Advice Service (or its successor body or bodies).

<sup>12</sup> Throughout this paper for shorthand we will refer to a 14-day stop period as we expect that most firms will want to provide consumers with a 14-day pre-contract right to withdraw, but these references should be read as also allowing for a 14-day cancellation period instead.

**Anticipated consumer journey**

- 1.33** The seller's consumer journey may be very different depending, in particular, on the value of their annuity. To illustrate this and support a better understanding of the impact of our proposed rules, Annex 2 provides illustrations of the main anticipated consumer journeys.

**Rules for each firm in the secondary annuity market**

- 1.34** Our rules will take effect on firms located in the UK whom we authorise. Where overseas firms are involved in any transaction, certain protections to support consumers must be delivered by the FCA authorised firms in any transaction. If all firms involved in the assignment of an annuity income on the secondary market are located in the UK the following rules will apply to each firm (the chapters below provide more detail on all of these proposals).

	<b>Annuity provider (when facilitating sale)</b>	<b>Buyer</b>	<b>Broker</b>	<b>Adviser- broker</b>
<b>Disclosure</b>				
Risk warnings*	✓	✓	✓	✓
Recommendation to seller to take advice*	✓	✓	✓	✓
Recommendation to seller to take guidance*	✓	✓	✓	✓
Recommendation to seller to shop around*	✓	✓	✓	✓
Other disclosures (e.g. of costs, of the possible need to take advice, obtain contingent beneficiary consent, etc)*	✓	✓	✓	✓
Contingent beneficiary consent requirements	✓	X	X	X
Panel disclosure	X	X	✓	✓
Advice requirement check	✓	X	X	X
<b>Presentation of offers</b>				
Quote presentation	X	✓	✓	✓
Price comparator	X	✓	✓	✓
14 day stop period	X	✓	✓	✓
<b>Charging</b>				
Broker incentives and charging	X	X	✓	✓
Annuity provider costs	✓	X	X	X
<b>Prudential</b>				
Prudential requirements	PRA rules	✓	✓	✓
<b>Other</b>				
Mental capacity guidance	✓	✓	✓	✓

\* It is possible that sellers will contact more than one firm. Where a seller can show a newly contacted firm that they have already received the risk warnings and other information from another firm, subsequent firms need not give them again. See below for detail.

### Financial Ombudsman Service consultation

- 1.35** We are responsible for setting the scope of the ombudsman service's compulsory jurisdiction and the ombudsman service is responsible for setting the scope and standard terms for the voluntary jurisdiction. The ombudsman service proposes to mirror the changes which we are making to the compulsory jurisdiction in its voluntary jurisdiction. To the extent that this CP proposes changes to the ombudsman service's voluntary jurisdiction as a result, this consultation paper is issued jointly by the FCA and the ombudsman service.

### Commencement of our proposals

- 1.36** While the Government has announced that its proposed tax changes will come into effect from April 2017, we intend that the rules outlined in this paper will apply as soon as they are made (which we expect to be in the autumn of this year), depending on the outcome of this CP. This will help firms to adjust their systems and make any other necessary changes in time for April 2017.

### Equality and diversity considerations

- 1.37** Under the Equality Act 2000, we are required to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions.

- 1.38** We have conducted an assessment of relevant equality and diversity impacts. In this assessment we noted that the population of those with annuities is necessarily composed of older people, including some of the very elderly. Given the evidence that there is a higher incidence of vulnerability issues such as mental capacity problems among older people (see chapter 6, below), we have carried out substantial work into whether we should make policy interventions to better protect such consumers. As set out in chapter 6, we have determined that the existing legal framework in the UK already requires firms treat those who may be lacking in full mental capacity appropriately. We are therefore not proposing to take any action beyond reminding firms of their existing obligations.

- 1.39** We welcome comments from any interested parties.

### Next steps

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- 1.40** **What do you need to do next?** We want to know what you think about the proposals in this paper. Please respond to our questions by 21 June 2016. You can find a consolidated list of questions in Annex 1. We are consulting for two months, instead of the normal three months. During this shorter consultation period, we will endeavour to engage fully with all stakeholders. The shorter than usual period will allow us to make final rules earlier and give firms more time to prepare ahead of the planned market launch date of April 2017 therefore supporting a successful launch of the market on that date.

- 1.41** **What will we do?** We will consider your feedback and publish our final rules and guidance in a Policy Statement (PS) later in the year.

## 2. Disclosures

- 2.1** This section considers the information that the seller should be given before proceeding to sell their annuity. We propose that firms interacting with a seller for the first time must give sellers:
- specific annuity sale risk warnings
  - information about the compulsory advice requirement and a recommendation to either seek advice (if not already taken or required) or seek guidance from Pension Wise
  - a recommendation to shop around
  - information about the potential need to seek consent from some contingent beneficiaries
  - information about the costs they may incur, including costs that may be levied by annuity providers, either directly or indirectly
  - a list of the buyers on the broker's panel, if a panel is used
- 2.2** A consumer will be identified as a seller when they have an annuity held in their name and they indicate that they want to do any of the following:
- obtain more information on annuity income sale
  - take steps toward obtaining a quote for their annuity income
  - obtain their annuity details from their annuity provider for the purposes of obtaining quotes for their annuity income from others
- 2.3** Once an individual has been identified as a seller, the firm must deliver the risk warnings and other information in a way that best supports that individual to understand the information and its relevance to their decision.
- 2.4** We propose that in all cases the risk warnings and other information are to be delivered in durable medium.<sup>13</sup> However, firms may proceed to give the risk warnings and other information verbally during the initial conversation with the customer and follow up by sending the material in a durable medium such as an email afterwards. Other firms may choose to stop a customer phone call so that they can email the information to the seller before proceeding. It is possible that some firms will give the risk warnings and other information as part of an online process, followed by sending the material in a durable medium. Firms should consider the needs and preferences of their customers when developing systems to deliver this information. Some older customers may not be comfortable with an online process or may not have an email

<sup>13</sup> 'Durable medium' as defined in the Handbook: <https://www.handbook.fca.org.uk/handbook/glossary/?starts-with=D>

address. A firm must not proceed until it is satisfied that they have given all the risk warnings and other information and that the consumer has acknowledged receipt.

- 2.5** It is possible that sellers will contact more than one firm. Where a seller can show a firm that they have already received the risk warnings and other information from another firm (for example, by forwarding an email they have already received from another firm), the subsequent firm need not give them again. It is however possible that a seller will receive the risk warnings and other information more than once. While this may be frustrating for some, our priority is to ensure that sellers do receive the risk warnings and other information at least once, given their importance.

### Risk warnings

- 2.6** The normal financial promotions rules will apply to this market, so firms' promotions must be fair, clear and not misleading. Nonetheless, we think sellers should be made aware of the main risks as early as possible. Behavioural economics suggests that once an attachment to an idea has formed it can distort an individual's ability to make a rational decision, despite new information coming to light later.<sup>14</sup> Given this, we propose that as soon as a firm is contacted by a seller they will be required to outline the key risks in the form of specified risk warnings, most to be given in question form, set out in Table 1 below.
- 2.7** Firms will be able, but not required, to use the exact wording of the risk warnings we set out below (we are seeking feedback on the final wording of the risk warnings, which will be developed during the consultation process). Firms should consider whether some risk warnings should be emphasised more than others e.g. potential loss of welfare benefits and the risk of investment scams, based on pre-existing information about the consumer that the firm may have.

**Table 1: Risk warnings**

#### **1. Risk of running out of money in retirement –**

'Your annuity guarantees to pay you an income for the rest of your life, no matter how long you live. Did you know that if you sell your annuity, you may be at risk of running out of money in retirement, especially if you live longer than you expect?'

#### **2. Tax –**

'Did you know that, if you sell your annuity, the amount you receive may be subject to tax?'

#### **3. Welfare benefits –**

'Did you know that annuity sale could seriously and permanently affect your eligibility for important welfare benefits? Make sure you are aware of the impact that selling your annuity could have on any means-tested benefits you receive or may receive in the future.'

#### **4. Dependants –**

'Some annuities make payments to your dependants or other beneficiaries in the event of your death. If you sell your annuity did you know that your dependants or other beneficiaries will not get these payments?'

<sup>14</sup> Nickerson, Raymond S. "Confirmation bias: A ubiquitous phenomenon in many guises." *Review of general psychology* 2, no. 2 (1998): 175 <http://www.sakkyndig.com/psykologi/artvit/nickerson1998.pdf>

**Table 1: Risk warnings (continued)****5. Price –**

'When you get a quote for your annuity, you will also be given the current cost of buying your annuity on the open market. Make sure you are happy with the difference between these two numbers.'

**6. Debt advice –**

'If you are selling your annuity to pay off debt, did you know that this may not be the best option? Consider talking to a 'not-for-profit' debt advice organisation.'

**7. Investment charges –**

'If you invest the proceeds of selling your annuity, did you know that your investment will involve charges? Make sure you shop around for the most cost-effective product.'

**8. Investment scams –**

'If you invest the proceeds of selling your annuity, did you know that you are vulnerable to investment scams? Visit [scamsmart.fca.org.uk](http://scamsmart.fca.org.uk).'

- 2.8** In many cases the delivery of specified annuity income risk warnings may be the only time at which important risks (e.g. running out of money in retirement, the possible loss of welfare benefits and the danger of scams) will be highlighted to those sellers who do not use the Pension Wise guidance service or take advice.
- 2.9** In the regulatory protections we introduced to coincide with the introduction of greater pensions freedom in 2015, we introduced retirement risk warnings which were designed to illustrate the risks inherent in specific choices made by a consumer at retirement. Retirement risk warning rules require firms to personalise the risk warnings based on the customer's circumstances and preferences. For the secondary annuity market we believe that the above warnings should be covered for all consumers seeking to sell their annuity. Firms should also consider whether other risk warnings are relevant in specific circumstances and, if necessary, highlight those additional risks to the customer. We believe the question format we propose for most specified risk warnings will help engage sellers' attention.
- 2.10** Firms acting only as advisers in this market, for which a specific secondary annuity market permission is not required, would not need to give the risk warnings or other notices at the point of first contact. However, if such advisers proceeded to give a personal recommendation on annuity income sale, we would still expect them to be covering the risks and other information as part of any advice given under our existing rules, which include suitability requirements.

**Q1: Do you agree with our proposal to require specific risk warnings to be given to consumers at first contact? Would you suggest any changes to the format and content of the risk warnings?**

## Advice and guidance requirements

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- 2.11** We propose to make rules requiring that at first contact all sellers should:
- be informed about the legal requirement to take advice in some circumstances
  - be given a recommendation to take advice even where there is no requirement to take advice
  - be given a recommendation to take Pension Wise guidance
  - be given a recommendation to shop around for the best value when selling their annuity income.<sup>15</sup>
- 2.12** The Government has indicated that it will legislate to make Pension Wise available to those interested in selling their annuity income and to their contingent beneficiaries. The Government has indicated that it will legislate so that some sellers will be required to seek appropriate advice before proceeding with any sale.
- 2.13** The Government's proposed compulsory advice requirement (in the Bank of England and Financial Services Bill) will require us to make rules that require certain authorised firms to check that a seller has taken appropriate advice before annuity income sale is permitted. The Government will set out the threshold that will be used to determine whether a seller is required to take advice and the definition of appropriate advice in secondary legislation.
- 2.14** We propose to make rules to require the annuity provider to check whether compulsory advice has been taken alongside the other checks they must make before facilitating or executing a sale e.g. checking consent has been given by contingent beneficiaries where necessary (see below). In some instances there may be no FCA authorised annuity provider in a transaction, for example, because the seller receives annuity income from an overseas annuity provider. In these instances our rules will ensure that, where present, another FCA authorised firm will carry out the check instead. However, references in the detail below will be to the annuity provider.
- 2.15** The annuity provider is to receive confirmation in a durable medium that advice has been duly given. The provider is also to take reasonable steps to check that the adviser meets the requirements of the relevant legislation.
- 2.16** An annuity provider is required to receive confirmation that advice has been taken before sale is allowed, as per the planned primary legislation. We do not intend to further specify when during the customer journey the advice must be taken. The annuity provider will not be required to check what the result of the advice was. If the advice received is not to sell, this is no reason, in and of itself, for an annuity provider to refuse to facilitate an assignment or execute a buy back (or for a buyer to refuse to proceed with a sale). Our rules will not require any firm (that is not giving advice), including annuity providers that are facilitating assignment, to advise the seller on the suitability of the annuity income sale.
- 2.17** We have recently published a factsheet<sup>16</sup> reminding advisers of our position on insistent clients. In practice, there may be occasions where the client (consumer) wishes to take a different course of action from the one recommended by the advisers. In this factsheet we reminded advisers of the key steps they should take when advising an insistent client.

<sup>15</sup> As part of this, relevant firms should explain to sellers how to shop around, for example, to point sellers toward a list of (other) FCA authorised brokers.

<sup>16</sup> Factsheet No.035: Pensions reforms and insistent clients.

- 2.18** Sellers will be made aware of the possibility of their being required to take advice at the start of the process. Firms making such a disclosure will not be required to determine whether a seller does or does not have a legislative requirement to take advice at that stage. We expect, as a matter of good practice, that firms will point sellers toward information on the advice requirement. This should allow consumers to find out whether they will be required to take advice at an early stage, which will likely influence the intermediary services they decide to use in their customer journey (see Annex 2 for a chart of consumer journeys).
- 2.19** The recommendation to take guidance or advice that sellers will receive may increase their take-up of these services. Guidance and advice will help sellers make a more informed decision about the sale of their annuity income. In addition, the recommendation to shop around will help ensure sellers find the best price for their annuity income.

**Q2: Do you agree:**

- **that at first contact all sellers should be:**
  - **informed about the compulsory advice requirement**
  - **given a recommendation to take advice and/or Pension Wise guidance**
  - **given a recommendation to shop around**
- **that annuity providers should check that legally required ‘appropriate advice’ has been taken, by receiving confirmation in a durable medium, prior to proceeding with annuity income sale?**

### **Contingent beneficiary consent requirements**

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- 2.20** Many annuity contracts provide for benefits to be paid to someone other than the main annuity holder in certain circumstances. For example, ‘joint life’ annuities will pay an income for life to the primary annuity holder, and then, assuming the primary holder dies first, will then pay all or a proportion of that income to another person until their death. The other person is therefore a beneficiary under the contract, but only if certain conditions are met (usually the death of the primary annuity holder). We refer to such persons as contingent beneficiaries.
- 2.21** There are many permutations of how contingent beneficiaries are defined under annuity contracts. Often contingent beneficiaries will be named on the face of the contract. In other cases, a person may be a contingent beneficiary as they are deemed to fall within a class of beneficiary such as ‘a dependant’, or ‘partner/spouse’. At the time that they originally purchased the annuity contract, the primary annuity holder will have decided who, or what sort of contingent beneficiaries, they want to provide for after their death (however, contingent beneficiary details can be updated at a later date in most cases).

- 2.22** If an annuity income was to be sold, contingent beneficiaries could no longer benefit under the contract.<sup>17</sup> Once sold, if the payments to the contingent beneficiaries are triggered, the income due to the contingent beneficiaries would be paid to the annuity income buyer.<sup>18</sup>
- 2.23** The legal position for annuity providers, in facilitating assignment or considering buyback, will depend on the specifics of the annuity contract in question and providers will need to ascertain whether there is a risk that a contingent beneficiary could bring a claim for an entitlement under an annuity.
- 2.24** A contingent beneficiary who is unhappy because their consent was not sought before the annuity income sale, when they believe it should have been, would potentially have recourse to the ombudsman service<sup>19</sup> and the courts, and may have recourse to the FSCS.<sup>20</sup>
- 2.25** We propose to make a rule requiring annuity providers to make sure that they have, where legally required, received consent from contingent beneficiaries that could potentially have an entitlement under the annuity contract before they facilitate assignment or buy back. The existence of an FCA rule may make it easier for unhappy contingent beneficiaries and the FCA to take action (including through the ombudsman service) against annuity providers that cause detriment to contingent beneficiaries by failing to follow their legal obligations in this area.
- 2.26** A consumer's awareness of the possible need to obtain consent from contingent beneficiaries may materially affect their willingness to further investigate the sale of their annuity income. In addition, contingent beneficiaries, whose consent may ultimately be sought, should be brought into the decision-making process as early as possible. Therefore, we propose rules that would require firms to highlight to sellers the possible need to obtain consent from contingent beneficiaries at first contact.

**Q3: Do you agree with our proposals that at first contact all sellers should be informed about the possible need for contingent beneficiary consent, and that FCA should make rules in relation to contingent beneficiary consent?**

### Disclosure of other costs

- 2.27** Finally, we want to ensure sellers are informed about the costs that they may be subject to in relation to annuity income sale before they proceed. We therefore propose to make a rule requiring a firm, at first contact, to inform the seller of the types, and reasonably estimated amounts of other costs that it may charge, for example, for a medical examination (brokerage fees and their disclosure are covered separately in Chapter 4, below). Firms will also be required to inform the seller that an annuity provider may cover its reasonable costs, directly or indirectly, from the seller (see Chapter 4 for more detail on annuity providers' costs).

<sup>17</sup> The Government has already indicated its intention to treat partial sales, e.g. an annuity income sale that leaves contingent beneficiaries with rights to payments, as 'unauthorised payments' (triggering serious tax charges).

<sup>18</sup> This should mean that an annuity with, for example, a contingent pension for a spouse will potentially be worth more than a single life annuity, just as an escalating annuity will be worth more than a level annuity to a buyer.

<sup>19</sup> DISP 2.7.6R(5) – the complainant is a *person* for whose benefit a *contract of insurance* was taken out or was intended to be taken out with or through the *respondent*.

<sup>20</sup> If the FSCS establishes the claim as a valid claim in respect of a civil liability owed by a 'relevant person' to the claimant.

**Q4: Do you agree that, at first contact, all sellers should be informed about:**

- **the ancillary costs the relevant firm reasonably believes it may charge for**
- **the possibility that the relevant annuity provider may cover its costs, directly or indirectly, from the seller?**

### **Panel disclosure**

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**2.28** Brokers have the tools and resources to reach the largest possible panel of buyers, helping sellers to shop around for the best price for their annuity. However, some may choose to use a more restricted panel of buyers. We want to ensure clarity for sellers about the size of the panel of buyers that the broker uses and their relationships with the buyers. This can enable a seller to make comparisons between brokers more easily and so enable choice and competition. This should also be in the interest of the broker, as it will enable them to highlight to sellers the service they provide.

**2.29** Our proposed rules require brokers and adviser-brokers to disclose up-front the size of their panel (number of buyers) and whether they have any commercial relationships with the buyers on the panel (for example an exclusive relationship with a buyer). We do not plan to prescribe a format for these disclosures, though we would expect them to be easily accessible by potential clients and in a clear format. We would also expect these disclosures to be both freely available (e.g. on the brokers website) and highlighted to sellers when they initially contact the broker.

**2.30** We considered other potential consumer protections, including the application of blind bidding rules to the bidding process. This would have meant that the buyers' quotes for the annuity income would have been provided in such a way that the seller would not know the identity of the buyer until they had accepted an offer for their annuity. We decided that imposing blind bidding rules would be contrary to our desire to have transparency in the bidding process, and have chosen not to introduce rules to mandate this.

**Q5: Do you agree with our proposals on panel disclosure rules?**

## 3. Presentation of offers

### Quote presentation and price comparator

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- 3.1** This section considers the rules we are proposing to introduce to support consumers who decide to proceed to receiving quotes for their annuity income. We make no distinction in our proposed rules between the treatment of an indicative quote (e.g. one made before the seller has submitted to a medical assessment) and a final quote which leads to an agreed price for a sale. The proposed rules would apply equally to all firms providing quotes for consumers seeking to sell their annuity income on the secondary market.
- 3.2** Given the risks we have identified for consumers (set out in Chapter 1), we want to make it simpler for consumers to understand the value of the annuity income they want to sell and compare quotes to get the best value available. We want to ensure that quotes themselves are directly comparable and presented in a standardised format that can be understood by the seller and explained by Pension Wise or an adviser when a customer seeks support. We propose to use the open market price from the primary annuity market to help provide consumers with a price comparator. This price comparator will be given to consumers alongside any quote allowing them to benchmark the price they are offered against the price of their annuity income if they were to buy it on the market today. We are also proposing to ensure that the seller should always have a period of reflection or ‘stop-period’ at the end of the process, to allow them to think again about whether they want to proceed with the transaction, even if they carry out the transaction face-to-face.<sup>21</sup>
- 3.3** Our proposed rules in this section include:
- quote presentation
  - introduction of a price comparator
  - extension of the DMD requirements to face to face transactions

### Quote presentation

- 3.4** We propose that quotes for a seller’s annuity income must always be presented as a single one-off lump sum payment in pound sterling terms in a standardised disclosure document. For example, our proposed rules would not allow the quote to be presented as an immediate partial lump sum, with the remainder coming over the following two years, or to present quotes in a different currency. This will minimise consumer confusion by allowing them to compare more easily between quotes and should promote rational decision-making.

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<sup>21</sup> The DMD, as implemented by existing FCA rules, allows consumers to cancel any decision to sell for 14 calendar days after any agreement carried out over telephone or internet (and other contracts which are distance contracts under the directive). We propose to extend this requirement to face-to-face transactions (and what are called ‘non-distance contracts’).

- 3.5** We also propose to make rules that will prevent firms making the purchase of an annuity income conditional on some other event occurring, such as the seller committing to put the proceeds into a particular product. If this was permitted, it is possible that some firms might offer a very competitive quote for the annuity income and subsidise this quote through a further linked sale e.g. a pension drawdown product. We are concerned that sellers would not be able to easily judge the overall value of such an offering against other quotes in such cases and believe that consumers should be able to judge the value of each product on its own merit. We also propose to replicate the existing rules in COBS 19 relating to shopping around so that buyers and brokers will be required to recommend that clients shop around when seeking to move the proceeds from an annuity income sale into drawdown.
- 3.6** However, buyers or others active in this market will be permitted to promote and provide quotes for other products as a destination for money released by annuity sale, as long as they comply with our normal COBS 4 Financial Promotions rules. Indeed, if sellers wish to place the proceeds of the sale into a drawdown product (delaying the income tax on the proceeds of the sale of the annuity income), this will need to be entirely arranged prior to annuity income sale, due to the Government's tax rules.
- 3.7** All quotes, no matter at which stage in the customer journey they are given, should be presented net of any additional charges the firm may levy (or estimated costs if actual costs are not known at the time a quote is given). For example, where a firm will require a seller to pay for a medical examination before annuity income sale, any quotes presented before the medical has been paid for must be presented net of the charge for the medical. Firms will not need to present their quotes net of costs that may be levied by an annuity provider or other third party (as the firms will not know what these costs are).
- 3.8** We recognise that the seller may want to see all quotes received for their annuity. Therefore the broker or adviser-broker will also have to present all other quotes received. These are to be presented by descending order of capital sum offered. This makes it less likely that the broker or adviser-broker will be able to inappropriately highlight a quote to the seller that is not the highest capital sum.
- Price comparator**
- 3.9** We expect that sellers will face significant challenges in valuing their annuity income. They will struggle to know what price they should sell at, and may also make a decision to sell that they would not have taken, had they had a better idea of the value of their annuity income. To support sellers we are proposing rules to help them assess the value of their annuity income.
- 3.10** There are many ways to evaluate annuity income. The cost of buying an annuity on the open market to replace the income sold can be seen as an alternative measure of the value of the income (though this will include various costs that an annuity provider incurs in setting up the new annuity and in selling it). We would like consumers to be presented with this open market value of replacing their annuity income as a comparator to help them decide whether to sell their annuity income and at what price. In this way a seller will have a sense of the difference between what they are being offered for their income, and what it would cost to replace it. Sellers will then be in a better position to decide whether even the best quote they receive on the secondary market is acceptable to them when compared to the replacement cost of the income.
- 3.11** We therefore propose to require that whenever a firm presents a seller with an indicative or final quote for their annuity income on the secondary market, they also provide the market price of the annuity income if purchased new.

- 3.12** Typically, on the annuity market, insurers provide a quote for the amount of income they will provide for a given lump sum. It is possible to reverse such market quotes so that they state the size of the lump sum required to achieve a certain income. There are already tools and IT solutions currently available to provide such a 'price comparator'.
- 3.13** We are proposing rules that will require the quote for the annuity income and the price comparator to be presented in a standardised format in a durable medium. We propose to set out this format in our rules (see Annex 3). If a quote is first given to the prospective seller over the telephone, the firm's representative must communicate the comparison price first, prior to communicating the firm's quote for the seller's annuity income.
- 3.14** We will not specify which of the commercially available tools firms must use to obtain the price comparator from the primary annuity market. It will be in the interests of buyers, brokers, and adviser-brokers to use a service which covers as much of the primary market as possible. The greater the number of primary market annuity providers a service is able to obtain quotes from, the higher the likelihood of the best price comparison being obtained to support the seller in making their choice. A more comprehensive price comparison tool will also present a quote made for a seller's annuity income in a better light, as the difference between them will be smaller.
- 3.15** A firm should use the same medical details to obtain the replacement cost from the primary market as it has used to create its quote to buy the seller's annuity income on the secondary market. If there is no primary market quote for that particular annuity with those particular details, firms should use their best efforts to find a quote that does exist which can be reasonably justified as likely to be as close as possible to the missing quote. Where it is necessary to estimate the replacement cost of the annuity income, the standardised disclosure will reflect this in a note outlining the fact that the comparison is with the closest estimate (also see Annex 3). We accept that this may not be possible where the inability to find a quote is purely related to the age of the prospective seller. For example, for those aged over 90 a comparison is likely to be very hard to obtain due to the low number of insurers willing to offer annuities to the very elderly. For annuitants aged over 90 our proposed rules do not require the price comparator to be presented.
- 3.16** An annuity provider must check whether there is another FCA authorised firm involved as buyer or broker or adviser-broker. If there is not (because the other firms are overseas), then it will need to provide the price comparator instead, based on self-certified medical conditions the prospective seller has disclosed to the insurer for this purpose. The annuity provider must warn the seller that they should disclose all medical conditions they have disclosed to their prospective buyer, to ensure the price comparison is as accurate as possible.

**Q6: Do you agree that firms providing quotes should be required to:**

- **present quotes for annuity income in certain prescribed ways**
- **provide the price comparator alongside their quotes for annuity income?**

### 14 day cancellation or stop period

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- 3.17** The Distance Marketing of Consumer Financial Services Directive 2002/65/EC (DMD) will apply to a decision to sell an annuity income where that sale is concluded by a 'distance contract'<sup>22</sup> and will mean that a seller has 14 days to withdraw from the contract. Given the likely difficulty in reversing an annuity income sale, we expect that firms will implement this by applying a pre-contract right to withdraw as a stop period of 14 calendar days prior to a sale being processed.
- 3.18** We envisage the 'stop period' as a period during which the firm and the seller cannot proceed to execute the sale of the annuity income. We propose to extend this DMD requirement to face-to-face transactions (and any other transactions which are "non-distance contracts"), to ensure that all consumers benefit from the ability to reconsider a decision to sell before finally transacting.<sup>23</sup>

**Q7: Do you agree that the 14 day stop period requirement should be extended to all secondary annuity market interactions?**

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22 A 'Distance contract' is defined in the Handbook: [www.handbook.fca.org.uk/handbook/glossary/?starts-with=D](http://www.handbook.fca.org.uk/handbook/glossary/?starts-with=D) and may be broadly summarised as a transaction carried out through the exclusive use (directly or through an intermediary) of one or more means of distance communication (any means which do not involve the simultaneous physical presence of the supplier or intermediary and the consumer). Examples could include the internet, phone, or post.

23 Under COBS 15, which is the Handbook provision which applies the DMD contract cancellation requirements, distance contracts which relate to designated investment business must provide a consumer with a 14-day cancellation period, and as above we plan to extend this to non-distance contracts for this market. For shorthand we will refer to this requirement throughout this paper as a 14-day stop period (as we expect that most firms will want to provide consumers with a 14-day pre-contract right to withdraw, as set out above) but these references should be read as also allowing for a 14-day cancellation period instead.

## 4. Restrictions on charging

- 4.1** This section outlines our proposals for restrictions on charges for those operating within the secondary annuity market. In particular we outline proposals for:
- preventing brokers and adviser-brokers receiving commissions set by buyers
  - limiting the charges that annuity providers can place on sellers

### Broker incentives and charging

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- 4.2** We want to avoid conflicts of interest, which we believe could arise if brokers' remuneration is set by a buyer. Therefore, we are proposing rules which would both prevent brokers' from receiving commissions set by buyers and prevent buyers from offering commissions in this market. Broker firms will not be able to receive commissions offered by buyers, even if they intend to rebate these payments to the seller.
- 4.3** Brokers will be expected to decide on their own charging structures, reflecting the services that they offer, and to apply these charging structures consistently to all sellers. Our rules will not specify that sellers must pay for brokerage services upfront – it would be acceptable for the pre-agreed brokerage fee to be taken from the proceeds of the annuity income sale.
- 4.4** Advisers should continue to apply the remuneration rules introduced as a result of the Retail Distribution Review (RDR).<sup>24</sup>

**Q8: Do you agree with our proposals on broker incentives and charging?**

### Annuity provider costs

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- 4.5** We are keen to ensure annuity providers do not place unreasonable financial barriers in the way of consumers seeking to sell their annuity income. To ensure that this doesn't happen, we propose to make a rule stating that an annuity provider can only cover reasonable costs when charging to help facilitate annuity income assignment to a third party, or when charging for tasks that need to be carried out when buying back an annuity.

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<sup>24</sup> COBS 6.1A.

- 4.6** The costs that could arise could include, but are not necessarily limited to, costs associated with the contingent beneficiaries' consent checks, checks on advice requirements and general administration such as changing payment details.
- 4.7** We intend to leave annuity providers to make their own decisions about whether they charge sellers for reasonable costs incurred, when (upfront, or only at the point of assignment/termination), and whether the costs would be recovered directly or indirectly, perhaps via a third party buyer. However, the costs recovered must only cover the reasonable costs incurred by providers, and we expect providers to disclose the charges they are recovering to the seller.

**Q9: Do you agree that the FCA should make rules requiring that an annuity provider can only cover reasonable costs when charging to help facilitate or execute an annuity income sale?**

## 5. Compensation and prudential arrangements

**5.1** This section considers our proposals for compensation arrangements available to sellers and firms and the prudential requirements for firms for whom the secondary annuity market is, or becomes, their principal activity. In particular we consider:

- access to the Financial Ombudsman Service (ombudsman service)
- access to the Financial Services Compensation Scheme (FSCS)
- prudential arrangements

### Financial Ombudsman Service protection

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**5.2** Under FCA rules the ombudsman service provides a mechanism to settle disputes between consumers and regulated firms. The rules covering disputes are in the Dispute (DISP) sourcebook of our Handbook.

**5.3** We have considered the protections that should apply in relation to the sale of annuity income, which will fall within the definition of designated investment business. Our intention is that consumers in this market should have the same access to the ombudsman service as they do for other designated investment business. Therefore, we are proposing to amend definitions relevant to the application of those rules to capture the new regulated activities, found in Appendix 1.

**5.4** In practice this will mean that:

- annuity sellers would continue to have recourse to the ombudsman service for complaints against firms involved in the sale of the annuity income
- contingent beneficiaries would continue to have recourse to the ombudsman service for complaints against annuity providers involved in the sale of the annuity income
- annuity buyers would usually not have recourse to the ombudsman service for complaints against the annuity provider, broker or adviser-broker because of restrictions on the size of entities that can take complaints to the ombudsman service.<sup>25</sup> An annuity buyer would also not be eligible if the complaint relates to an activity which the firm itself has permission to carry out<sup>26</sup>

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<sup>25</sup> DISP 2.7.3 and DISP 2.7.4.

<sup>26</sup> DISP 2.7.9.

- 5.5** The FCA is responsible for setting the scope of the ombudsman service’s compulsory jurisdiction and the ombudsman service is responsible for setting the scope and standard terms for the voluntary jurisdiction. The ombudsman service proposes to mirror the changes which we are making to the compulsory jurisdiction in its voluntary jurisdiction. So, to the extent that this consultation paper proposes changes to the ombudsman service’s voluntary jurisdiction, this consultation paper is issued jointly by the FCA and the ombudsman service.

**Q10: Do you agree with our proposals to continue to provide access to the ombudsman service in relation to the sale of annuity income on the secondary market?**

### Financial Services Compensation Scheme protection

- 5.6** Under FCA rules the FSCS can pay compensation for acts or omissions of firms involved in the sale of the annuity income if a number of conditions are met:

- the claim must be in respect of a protected claim
- the claimant must be eligible to make a claim on the FSCS
- the claim must be against a firm that is unable, or unlikely to be able, to meet civil liability claims brought against it

The rules covering FSCS compensation are in the Compensation sourcebook (COMP) of our Handbook.

- 5.7** A claim under a contract of insurance would be assessed under the Policyholder Protection Part (PPP) of the PRA Rulebook.<sup>27</sup>

- 5.8** We have considered the protection that should apply in relation to the sale of annuity income under FCA COMP rules. Our intention is that consumers in this market should have the same access to the FSCS as they currently do for other ‘designated investment business’.<sup>28</sup> Therefore, we are proposing to amend the definition of ‘designated investment business’ to expressly capture the new regulated activities and thus ensure that claims arising in connection with these new activities are ‘protected claims’ for the purposes of our compensation rules. These changes are reflected in the draft instrument attached as Appendix 1.

- 5.9** In practice this would mean that under FCA COMP rules:

- a claim by a seller or contingent beneficiary against firms involved in the sale of the annuity income would fall under COMP.<sup>29</sup> A claim could be made for the acts or omissions of these firms during the sale that caused losses to the seller, subject to the normal conditions for payment of compensation being met

<sup>27</sup> <http://www.bankofengland.co.uk/pr/Pages/authorisations/fscs/insurance.aspx>

<sup>28</sup> See definition of “designated investment business” in the Handbook Glossary. It currently includes the activities of dealing with investments as principal or agent and arranging deals in investments.

<sup>29</sup> The maximum limit for claims for investments is £50,000 per person per firm for claims against firms declared in default from 1 January 2010.

- a claim by a buyer of an annuity against firms involved in the sale of the annuity income would fall under the Compensation sourcebook (COMP) of the Handbook. However, it is likely that the buyer would, in most instances, not be eligible to claim on the FSCS because of restrictions on the type of entity that can be an eligible claimant<sup>30</sup>

**Q11: Do you agree with our proposal to continue to provide access to the FSCS in relation to the sale of annuity income on the secondary market?**

### Prudential requirements

- 5.10** Firms that undertake investment business are generally required to meet minimum capital resources requirements and, in some cases, to hold a minimum level of professional indemnity insurance (PII). We aim to set requirements that reflect the financial and business risks posed by firms. Prudential standards are important because they aim to minimise the risk of harm to consumers by ensuring that firms behave prudently in monitoring and managing business and financial risks. These prudential standards are set out in a variety of sourcebooks.
- 5.11** We propose that firms carrying out one, or more, of the relevant regulated activities in the secondary annuity market should continue to be subject to the same prudential requirements that would apply if they carried out the activities today, depending on their structure and permissions. Firms will be subject to existing rules in the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU), the Prudential sourcebook for Investment Firms (IFPRU), the Interim Prudential sourcebook for Investment Business (IPRU (INV)) or if dual-regulated and subject to prudential regulation by the PRA, the relevant parts of the PRA Rulebook.<sup>31</sup>
- 5.12** Under existing rules a firm that purchases or intermediates the sale of secondary annuity incomes as its main activity would be classified as undertaking designated investment business and subject to IPRU (INV) Chapter 13. A buyer would be classified as a Category B1 Firm (i.e. a Category B Personal Investment Firm whose permissions include dealing in non-MiFID investments as principal). An intermediary would be classified as a Category B2 or B3 Personal Investment Firm, the latter would apply if the firm was restricted from holding client money and custody assets.
- 5.13** To maintain this approach, we intend to apply the IPRU (INV) Chapter 13 prudential standards to any firms for whom regulated activities in relation to the sale of annuity income on the secondary market form their principal investment business.<sup>32</sup> From 30 June 2016 the new Personal Investment Firm (PIF) rules included within PS 15/28<sup>33</sup> will replace the current IPRU (INV) Chapter 13 rules. We propose to amend definitions relevant to the application of those rules to capture the new regulated activities. This can be found in Appendix 1.

<sup>30</sup> COMP 4.2.2.1 and COMP 4.2.2.

<sup>31</sup> <http://www.prarulebook.co.uk/>

<sup>32</sup> The meaning of this in our rules is that these activities form the most substantial part of the firm's gross income from investment business.

<sup>33</sup> <http://www.fca.org.uk/news/ps15-28-pifs-capital-resources-requirements>

- 5.14** Under these PIF rules there is a minimum capital resources requirement of £20,000.<sup>34</sup> There is also an income-based requirement. For a buyer the income-based requirement will be 10% of the annual investment business income earned in the previous year; for a broker this will be 5%. The new capital resources requirement is the higher of the minimum and the income-based requirements.
- 5.15** Secondary annuity market activity will not be insurance mediation activity and therefore will not be within the scope of the Insurance Mediation Directive (IMD). As a result for both buyers and brokers, these rules will apply a minimum PII level of indemnity of £500,000 for a single claim against the firm and £500,000 in the aggregate if the firm has relevant income of up to £3,000,000. If the firm has a relevant income of more than £3,000,000 these levels will be £650,000 for a single claim against the firm and £1,000,000 in the aggregate.
- 5.16** For a firm that undertakes regulated activities in relation to the sale of annuity income in the secondary market and this does not form their principal investment business we propose that they will continue to be subject to the prudential sourcebook that is determined by their other investment business activities.
- 5.17** We also propose to make consequential amendments to the financial reporting rules in SUP 16.12 to reflect the above changes. This can be found in Appendix 1.

**Q12: Do you agree with our proposal to continue to apply IPRU (INV) Chapter 13 to firms when these new regulated activities are their principal business?**

**Client asset rules**

- 5.18** Firms that hold or control client money and/or custody assets in relation to designated investment business are subject to the relevant rules in our client assets sourcebook (CASS).<sup>35</sup> These rules require firms to ensure adequate protection of client money and custody assets when the firm is responsible for them.
- 5.19** If a secondary annuity market broker receives money from the buyer that is destined for the seller it will be client money when it is held by the firm and must be held in accordance with CASS 7. In accordance with the client money rules, the firm must hold this money as trustee and comply with the requirements including that the money must be segregated from the firm's own money.<sup>36</sup> There may be instances where the firm receives an instruction from the buyer to control their money rather than hold it, for example, if the buyer instructs the firm to transfer the buyers' money to the seller. This arrangement would fall within our mandate rules under CASS 8.<sup>37</sup> These rules require the firm to maintain a clear record of the client's instructions and ensure that these instructions are complied with.<sup>38</sup> We think it unlikely that our custody rules under CASS 6 would apply in respect of secondary annuity market activity, however firms should make their own determination of this when considering their specific business model. We do not propose to make any changes to our CASS rules.

<sup>34</sup> Under a transitional arrangement the minimum requirement will be £15,000 until 30 June 2017.

<sup>35</sup> CASS 6 for custody assets and CASS 7 for client money.

<sup>36</sup> CASS 7.13

<sup>37</sup> CASS 8

<sup>38</sup> CASS 8.3

## 6. Other regulatory requirements

- 6.1** We believe that consumers in this market are more likely than in other markets to be vulnerable.<sup>39</sup>
- 6.2** We are also aware that the scale and uncertainty of this new market poses particular challenges for us as a regulator. Given this, we are proposing some additional regulatory requirements to support consumers. This section summarises our proposals for:
- record keeping requirements
  - mental capacity guidance
  - secondary annuity market fees
  - other applicable regulatory requirements
  - regulation of the tertiary market

### Record keeping requirements

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- 6.3** We gather and use a wide range of data, information and intelligence from a range of sources to help us identify and assess risks in financial markets. The primary reason for collecting data from secondary annuity market firms is so that we can supervise firms according to our rules as efficiently and effectively as possible.
- 6.4** FCA general rules and guidance on record-keeping (SYSC 9.1), require that a firm must, in summary:
- arrange for orderly records to be kept of its business and internal organisation, including all services and transactions undertaken by it, which must be sufficient to enable the FCA to monitor the firm's compliance with requirements under the regulatory system and to ascertain that the firm has complied with all obligations with respect to clients
  - have appropriate systems and controls in place with respect to the adequacy of, access to, and the security of its records

Firms must ensure that they are fully compliant with these existing record keeping requirements.

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<sup>39</sup> A vulnerable consumer is someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care (FCA Occasional Paper No.8, Consumer Vulnerability, February 2015).

- 6.5** We will issue data requests and undertake supervisory work in accordance with our duties under FSMA. Due to the risks in this market, data requests are likely to be frequent in the initial years of the secondary annuity market.

#### **Mental capacity guidance**

- 6.6** The population of those with annuities is inevitably made up of older people, and includes some of the very elderly. Given the evidence that there is a higher incidence of mental capacity problems among older people,<sup>40</sup> we propose to provide guidance in our Handbook to remind firms active in this market about their existing legal obligations with regard to sellers who may be vulnerable due to a lack of full mental capacity. Our guidance will echo similar guidance found in our consumer credit rules (CONC).
- 6.7** In the UK, the common law provides the basis for the treatment of those who may lack full mental capacity, together with statute that builds on the common law in England and Wales (the Mental Capacity Act 2005 and the Mental Health Act 2007) and Scotland (the Adults with Incapacity (Scotland) Act 2000.<sup>41</sup> The FCA could take action under our Principles (e.g. Principle 6, Treating Customers Fairly) against firms that fail to follow the relevant law and cause detriment to sellers.
- 6.8** A further concern relates to the risk that those with powers of attorney over the property of those who may lack full mental capacity (the ‘donor’<sup>42</sup>) may choose to sell the donor’s annuity income where it is not in the donor’s interest, but rather for the benefit of the attorney. Our guidance will not change the existing law relevant for this area, including the laws governing powers of attorney. The Mental Capacity Act 2005 imposes certain obligations on attorneys when they are acting on behalf of a donor, and attorneys who are considering selling a donor’s annuity income will need to have regard to the requirements of the Act and the Code of Practice when making their decision.<sup>43</sup>

**Q13: Do you agree that we should provide guidance reminding firms active in this market about their existing legal responsibilities in respect of sellers who may lack full mental capacity?**

#### **Secondary annuity market fees and levies FCA (Fees 3 and 4)**

- 6.9** The FCA is funded by the organisations we regulate and we recover our costs mainly through:
- application fees – one-off payments towards our costs of processing certain applications, e.g. when a new entrant to the financial services market is seeking authorisation or registration
  - periodic fees – annual payments to recover our ongoing costs of regulating authorised firms and other bodies

<sup>40</sup> Analysing data from the English Longitudinal Study of Ageing (ELSA), Huppert F et al (2004) were able to identify age-related reductions in a range of cognitive performance tests relating to memory (e.g. word recall) and executive functioning (e.g. numerical ability, visual search, mental speed). <http://strategicsociety.org.uk/wp-content/uploads/2015/03/Default-Reform-Preventing-low-incomes-with-an-automatic-income-plan.pdf>. Dementia affects 850,000 people in the UK. Of this number, 773,500 are over 65 (Age UK 2014/15, <http://www.ageuk.org.uk/health-wellbeing/conditions-illnesses/dementia/what-is-dementia/>)

<sup>41</sup> [www.legislation.gov.uk/ukpga/2005/9/contents](http://www.legislation.gov.uk/ukpga/2005/9/contents); <http://www.legislation.gov.uk/ukpga/2007/12/contents>; <http://www.legislation.gov.uk/asp/2000/4/contents>

<sup>42</sup> The person an attorney acts on behalf of under a power of attorney is known as a ‘donor’.

<sup>43</sup> See the Mental Capacity Act 2005 Code Of Practice, especially Chapter 7 on powers of attorney.

[www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/497253/Mental-capacity-act-code-of-practice.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/497253/Mental-capacity-act-code-of-practice.pdf)

- 6.10** The level of the application fee depends on the complexity of the application and reflects our work in processing the application, while aiming not to create a barrier to entering the market.
- 6.11** The periodic fee charged for a particular firm does not reflect the actual amount of work we put into regulating it, because tailoring fees across all regulated firms would not be practicable. Instead, we allocate firms to 'fee-blocks', based on the regulated activities they are permitted to undertake. We then allocate the proportion of our total annual funding requirement (AFR) that represents the costs of the resources we will require to regulate the firms covered by each fee-block and charge firms a fee-rate based on the amount of the permitted regulated activity they undertake (tariff base).
- 6.12** We are proposing adjustments to FEES 4 Annex 1A to incorporate acting as a broker in the secondary annuity market into the definition of fee-block A.13 (advisors, arrangers, dealers or brokers) and buying or buying back annuity incomes into fee-block A.10 (firms dealing as principal). The tariff base for fee-block A.13 is annual income and for fee-block A.10 is number of traders. Firms will be required to report their amount of the tariff base (tariff data) each year to enable us to calculate the periodic fee-rates set out in FEES 4 Annex 2A and the fees we invoice.
- 6.13** As a result of the adjustments to FEES 4 Annex 1A, under FEES 3.2.7 and FEES 3 Annex 1 applicants applying to be authorised to act as a broker in the sale of an annuity income will be treated as straightforward cases and will pay an application fee of £1,500. Applicants applying to be authorised to buy or to buy-back annuity income will be treated as complex cases and will pay an application fee of £5,000. Existing firms applying to vary their permissions to carry out these activities will pay 50% of the authorisation application fees if they are not already in fee-blocks A.13 and A.10. Existing firms applying to carry out these activities who are already in the respective fee-blocks will pay £250.

***Financial Ombudsman Service levies (FEES 5) and the Financial Services Compensation Scheme levies (FEES 6)***

- 6.14** For the purpose of calculating levies in FEES 5 and FEES 6, we will include brokers in the secondary annuity market in FEES 5 Annex 1 fee-block 8 or 9<sup>44</sup> (advisors, arrangers, dealers and brokers) and in FEES 6 Annex 3A C2 (life and pensions intermediation). Firms buying or buying back annuity income will be included in FEES 5 Annex 1R fee-block 7 (firms dealing as principal) and in FEES 6 Annex 3A C2 (life and pensions intermediation).<sup>45</sup>
- 6.15** The tariff base for FEES 6 Annex 3A will be their annual eligible income as applicable for class C2 activities, calculated on the following basis:
- broker or advisor broker: net amount retained by the firm of all brokerages, fees and other related income in relation to class C2 activities, which will include the new activities
  - buyer: it will include the income they receive from the annuity purchase for the lifetime of the annuity
  - buy-back: it will include the savings accruing to the firm for the lifetime of the annuity, based on the longevity assumption they use at the point of buy-back

<sup>44</sup> Fee-block 8 if the firm holds client money and/or custody assets. Fee-block 9 if the firm does not hold client money and/or custody assets.

<sup>45</sup> When annuity providers sell an annuity on the primary market they will be in life and pensions provision (C1) block. When they buy the annuity income back they would fall into block C2.

**Money Advice Service levies (FEES 7)**

- 6.16** Firms undertaking the new activities will contribute towards the Money Advice Service (CFEB) levies (or its successor body or bodies), as set out in FEES 7. These levies will be calculated using the same fee-block structure, tariff bases and tariff data as for FCA fees. Money Advice Service levy rates are set out in FEES 7 Annex 1.

**Pension Wise levy**

- 6.17** The FCA will consult on the Pension Wise levy for firms that will benefit from this market in its periodic fees consultation.

**Q14: Do you have any comments on our proposed amendments to FEES?**

### Other regulatory requirements

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- 6.18 Financial promotions:** the FSMA financial promotions regime will apply in full to all firms in the secondary annuities market. Financial promotions for the secondary annuity market must either be issued by an FCA authorised firm or, if not, approved by an FCA authorised firm. Our COBS 4<sup>46</sup> rules will apply, which includes preventing firms from cold calling consumers about annuity income sale.
- 6.19 Regulatory Perimeter:** these activities will fall within the regulatory perimeter. We have made draft amendments to our Perimeter Guidance (PERG) to capture the new regulated activities legislation. These can be found in Appendix 1.
- 6.20 Supervisory Manual:** we are proposing amendments to the Supervision manual (SUP) to capture the application of the new regulated activities. We also propose extending the requirement to submit an appointed representatives annual report (SUP 16.9) to firms acting as market intermediaries and firms entering into regulated annuity buy back agreements. This is a consequence of the Government's proposal to amend the Financial Services and Markets Act (Appointed Representative) Regulations 2001 to allow authorised principal brokers and insurers to engage appointed representatives to undertake these activities in the secondary annuities market. These changes can be found in Appendix 1.
- 6.21 Training and Competence (TC) requirements:** firms must ensure they appropriately supervise and assess employees giving advice on sales as being competent to carry out that activity. As with other investment advice, advisers will need to be qualified to QCF level 4, with no specific additional qualifications.
- 6.22 The promotion of securitised secondary market annuity incomes to retail investors:** if annuity incomes bought on the secondary market are packaged up in a special purpose vehicle (that vehicle could then issue debt or equity etc), this vehicle would qualify as a non-mainstream pooled investment (NMPI) under our rules. Investments in NMPIs cannot be promoted to retail investors.

<sup>46</sup> [www.handbook.fca.org.uk/handbook/COBS/4/1.html](http://www.handbook.fca.org.uk/handbook/COBS/4/1.html)

- 6.23 Insurance Mediation Directive (IMD):** secondary annuity market brokers may (depending on the terms of the underlying annuity contract and the tasks performed) be undertaking a regulated activity under article 39A of the RAO (assisting in the administration and performance of an insurance contract). As this is an activity within the scope of IMD the minimum directive requirements will apply in those circumstances. As a consequence, those firms who are taking such steps that bring them within the article 39A regulated activity when engaging in broking activities in the secondary annuity market will need to obtain that permission (where they do not already hold it) and will be required to comply with those requirements in the FCA Handbook which apply to article 39A.<sup>47</sup> Firms should also be aware that the Insurance Distribution Directive (IDD) is set to come into force by February 2018 and this could introduce different requirements on brokers undertaking insurance mediation activities.
- 6.24** FCA rules applying to firms undertaking investment business will also apply to firms undertaking the new regulated activities of purchasing, intermediating and buying-back an annuity income. These rules can be found in numerous sourcebooks including the Principles for Business (PRIN), Senior Management Arrangements, Systems and Controls (SYSC), Conduct of Business (COBS) and Threshold Conditions (COND). Firms should familiarise themselves with the Handbook, and seek legal guidance if necessary.

### Regulation of the tertiary market

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- 6.25** The government has indicated that the FCA will continue to regulate the so-called tertiary market, but under pre-existing FSMA regulated activities, which apply where the relevant transaction is carried out by way of business.<sup>48</sup> The term 'tertiary market' refers to 're-assignments', i.e. in a situation in which a consumer has assigned their annuity income to an authorised firm, the transaction in which the firm then assigns the annuity income to a third party. We will also use the term tertiary market to refer to fourth, fifth, sixth (etc.) re-assignments which while unlikely, are theoretically possible, and would be regulated in the UK under the pre-existing FSMA regulated activities assuming they are carried out by way of business.
- 6.26** As part of introducing new regulated activities for the *secondary* market, the Government is also consulting on changes that would require *all* buyers of annuity income in the secondary market to be authorised – even if they were not buying annuity incomes 'by way of business'. This would mean that retail (i.e. unauthorised) investors would be committing an offence if they were to invest directly in this market. In practice we expect that this will mean that annuity providers would not consider helping to facilitate annuity income assignment to retail investors. The Government does not currently plan to apply this principle in the tertiary market. Therefore, in theory, retail investors would be able to invest directly in re-assigned annuity incomes. There are risks to retail investors in such an investment, because unless annuity incomes are bought in bulk, a buyer faces an undiversified risk with returns based on the life of a single individual (or a small number of individuals).

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<sup>47</sup> Such as those found in ICOBS.

<sup>48</sup> E.g. dealing as principal, dealing as agent and arranging deals in investments, etc. 'By way of business' refers to the concept used in FSMA.

- 6.27** Rights under a contract of insurance (i.e. rights to an annuity income) are investments. Therefore where an investor buys such an income from an authorised firm,<sup>49</sup> the firm would be subject to certain rules under our Handbook, including our COBS rules. We consider that our existing COBS rules give adequate investor protections to retail buyers. For example, in an execution only transaction, our appropriateness (COBS 10) rules would apply to an authorised firm's sale of annuity income to a retail buyer. Our existing rules also provide scope for buyers on the tertiary market to be treated as professional clients where requested and appropriate, where they would receive less protection.
- 6.28** Sellers in the tertiary market located in the UK will be authorised (at least for the initial re-assignment). It is possible that buyers on the secondary market will themselves be authorised, depending on whether they are carrying out such buying by way of business. Authorised firms acting as sellers do not need to receive the standard consumer protections designed for retail sellers. Therefore we do not intend to require buyers on the tertiary market (where the buyers are authorised) to give the protections described earlier in this consultation such as the risk warnings, price comparators, etc.

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<sup>49</sup> In the UK the firm would always be authorised by the FCA both as a buyer on the secondary market and then as a re-seller of annuity incomes.

# Annex 1

## List of questions

- Q1:** Do you agree with our proposal to require specific risk warnings to be given to consumers at first contact? Would you suggest any changes to the format and content of the risk warnings?
- Q2:** Do you agree:
- that at first contact all sellers should be:
    - informed about the compulsory advice requirement;
    - given a recommendation to take advice and/or Pension Wise guidance
    - given a recommendation to shop around; and
  - that annuity providers should check that legally required 'appropriate advice' has been taken, by receiving confirmation in a durable medium, prior to proceeding with annuity income sale?
- Q3:** Do you agree with our proposals that at first contact all sellers should be informed about the possible need for contingent beneficiary consent, and that FCA should make rules in relation to contingent beneficiary consent?
- Q4:** Do you agree that, at first contact, all sellers should be informed about:
- the ancillary costs the relevant firm reasonably believes it may charge for
  - the possibility that the relevant annuity provider may cover its costs, directly or indirectly, from the seller?

- Q5:** Do you agree with our proposals on panel disclosure rules?
- Q6:** Do you agree that firms providing quotes should be required to:
- present quotes for annuity income in certain prescribed ways; and
  - provide the price comparator alongside their quotes for annuity income?
- Q7:** Do you agree that the 14 day stop period requirement should be extended to all secondary annuity market interactions?
- Q8:** Do you agree with our proposals on broker incentives and charging?
- Q9:** Do you agree that the FCA should make rules requiring that an annuity provider can only cover reasonable costs when charging to help facilitate or execute an annuity income sale?
- Q10:** Do you agree with our proposals to continue to provide access to the ombudsman service in relation to the sale of annuity income on the secondary market?
- Q11:** Do you agree with our proposal to continue to provide access to the FSCS in relation to the sale of annuity income on the secondary market?
- Q12:** Do you agree with our proposal to continue to apply IPRU (INV) Chapter 13 to firms when these new regulated activities are their principal business?
- Q13:** Do you agree that we should provide guidance reminding firms active in this market about their existing legal responsibilities in respect of sellers who may lack full mental capacity?
- Q14:** Do you have any comments on our proposed amendments to FEES?

# Annex 2

## Anticipated consumer journeys



### Journey 1 – seller appoints adviser-broker to shop around for them (compulsory advice required or if not required seller wants advice anyway)





**Journey 2** – seller chooses to shop around themselves – whether compulsory advice required OR if not required, whether Seller chooses to take advice anyway or not



## Annex 3

# Standardised quote presentation format with price comparator

**Quote presentation and price comparator form 1 – where an exact comparator can be found on the primary market.**

### Price comparator

**Our quote for your annuity income is:**

**£5,800**

**How does this compare with the amount it would cost you to buy your annuity today?**

You would have to pay **£7,400** if you were to buy your annuity income today on the open market.

This means that you will get **£1,600** less for your annuity than it would cost you to buy that income today on the open market.



Please make sure you are comfortable with the difference between our quote for your annuity income and what it would cost to replace that income.

Don't forget that you can shop around for other quotes for your annuity income, and that you do not have to go through with the sale of your annuity income.

#### Notes:

- 1 Our quote for your annuity income is net of any costs that we estimate we will cause you to incur prior to our agreeing to buy your income.
- 2 Other parties in the transaction, such as the annuity provider, may also require payments or recover costs from the proceeds of the annuity income sale.
- 3 The amount it would cost you to buy your annuity income again from an annuity provider includes the annuity provider's administration costs, underwriting costs, intermediation costs and profit margins.

**Quote presentation and price comparator form 2 – where an exact comparator cannot be found on the primary market (firm to present reasonable approximation instead).**

### Price comparator

**Our quote for your annuity income is:**

**£5,800**

**How does this compare with the amount it would cost you to buy your annuity today?**



Please make sure you are comfortable with the difference between our quote for your annuity income and what it would cost to replace that income.

Don't forget that you can shop around for other quotes for your annuity income, and that you do not have to go through with the sale of your annuity income.

Notes:

- 1 Our quote for your annuity income is net of any costs that we estimate we will cause you to incur prior to our agreeing to buy your income.
- 2 Other parties in the transaction, such as the annuity provider, may also require payments or recover costs from the proceeds of the annuity income sale.
- 3 The amount it would cost you to buy your annuity income again from an annuity provider includes the annuity provider's administration costs, underwriting costs, intermediation costs and profit margins.
- 4 It was not possible to find an exact comparator on the primary market to show what it would currently cost to replace your annuity income. We have therefore used certain simplifying assumptions to arrive at a reasonable approximation of what it would cost to replace your annuity income, and this is the figure presented above. We can provide an explanation of how we have arrived at the reasonable approximation on request.

**Quote presentation and price comparator form 3 – where a FCA authorised annuity provider provides the comparator due to the buyer or broker being located overseas.**

**Price comparator**

**You have a quote for your annuity income from a non-FCA authorised person.**

*[state if known, in £, e.g. 'It is £5,700']*

**How does this compare with the amount it would cost you to buy your annuity today?**

You would have to pay **£7,200** if you were to buy your annuity income today on the open market in the U.K..

[If possible to complete only: This means that you will get **£[1500]** less for your annuity than it would cost you to buy that income today on the open market.]



Please make sure you are comfortable with the difference between the quote for your annuity income and what it would cost to replace that income.

Don't forget that you can shop around for other quotes for your annuity income, and that you do not have to go through with the sale of your annuity income.

*Notes:*

- 1 *The amount it would cost you to buy your annuity income again from an annuity provider includes the annuity provider's administration costs, underwriting costs, intermediation costs and profit margins.*
- 2 *We may charge to recover our reasonable costs in facilitating the transaction.*
- 3 *Other parties in the transaction may also require payments or recover costs from the proceeds of the annuity income sale.*
- 4 *The primary market comparator used to show what it would currently cost to replace your annuity income in the U.K. has been calculated using the medical and other information you have disclosed to us. If the medical and other information you have provided us with is not accurate then the comparator may not provide an accurate indication of the current replacement cost of your annuity income in the UK.*

## Annex 4

# Cost benefit analysis

- 1.1 Section 138I of FSMA requires us to publish a cost benefit analysis (CBA) of proposed rules. It also requires us to include estimates of those costs and benefits, unless these cannot reasonably be estimated or it is not reasonably practicable to produce an estimate (FSMA s138I(8)(a)&(b)). If we consider that, in making the appropriate comparison, there will be no increase in costs, or there will be an increase in costs but that increase will be of minimal significance, we do not need to carry out a cost benefit analysis under FSMA 138L(3).
- 1.2 This Annex sets out our CBA for the proposals in this consultation paper and explains why we do not consider the other proposals need a CBA because they do not change firms' current substantive regulatory obligations. We assess the costs and benefits of our proposals against the benchmark of what would happen without our intervention ('the baseline') unless otherwise stated.

### Summary

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- 1.3 **Market overview:** The proposed new regulated activities of buying annuity incomes on the secondary market, buying back annuity incomes on the secondary market and acting as a market intermediary are already regulated by FSMA under existing general regulated activities. They are classified as designated investment business.
- 1.4 Given the proposed tax changes, we expect the market to grow significantly from its current low level of activity in which few, if any, transactions are made. We expect activity to peak in the first two years, when it is reasonable to expect that pent-up supply will be released. We believe that the number of consumers selling their annuity income will decline significantly in subsequent years to a low but relatively stable number.<sup>50</sup> However, it is difficult to estimate how many consumers will look into and ultimately sell their annuity income in the secondary annuity market.
- 1.5 To reflect this uncertainty we have undertaken our CBA based on two scenarios – 'smaller market' and 'larger market'. In both scenarios, there will be an initial peak of activity in year one, a still elevated but lower amount of interest in year two, and then a low level of activity thereafter.

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<sup>50</sup> As the secondary annuity market offers those savers with guaranteed annuity rates (GARs) the ability to capture the value of the GAR and then access the pension freedoms (by selling the annuity income they obtained with their GAR), and because it will be a venue in which those who have had their defined benefit pensions converted into an annuity in their own name can then sell that annuity income (monetising their defined benefit pension), we think there will be an ongoing market.

**1.6** These scenarios represent two possible ‘baseline’ market outcomes in the absence of interventions. As discussed in the analysis below, some of our interventions are likely to reduce the number of transactions, as consumers may revise their perception of the value of their annuity incomes upwards and become less willing to sell. This would increase the prices that consumers who still sell manage to obtain. For such measures, while the *volume* of exchanges would decrease, the total *value* of exchanges may increase or decrease. Other measures helping consumers to search and obtain the highest possible bids should increase both the volume and the value of transactions. Given the uncertainty over volumes in this new market pre- and post-intervention, we have scaled our estimates of costs, and where relevant benefits, using these two scenarios.

**1.7** ‘Smaller market’ scenario.

	Number of consumers who will enquire about sale	Number of consumers who will get as far as receiving quotes	Number of consumers who will sell their annuity income
Year 1	500,000	250,000	75,000
Year 2	100,000	50,000	25,000
Year 3 onwards per year	10,000	5,000	2,500

**1.8** ‘Larger market’ scenario

	Number of consumers who will enquire about sale	Number of consumers who will get as far as receiving quotes	Number of consumers who will sell their annuity income
	Number of consumers who will enquire about sale	Number of consumers who will get as far as receiving quotes	Number of consumers who will sell their annuity income
Year 1	500,000	375,000	250,000
Year 2	100,000	75,000	50,000
Year 3 onwards per year	10,000	7,500	5,000

**1.9** It is also difficult to estimate the number of firms that will be involved in either buying or intermediating the sale of secondary annuity incomes. Based on meetings with industry before our consultation, the figures below represent our best estimate of the number of selected types of FCA authorised firms in this market:

	Adviser-brokers	Brokers	Direct buyers	Annuity providers not involved in buy back <sup>51</sup>
Year 1	6	3	10	30
Year 2	6	3	10	30
Year 3 onwards p.a.	4	2	7	30

<sup>51</sup> However, they will be affected by this market in terms of their role in facilitating assignment of their annuity clients’ annuity incomes to third parties.

- 1.10** We predict that most buyers, while still needing to be FCA authorised, will purchase annuity incomes through intermediaries. In most cases we expect that buyers and sellers will find it more efficient and convenient to use a broker to intermediate the sale of annuity incomes.<sup>52</sup> Indirect buyers will also generally be subject to few of our new policy interventions in this market. We also think that most of the consumers subject to the legislative compulsory advice requirement would choose to appoint an adviser-broker to act on their behalf. Based on meetings with industry before our consultation we estimate there will be ten direct buyers in the secondary annuity market – seven insurers buying back directly, and three other firms.
- 1.11 Potential market failures:** By using their retirement assets to buy annuities, consumers can insure themselves against the risk that they live so long that they spend all of these assets. Annuities allow consumers to pool their individual risks, guaranteeing them an income for the rest of their lives. In exchange for guaranteed income, consumers accept the possibility that they will die before the income they receive has recovered the initial price they paid for the annuity. Academic research suggests that, under most circumstances, it is best for retirees to annuitise most, and in some cases all, of their retirement assets.<sup>53</sup> This means that, even if the market for secondary annuities itself works well, there is a risk that many consumers make hasty decisions, which they might not have made with more thorough or better-informed consideration. Behavioural insights and evidence in financial markets indicate that some consumers are particularly likely not to fully consider their choices when seeking to get cash. We are therefore analysing the range of market and behavioural drivers that could lead to poor consumer outcomes, and proposing what we consider a proportionate package to alleviate these risks.
- 1.12** Once it begins to develop, the relationship between different types of market failures may affect how the secondary annuity market functions in ways that are complex and difficult to predict in advance. This makes it even more difficult to predict how the size of the market will develop and whether it will work well for consumers. So estimating the costs and benefits is therefore problematic and subject to significant uncertainty.
- 1.13** ‘Traditional’ market failures that may occur include market power in two parts of the secondary annuity market, as well as two problems related to asymmetric information: adverse selection and the ‘principal-agent’ problem. In addition to the ‘traditional’ market failures, behavioural issues can also undermine the proper functioning of this market. Behavioural ‘biases’ are likely to distort consumers’ assessment of their needs and of the benefits they would achieve when giving up annuities in exchange for a lump sum.
- Behavioural biases**
- 1.14 Present bias:** Unlike rational decision makers, consumers affected by present bias make choices that are inconsistent with their long-term welfare. Broadly speaking, they take decisions ‘today’ that they will regret in the future. Present-biased sellers will tend to overestimate the need for immediate access to money and/or underestimate the benefits of future payments.
- 1.15 Overconfidence:** People tend to overestimate their own abilities in a variety of settings. Sellers may believe that their money management abilities would allow them to get better outcomes after taking all their pension pots than is really the case.

<sup>52</sup> For example entering of one set of medical data, a seller could obtain many bids for their annuity income.

<sup>53</sup> See Yaari, M. (1965): ‘Uncertain lifetime, life insurance, and the theory of the consumer’ *Review of Economic Studies*, 65(2), 137 – 150 and Davidoff, T., Brown, J. R., & Diamond, P. A. (2005), ‘Annuities and Individual Welfare’ *The American Economic Review*, 1573 – 1590: 95(5).

- 1.16 Limited attention:** Consumers may fail to grasp the value of the annuities they hold. Frames that cast selling in a positive light, for example focusing on new rights to access ‘your money’, may hinder consumers’ willingness and ability to compare offers of cash with the stream of income they give up when they sell their annuity. Limited attention during the ‘journey’ from initial contact to final agreement can also compound the risk of market power. Informal contacts and offers may lure consumers, particularly vulnerable ones, into contractual arrangements with details that they fail to grasp and which weaken their bargaining position.
- 1.17** Consumers’ circumstances may also lead them to behave in particular ways that undermine their assessment of different annuity offers. For example, if consumers have a pressing need for cash, then they may be less likely to shop around. This has implications for firm behaviour. If firms believe that a significant proportion of consumers may not shop around, then buyers may still find it worthwhile to give very poor offers in order to make large profits from those consumers that accept them.
- 1.18 Loss aversion:** People dislike uncertainty and the risk of making losses. As shown in a recent FCA Occasional Paper,<sup>54</sup> choice frames that increase the focus on the risk of ‘losing out’ when dying early have a big, negative impact on the demand for annuities in the primary market. Similarly, framing effects may arise in the secondary market, in this case increasing consumers’ desire to sell their annuity. The tendency of consumers to underestimate their own longevity exacerbates these problems.
- Traditional market failures**
- 1.19 Adverse selection:** The expected values of annuities depend on sellers’ life expectancies. Sellers are likely to have private information about this. Prospective buyers may therefore believe that sellers’ willingness to sell at a given price reveals that the expected value is lower than that price. This reasoning applies to any price level. As a result, buyers may want to verify life expectancy, for instance through health checks.
- 1.20 Principal-agent problems:** Intermediation through brokers may improve or worsen sellers’ ability to ‘shop around’. When sellers use brokers as ‘agents’ to find the best price from buyers, brokers’ incentives may not be aligned with those of sellers if buyers pay variable commission to brokers. This could lead to brokers failing to obtain and highlight the best offers and to consumers making inappropriate choices when choosing among offers.
- 1.21 Buyer market power:** The number of buyers may be small, especially during the early phases of market development. This may lead to a market with only a few large firms and limited competition. Furthermore, firms may be able to frame the choices that sellers face in a way that exploits behavioural biases, thereby acquiring market power.
- 1.22** An example of one possible mechanism of this kind will illustrate the point. It is likely that buyers will need to obtain information on sellers through medical checks. It is possible that buyers could offer to pay for these checks up front, on the condition that consumers pay back the buyer if they do not subsequently sell their annuity. Although fully rational sellers would take into account the potential cost of the medical check if they did not sell to the particular buyer, in reality consumers with limited attention may agree to undergo medical checks without taking this future cost into account. Such consumers would then find themselves having to pay for a medical or sell to one particular seller. In this case, features of consumer behaviour effectively lead to buyers acquiring a degree of market power, based on private holding of health information, which the annuitant would not be able to share with other

<sup>54</sup> Aquilina, M., Baker, R., Majer, T. (2014): “Does the framing of retirement options matter? A behavioral experiment” Financial Conduct Authority, Occasional Paper

potential buyers. We are aware that one or more mechanisms of this kind could potentially limit the effectiveness of competition working in the interest of consumers, and will be monitoring for any harm arising.

- 1.23 Buyers' power on the part of annuity providers:** The possibility of buy-back by the current provider of the annuity may also entail further risk that consumers fail to seek alternative offers, and instead only consider offers from their existing provider. As the original annuity provider will have conducted an initial assessment of the seller's health, they may have an information advantage over other potential buyers. Although this will be an imperfect indicator of the seller's current health, it may convey important information about the direction of the seller's health in conjunction with a new medical test.
- 1.24 Monopoly power on the part of annuity providers:** When a buyer and a seller agree to the sale of an annuity, the annuity provider will have to redirect payments to the buyer. The annuity provider is the only entity that can perform this service, effectively giving it a veto power over the sale –equivalent to being a transfer service monopolist. Annuity providers could therefore have an incentive to charge high fees that do not reflect the costs they incur in facilitating assignment. Theoretically, they could also charge high prices for facilitating assignment in order to make other buyers less attractive, making it more attractive for sellers to sell to them (buyback), reinforcing the risk set out in the paragraph above.
- 1.25** As highlighted in the FCA Occasional Paper, consumers who did not shop around paid substantially more for their annuities.<sup>55</sup> On average, over the period from January 2006 to June 2014, retirees who shopped around could increase their income by 5.9% on the average quote. The fact that several of the drivers identified above may limit shopping around by those who choose to enter the market is therefore of concern in developing our proposals.
- 1.26** In view of the evidence suggesting that it is better for retirees to annuitise at least part of their retirement assets, and the potential drivers of poor consumer outcomes set out above, we are proposing a package of measures. The table below groups these policy proposals according to the market failures that they are designed to tackle.

**Table 1: Policy proposals and market failures**

<b>Market Failure</b>	<b>Proposals</b>
Behavioural biases and cognitive limitations affecting consumers' assessments of their needs and of the value of their annuities versus lump sum offers	Risk warnings and other notices Quote presentation and price comparison tool Mental capacity guidance Fourteen day stop period Advice requirement check
Principal-agent problems	Broker charging and disclosure rules
Buyers' market power	Broker charging and disclosure rules Extension of rules requiring firms to recommend that consumers shop around
Monopoly power on the part of annuity providers	Annuity provider 'reasonable costs' only recovery requirement

<sup>55</sup> FCA Occasional Paper No.5: The value for money of annuities and other retirement income strategies in the UK

**Table 1: Policy proposals and market failures**

Market Failure	Proposals
Supporting measures	Financial Ombudsman Service and FSCS protection Prudential requirements Contingent beneficiary consent requirements Record keeping requirements

- 1.27** **Proposals and baseline:** we will estimate the *incremental* costs and benefits of our proposed introduction of new FCA rules to the secondary annuity market. As outlined earlier in this paper, activity in this market is already included under existing regulated activities. They are classified as designated investment business. In numerous cases our rule changes are simply intended to ensure that rules which would have previously applied to these activities continue to apply. In these instances, we have undertaken a CBA and have estimated that the incremental cost and benefit change is zero, as there are no changes in firms' existing substantive regulatory obligations.
- 1.28** The government has announced its intention to require advice when an annuity is above a certain value. Advisers would currently need to be qualified to QCF level 4 to provide advice on annuity income sales on the secondary market, were there to be any current demand for such a service. We are not proposing to introduce any additional qualification rules for advisers. Where we are not changing the substantive requirements for undertaking an activity, we judge that costs and benefits versus the relevant baseline are zero.
- 1.29** We group the measures curbing the impacts of behavioural biases as 'policies supporting consumers' decision-making', as they share the objective of improving sellers' assessment of their needs and options.
- 1.30** For measures entailing potentially non-minimal costs of compliance, we provide estimates following the different market scenarios given above. The other impacts, and in particular the benefits to consumers, are much harder to quantify, as they would require testing changes in consumers' choices, brokers' behaviour and buyers' strategic responses, in conditions (e.g. surveys or experiments) which may only partially reproduce the environments in which these agents will operate. The fact that this market is virtually non-existent at the moment compounds these difficulties. We have therefore concluded that it is not useful or reasonably practicable to produce an estimate of the benefits of these interventions. Where possible we *illustrate* the potential magnitude of these impacts.

### Policies supporting consumers' decision-making

- 1.31** Policies supporting consumers' decision-making aim to improve consumers' assessments of their needs and how they behave in response to these needs.
- 1.32** Risk warnings, the price comparison tool, encouragement to take advice, and the extension of the 14-day stop period to all transactions serve similar purposes; to curb the impacts of behavioural biases which can make consumers underestimate the value of their annuities and, conversely, overestimate the benefits of receiving a lump sum instead.
- 1.33** The price comparison tool helps consumers to value annuity incomes. While this need not coincide with the 'right' value for the annuity income, which also depends on individual needs,

these comparisons provide useful reference points for consumers, with potentially powerful visual impacts that could affect sellers' choices.

- 1.34** Some risk warnings (for example the one focusing on the risk of running out of money in retirement) may further support consumers' estimation of the value of their annuity income. Other measures aim to help sellers identify factors which will reduce the net amount that they would receive from the sale. Without these warnings consumers are likely to pay limited attention to important aspects of their needs, or focus solely on the headline lump sum, leading them to overlook important factors such as the impacts of taxes and potential future loss of means-tested benefits. The recommendation to take advice or guidance, if followed up by consumers, may also result in better informed estimates of the costs and benefits of selling.
- 1.35** We want to help sellers make a rational decision by proposing that quotes for a seller's annuity income must be presented in certain ways, addressing behavioural biases and cognitive limitations affecting consumers' assessments of options.
- 1.36** The 14-day stop period could in principle reduce the impact of the 'present bias' discussed earlier and allow sellers to revise choices which may have been based on emotional responses to the possibility of receiving an attractive lump sum.

### Price comparator

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#### Benefits

- 1.37** The most significant impacts are potential **changes in market outcomes** following the implementation of the price comparator and consumers' improved assessment of the value to them of their annuity income. Despite the uncertainties surrounding a market that is yet to develop, there are three likely outcomes following these interventions:

Some sellers will not modify their choices.

- In this case there is **no impact**.

Other sellers will demand and get a higher price

- The impact consists of a higher price at which annuity incomes are exchanged, which entails a **transfer from buyers to sellers**.

Finally, other sellers will keep their annuity incomes, as they will not find a price equal to or above the new price at which they are "willing to accept" (WTA), i.e. the 'lowest price' they are prepared to accept *after* receiving the comparator.

- This entails **net benefits**. The fact that buyers are not willing to offer that WTA price implies that the avoided transactions would entail a detriment to consumers that exceeds the potential gains to buyers, as illustrated below for a £10,000-value annuity.

- 1.38** The magnitude of net benefits will depend on several factors, including (but not limited to):
- the number of potential buyers and the amount of money they consider investing in annuity incomes

- buyers' bidding strategies and resulting differences between their offers and the amounts shown in the price comparators, which may affect sellers' choices
- potential frequency and extent of consumers' underestimation of the value of their annuities
- consumers' attention and proper understanding of price comparators and risk warnings

**1.39** There is, at this stage, insufficient information on these four points to support a reliable estimation of the aggregate benefits of these interventions. It is also highly unlikely that using surveys or experiments would give us an accurate understanding of how these points would materialise in a market that is yet to develop. We therefore conclude that it is not reasonably practicable to estimate these benefits.

**1.40** We can, however, illustrate two cases:

- for an annuity worth £10,000 to the potential buyer that would otherwise have been sold for £9,000 but now sells at £10,000, the consumer gains £1,000 from being informed and the buyer loses £1,000
- for an annuity worth £10,000 to the potential buyer that would otherwise have been sold for £9,000 but now is not sold, the buyer loses £1,000 and the consumer gains more than £1,000, as he values his annuity at more than £10,000 (otherwise he would sell)

**1.41** Suppose the average amounts were of this magnitude, and 10% of projected transactions were in each of these two categories, then for the lower estimate of market size the reduction in expected profits to buyers is illustrated below for the 'small market scenario':

Year 1	<ul style="list-style-type: none"> <li>• £75m reduction in expected excess profits to the industry</li> <li>• More than £75m gains to consumers</li> </ul>
Year 2	<ul style="list-style-type: none"> <li>• £25m reduction in expected excess profits to the industry</li> <li>• More than £25m gains to consumers</li> </ul>
Year 3 plus, per annum	<ul style="list-style-type: none"> <li>• £2.5m reduction in expected excess profits to the industry</li> <li>• More than £2.5m gains to consumers</li> </ul>

**1.42** In the 'large market scenario' we get:

Year 1	<ul style="list-style-type: none"> <li>• £250m reduction in expected excess profits to the industry</li> <li>• More than £250m gains to consumers</li> </ul>
Year 2	<ul style="list-style-type: none"> <li>• £50m reduction in expected excess profits to the industry</li> <li>• More than £50m gains to consumers</li> </ul>
Year 3 plus, per annum	<ul style="list-style-type: none"> <li>• £5m reduction in expected excess profits to the industry</li> <li>• More than £5m gains to consumers</li> </ul>

**1.43** The figures above are for illustrative purposes, as the average values of the annuities sold may differ from the illustrative £10,000 figure and average increases in consumers' initial valuations and transaction prices may be substantially different from our 10% assumption.

**1.44** Further uncertainties exist about the magnitude of the positive net impacts. Note, however, that even a net impact of 1% of the total transfer would create net gains of millions of pounds, so greatly exceeding the compliance costs estimated below.

### Costs

- 1.45** The price comparator entails **compliance costs** which are made of **one-off costs** to set up systems and **ongoing costs** for the actual production of specific comparators and their presentation to prospective sellers.
- 1.46** *One-off costs:* We estimate three quarters of relevant firms (14 under our assumptions) will develop an automated IT solution to produce the price comparator as part of setting up a semi or fully automated secondary annuity market underwriting process. Buyers, brokers and advisor-brokers will expect to produce many price comparators, as the costs to enter the market make it likely to only be worth entering if significant transactions are anticipated. It would clearly be cheaper to incur the upfront cost to automate this, rather than incur higher on-going costs by manually producing comparators that would rise in proportion with the number of comparators needed. As such, firms will be setting up new IT in any case. Our rules will require them to incur the incremental cost of adding an interface with the commercially available systems capable of providing the price comparator. Based on discussions held with industry experts, we estimate that such development will cost a one-off £21,000 per firm, based on an IT project lasting 60 days at a cost of £350 a day.
- 1.47** We therefore estimate that the incremental 'one-off' set-up costs to be £294,000 (£21,000 x 14) for the industry, which is 98p per consumer benefiting from receiving the comparator during years one and two under the 'smaller market' scenario, and 65p per consumer under the 'larger market' scenario (one-off costs are diluted by higher numbers of those proceeding to the quotation stage of the consumer journey in the 'larger market' scenario).
- 1.48** *On-going costs:* We assume that the 75% of firms expected to invest in these automatic interface IT systems will incur ongoing cost solely from paying to access such commercial systems, and not from additional staff time. We assume that the other 25% firms will incur the cost of access to the commercial systems as well as staff administration time to manually obtain the comparator from the commercial systems.
- We understand the cost of access to the commercially available systems need not depend on the number of enquiries made, but rather on the size of the firm/the number of users within the firm (i.e. that the normal charging model for firms wishing to make more than a handful of enquiries per year is to pay an annual subscription for unlimited access).
  - Very broadly, we understand that annual access to such systems for 'small firms' with few users might cost around £1,800, whereas a large firm with many users might pay more like £18,000. These figures are based on discussions held with industry experts.
  - We have used estimates of how many of the firms (brokers and direct buyers) needing to fulfil this requirement would be likely to qualify as large and small to inform our calculations. In years 1 and 2, we assume 8 'small firms' and 11 'large firms'. In years 3 onwards, we assume 9 'small firms' and 4 'large firms'.
  - For those firms producing the comparator manually, we have assumed that inputting the data into the commercially available system to get a comparator to accompany an indicative bid would take 15 minutes of staff time (based on our estimate on how long it would take to understand details and to enter them into a Common Quotation Form, CQF), at staff costs of £27 per hour.<sup>56</sup>

<sup>56</sup> Wage assumed to be £28,000 – we do not think this task would be carried out by entry-level personnel. Total cost to firm is wage x1.25 (wage, buildings, N.I.), which is £35,000. Days worked per year assumed to be 220. Effective net working hours per working day assumed to be 6. Therefore the cost per 1 hour is £26.52, rounded to £27.

- We assume that there would be one extra final quote for every five indicative bids made on average, and that the production of the comparator to go alongside a final quote will take an additional 30 minutes in two thirds of these cases as more time is needed to input more detailed medical information into the common quotation form used on the commercial systems that produce the comparator, again at £27 per hour staff cost. For one third of the comparators produced for to go alongside a final quote, we assume the firm will not need or choose to add more detailed medical information into the common quotation form, leading to no additional cost.
- Therefore, the different numbers of quotes under the ‘smaller’ and ‘larger’ market scenarios lead to different cost figures between the scenarios due to the incremental costs of some firms doing manual enquiries.

**1.49** Under the ‘smaller market’ assumption, we estimate that on-going costs are, for:

Year 1	<ul style="list-style-type: none"> <li>• £1,090, across the industry. This is made up of £212,400<sup>57</sup> in costs to access the commercial systems mentioned above, £421,875<sup>58</sup> in labour costs associated with comparators for indicative quotes, and £450,000<sup>59</sup> in labour costs associated with comparators for final quotes (and then rounded).</li> <li>• This is £4.34 per person benefiting from the comparator in year 1</li> </ul>
Year 2	<ul style="list-style-type: none"> <li>• £387,000 across the industry. This is made up of £212,400 in costs to access the commercial systems mentioned above (same as for year 1), £84,375<sup>60</sup> in labour costs associated with comparators for indicative quotes, and £90,000<sup>61</sup> in labour costs associated with comparators for final quotes (and then rounded).</li> <li>• This is £7.74 per person benefiting from the comparator in year 2</li> </ul>
Year 3 plus, per annum	<ul style="list-style-type: none"> <li>• £106,000 across the industry. This is made up of £88,200<sup>62</sup> in costs to access the commercial systems mentioned above, £8,438<sup>63</sup> in labour costs associated with comparators for indicative quotes, and £9,000<sup>64</sup> in labour costs associated with comparators for final quotes (and then rounded).</li> <li>• This is 21.13p per person benefiting from the comparator in year 3 onwards p.a.</li> </ul>

<sup>57</sup> 8 x £1,800 (‘small firms’) plus 11 x £18,000 (‘large firms’)

<sup>58</sup> 1/4 of 250,000 year one quotes is 62,500, multiplied by £6.75 (15 min ie £27per hr/4).

<sup>59</sup> 20% of 250,000 year one quotes go to a final quote (50,000). Two thirds of 50,000 is 33,333. 33,333 then multiplied by £13.50 (30 min ie £27per hr/2).

<sup>60</sup> 1/4 of 50,000 year two quotes is 12,500, multiplied by £6.75 (15 min ie £27per hr/4).

<sup>61</sup> 20% of 50,000 year two quotes go to a final quote (10,000). Two thirds of 10,000 is 6,666. 6,666 then multiplied by £13.50 (30 min ie £27per hr/2).

<sup>62</sup> 9 x £1,800 (‘small firms’) plus 4 x £18,000 (‘large firms’) – for year 3 plus (fewer firms than years 1 and 2).

<sup>63</sup> 1/4 of 5,000 year three quotes is 1,250, multiplied by £6.75 (15 min ie £27per hr/4).

<sup>64</sup> 20% of 5,000 year three quotes go to a final quote (1,000). Two thirds of 1,000 is 666. 666 then multiplied by £13.50 (30 min ie £27per hr/2).

**1.50** Under the ‘larger market’ assumption, we estimate that on-going costs are, for:

Year 1	<ul style="list-style-type: none"> <li>£1,520,000 across the industry. This is made up of £212,400 in costs to access the commercial systems mentioned above<sup>65</sup>, £632,813<sup>66</sup> in labour costs associated with comparators for indicative quotes, and £675,000<sup>67</sup> in labour costs associated with comparators for final quotes (and then rounded).</li> <li>This is £4.05 per person benefiting from the comparator in year 1</li> </ul>
Year 2	<ul style="list-style-type: none"> <li>£474,000 across the industry. This is made up of £212,400 in costs to access the commercial systems mentioned above, £126,563<sup>68</sup> in labour costs associated with comparators for indicative quotes, and £135,000<sup>69</sup> in labour costs associated with comparators for final quotes (and then rounded).</li> <li>This is £6.32 per person benefiting from the comparator in year 2</li> </ul>
Year 3 plus, per annum	<ul style="list-style-type: none"> <li>£114,000 across the industry. This is made up of £88,200 in costs to access the commercial systems mentioned above, £12,656<sup>70</sup> in labour costs associated with comparators for indicative quotes, and £13,500<sup>71</sup> in labour costs associated with comparators for final quotes (and then rounded).</li> <li>This is £15.25 per person benefiting from the comparator in year 3 onwards p.a.</li> </ul>

**1.51** Other firms, such as annuity providers solely involved in facilitating assignment, may very occasionally need to produce a price comparator due to the relevant buyer/brokers being located outside the UK (and therefore not subject to our rules). However, we think this will happen so rarely that it is immaterial for the purposes of the cost benefit analysis (we expect such firms would produce the comparator manually on an *ad hoc* basis).<sup>72</sup>

**1.52** As noted above, these costs are small in comparison to the magnitude of the impacts on market outcomes, including the net aggregate benefits from avoiding transactions for which consumers value their annuities more than prospective buyers.

## Quote presentation

### Benefits

**1.53** We propose that:

- quotes for a seller's annuity income must be presented in all cases in pound sterling,
- quotes must not be conditional on some other event occurring,

<sup>65</sup> Same as in the ‘smaller market’ scenario as the same number of firms assumed to be involved.

<sup>66</sup> 1/4 of 375,000 year one quotes is 93,750, multiplied by £6.75 (15 min ie £27per hr/4).

<sup>67</sup> 20% of 375,000 year one quotes go to a final quote (75,000). Two thirds of 75,000 is 50,000. 50,000 then multiplied by £13.50 (30 min ie £27per hr/2).

<sup>68</sup> 1/4 of 75,000 year two quotes is 18,750, multiplied by £6.75 (15 min ie £27per hr/4).

<sup>69</sup> 20% of 75,000 year two quotes go to a final quote (15,000). Two thirds of 15,000 is 10,000. 10,000 then multiplied by £13.50 (30 min ie £27per hr/2).

<sup>70</sup> 1/4 of 7,500 year three quotes is 1,875, multiplied by £6.75 (15 min ie £27per hr/4).

<sup>71</sup> 20% of 7,500 year three quotes go to a final quote (1,500). Two thirds of 1,500 is 1,000. 1,000 then multiplied by £13.50 (30 min ie £27per hr/2).

<sup>72</sup> We understand that occasional access to the commercially available systems able to provide the price comparator can be arranged at one or two pounds a query with no other costs.

- all quotes must be provided net of any additional costs to be levied by the firm, and
- that multiple bids for an annuity income must be presented by a broker or adviser-broker in a descending order we aim to aid sellers in making a rational decision.

**1.54** This will reduce the chance of confusing consumers with complicated or deliberately misleading promotion styles, and promote rational decision-making. It will also address behavioural biases and cognitive limitations affecting consumers' assessments of their needs and of the value of their annuities versus lump sum offers.

**1.55** The economic value of this reduction in potential customer confusion is intrinsically uncertain. It is difficult to quantify when the market has yet to develop and surveys and experiments would be unable to replicate the environment in which consumers would make choices. It is therefore not reasonably practicable to estimate the benefits of this policy.

#### Costs

**1.56** The requirements mean that firms will have to present information on quotes in a particular manner, but firms would have to present the quotes in *some* manner in any case. As systems and processes have yet to be set up these requirements can simply be taken into account when firms are setting up their business processes. We therefore expect that the costs of this requirement will be of minimal significance.

### Extension of rules requiring firms to recommend that consumers shop around

#### Benefits

**1.57** If consumers do not shop around, they are unlikely to secure the highest potential bids for their annuities. Prospective buyers would have incentives to submit much lower offers than their maximum 'willingness to pay' levels, as consumers are more likely to accept a lower offer if they cannot compare other buyers' bids. In other words, consumers' comparison of alternative offers is a necessary condition for competition to work properly in the market for secondary annuities.

**1.58** The potential benefits to consumers from shopping around to find the highest bids are significant. However, they obviously depend on the actual effectiveness of this recommendation, which, in turn, depends on how it is delivered. If proposed by the same investors who are trying to convince potential sellers to sell, the recommendation may convert into one of the tick-box exercises in many markets that hardly attract any consumer attention. The possibility that consumers have a strong desire for cash when they process the information may further undermine the impact of this encouragement.

**1.59** If the increase in shopping around materialises, the impacts could be twofold:

- some consumers would receive more money in exchange for their annuities. This would involve a **transfer from firms to sellers**
- some consumers may not have sold in the absence of these rules, but do sell once they shop around due to this rule and find a higher offer. This entails **benefits to consumers and firms**

- 1.60** Before the market develops, it is difficult to assess the magnitude of these likely potential gains from shopping around or the effectiveness of these rules. It is unlikely that using surveys or testing would improve our understanding of these factors. We therefore conclude that it is not reasonably practicable to estimate the benefits of this policy.
- 1.61** However, evidence in the primary market provides some insights on potential gains to consumers of shopping around, and we provide an illustration of the benefits of the policy. This is an illustration of the potential scale of the transfer from firms to sellers, and does not illustrate the scale of benefits from additional sales.
- 1.62** The FCA Occasional Paper<sup>73</sup> on the value for money of annuities<sup>74</sup> indicates that shopping around in the primary annuity market would enable buyers of the “average” product to gain 5.9% if they switched to the best available offer in the open market. Data on February 2015 transactions suggests gains of up to 10.4% for 75-year-old annuitants (single-life standards). The gains for sellers are higher if people buying the lowest-value annuity switch to the best value ones, ranging from 11.5% to 15.9%. Differences are much larger for enhanced annuities: gains are between 9.6% and 15.4% comparing the average to the best, and between 16.2% and 29.8% comparing the worst to the best. This may be due to the relatively small size of this market compared to the general annuities market.
- 1.63** The market for secondary annuities is also likely to be relatively small. Additionally, the processes by which firms assess health may increase the risk of consumers’ perception of having a single offer available (although indicative quotes can be provided without a medical exam). So, shopping around in the market for secondary annuities could lead to consumers securing higher offers, with increments in the areas observed for enhanced annuities (i.e. 10-15% from average offers).
- 1.64** If we assume, for the purposes of illustration, that;
- the average price paid for annuity income on the secondary market is around £10,000
  - that the recommendation to shop around causes an additional 5 percentage points of sellers to shop around when they would not otherwise have done so
  - taking 12.5% as the average uplift from shopping around (the midpoint of the 10 – 15% stated above)
  - using the estimated number of transactions for our small and large market transactions, we can provide an illustration of the possible benefits to consumers the recommendation to shop around may bring, as below
- 1.65** As this illustration is for the transfer component of the benefits to consumers, the benefits to consumers are matched exactly by a reduction in firms’ excess profits.

<sup>73</sup> FCA Occasional Paper No.5: The value for money of annuities and other retirement income strategies in the UK

<sup>74</sup> Aquilina, M., Baker, R., Majer, T. (2014): “The value for money of annuities and other retirement income strategies in the UK” Financial Conduct Authority, Occasional Paper N.5

1.66 For the 'small market scenario', the impacts are:

Year	Benefits to consumers from higher bids	Reduction in firms' excess profits
Year 1	£4,690,000 <sup>75</sup>	£4,690,000
Year 2	£1,560,000	£1,560,000
Year 3 pa onwards	£156,000	£156,000

In the 'large market scenario' these impacts are as follows.

Year	Benefits to consumers from higher bids	Reduction in firms' excess profits
Year 1	£15,600,000	£15,600,000
Year 2	£3,130,000	£3,130,000
Year 3 pa onwards	£313,000	£313,000

1.67 This illustration does not incorporate additional benefits that we expect to accrue to both consumers and firms. These benefits occur because, as a result of shopping around, consumers who would otherwise not have sold their annuity find higher bids at which they are willing to sell. Consumers and firms are better off as trades take place at prices at which buyers' willingness to pay exceeds consumers' willingness to accept.

#### Costs

1.68 On the other hand, the incremental costs to firms of the proposed rules are likely to be minimal. We assume providers of new annuities and drawdown products which are sold at annuity assignment will need to produce new paperwork/processes to support this. Therefore adding the call to shop around at that design stage will not add any costs. In a scenario in which a firm uses existing standard disclosures/processes for annuities and drawdown sale, this new rule would not cause extra costs as these disclosures/processes would already follow COBS 19.4.

### Risk warning and other disclosures

#### Benefits

1.69 The main impact consists of a reduction in the extent to which consumers underestimate the value/usefulness of annuities:

- the warning about the **risk of running out of money** and the one about the adequacy of the **price** act in a similar way to price comparators, the impacts of which we discussed above
- warnings in relation to **welfare benefits, tax impacts, dependants' eligibility, debt advice and charges** support sellers' ability to consider effects that would otherwise be easily overlooked. These effects reduce the benefits sellers associate with the lump sum offered
- warnings about **investment scams** should help tackle risks that may be significant, especially among the most vulnerable groups of consumers

<sup>75</sup> As an example calculation = £10,000 x (75,000 year 1 sellers x 0.05) x 0.125 = £4,687,500, then rounded.

**1.70** The actual impact of these warnings is inherently uncertain and difficult to estimate, as the market is yet to develop and we cannot know the extent to which consumers would in practice underestimate the value or usefulness of annuities. As testing or survey evidence is unlikely to be able to replicate the choices that consumers would face in practice, we conclude that it is not reasonably practicable to estimate the benefits of this policy.

**1.71** Nevertheless, the benefits are similar to the illustration that we provided above for the price comparator. Even a limited reinforcement of the impact of the comparators would make these warnings net beneficial, given the small magnitude of the costs involved.

### Costs

**1.72** A minority of firms (we estimate 25%) may develop an online offering to give the risk warnings and other notices. This assumption is based on discussions we had with prospective brokers and other firms before we published this CP. It should be noted that if a firm chooses the initial contact to be carried out online, this does not imply that the firm intends that it cannot be contacted at a later stage by the seller by telephone. As such firms will be setting up an entirely new IT offering, we think the *incremental* cost of adding some content for risk warnings and other notices will be minimal.

**1.73** We assume that the 25% minority of firms that avoid phone-based channels and instead use an online only channel will have no ongoing staff costs for giving the risk warnings and other notices using staff time. The ongoing costs for the other 75% of firms are for staff time to either give the risk warnings in full over the phone (followed up by sending them in a durable medium), obtaining e.g. an e-mail address over the phone to which to send the risk warnings, or for the cost of sending the risk warnings by post. These cost figures are obtained by using:

- the assumptions for the number of enquiries per year set out in the introduction to the CBA above
- an assumption about the number of sellers who would come into contact with more than one firm *and* the number of such contacts where consumers are not able to show a firm in a durable medium that they have already received them<sup>76</sup> – in summary we assume this will lead to additional provision of the warnings by firms amounting to an extra 30% of the initial enquiries made in each year
- assumptions about how many warnings are given in different ways (we assume 50% of all provision of warnings will be done in full over the phone initially and then followed up by email or other durable medium, 5% by post only, and 20% by a brief call to obtain e.g. an email address (as above we assume the other 25% will be delivered online only, with automated email follow-up, incurring no incremental costs)
- assumptions about how long it would take to give the risk warnings and other notices by phone (5 min), how long it would take to have a brief call to obtain e.g. an email address (1 min) – both at a staff cost rate of £20 an hour – and the cost of using post (50p per enquiry) – these costs have then been multiplied by the relevant number of enquiries

A small amount of the cost relates to annual training staff:

- at 2 hours training per consumer facing staff member per year, costing £40 per staff member (cost includes trainee costs plus apportioned trainer costs)

<sup>76</sup> We assume that the cost to a firm in judging whether such proof fulfils our requirements will be minimal.

- assumption on numbers of firms in the market set out at the start of the CBA section (note there are assumed to be a few less firms in years 3 onwards)
- assumptions about the numbers of staff needing training across those firms – none in the 25% using online channels only, 2 per firm for 25% (=23 staff), 5 per firm for 25% (=123 staff) and 10 per firm (=613 staff) for the remaining 25% of firms.

**1.74** Under both the ‘smaller’ and ‘larger’ market assumptions, we estimate that on-going costs are:

Year 1	<ul style="list-style-type: none"> <li>• £628,000 across the industry (this is made up of £597,920<sup>77</sup> in warnings provision related costs and £30,380 in training costs<sup>78</sup>).</li> <li>• This is £1.26p per person benefiting from the risk warnings and other notices in year 1</li> </ul>
Year 2	<ul style="list-style-type: none"> <li>• £150,000 across the industry (this is made up of £119,585 in warnings provision related costs and £30,380 in training costs).</li> <li>• This is 1.50p per person benefiting from the risk warnings and other notices in year 2</li> </ul>
Year 3 plus, per annum	<ul style="list-style-type: none"> <li>• £39,600 across the industry (this is made up of £11,959 in warnings provision related costs and £26,660 in training costs).</li> <li>• This is 3.86p per person benefiting from the risk warnings and other notices in year 3 onwards p.a.</li> </ul>

The figures for the ‘larger market’ assumptions are the same as for the ‘smaller market’, as the number of *enquiries* predicted for each scenario is the same, and due to firm training costs (driven by number of firms involved) being the same across both scenarios.

### Mental capacity guidance

**1.75** We propose to provide guidance in our Handbook to remind to firms active in this market about their existing legal obligations towards sellers who may be vulnerable due to a lack of full mental capacity. Our interventions do not change existing substantive requirements in this area, therefore costs and benefits versus the relevant baseline are zero.

### Contingent beneficiary consent requirements (additional requirements for annuity providers)

#### Benefits

**1.76** The existence of an FCA rule may make it easier for aggrieved contingent beneficiaries, the Financial Ombudsman Service and the FCA to take action against annuity providers who cause detriment to contingent beneficiaries by failing to follow their legal obligations in this area. This should make it easier and cheaper for aggrieved contingent beneficiaries to obtain compensation. In turn this could provide incentives for firms to ensure that they carry out appropriate checks.

<sup>77</sup> 500,000 year 1 initial enquires. Plus 30% where given twice, = 650,000 in total. 325,000 (50%) given by phone in full (then sent in a durable medium) at 5 minutes staff time at a rate of £20 an hour (£1.66), plus 32,500 (5%) by post at £0.50 per contact, plus 130,000 (20%) where a phone call is used simply to enable the sending of the information by email or other durable medium at 1 minutes staff time at a rate of £20 an hour (£0.33). For Years 2 and 3 the relevant number of initial enquiries, i.e. 100,000 and 10,000 respectively, are used.

<sup>78</sup> £40 overall training cost per relevant employee, x 760 employees across the firms.

**1.77** The extent to which aggrieved contingent beneficiaries would emerge as a problem is inherently uncertain, and it is unlikely that conducting surveys or testing would provide any useful information. It is therefore not reasonably practicable to estimate the benefits of this policy.

#### **Costs**

**1.78** The incremental costs to firms of this rule will be minimal, as the rule builds on and reinforces the existing legal situation without materially changing it. In respect of the possible need for contingent beneficiary consent, the legal position for annuity providers facilitating assignment or buying back will depend on the specifics of the annuity contract in question. Providers will need to ascertain whether there is a risk that a contingent beneficiary could bring a claim for an entitlement under an annuity contract.

**1.79** We propose to make a rule requiring annuity providers (where legally required) to make reasonable efforts to receive consent from contingent beneficiaries who could potentially have an entitlement under the annuity contract before they facilitate assignment or buy back. We propose to set out what reasonable efforts are in the Handbook.<sup>79</sup> The existence of an FCA rule may make it easier for unhappy contingent beneficiaries and the FCA to take action (including through the ombudsman service) against annuity providers that cause detriment to contingent beneficiaries.

#### **Advice requirement check (additional requirements for annuity providers)**

**1.80** The Government's proposed legislative compulsory advice requirement will require the FCA to make rules determining which authorised persons must check that 'appropriate advice' has been taken before an annuity income sale.<sup>80</sup> We propose to make rules to require the FCA authorised annuity provider to carry out this check. A provider is to receive confirmation in a durable medium from the relevant adviser. The provider is also to take reasonable steps to check that the adviser meets the requirements of the relevant legislation.

**1.81** If there is no FCA authorised annuity provider in this scenario (for example, because the seller receives his annuity income from an overseas insurer), our rules will ensure that, where present, another FCA authorised firm involved in the transaction will carry out the check.

**1.82** For the cost benefit analysis of this requirement we will use a baseline that assumes that this legal requirement is not present. However, the costs and benefits of imposing this requirement cannot be reasonably estimated because the government has not yet set the threshold for the compulsory advice requirement, nor defined what the compulsory 'appropriate advice' would be. We therefore set out a high-level qualitative description of the possible costs and benefits associated with this proposed Government policy.

#### **Benefits**

**1.83** Sellers may benefit from compulsory advice as they will be better informed as to whether they should sell their annuity income (and at what price). In the case of sellers who would not otherwise have taken advice, this may prevent detriment.

**1.84** These benefits will be similar in nature to those we describe above for policies that enhance consumers' ability to assess their needs and options. The magnitude of these benefits is intrinsically uncertain and difficult to quantify. As a result, we conclude that these benefits cannot be reasonably estimated.

<sup>79</sup> See the draft instrument.

<sup>80</sup> The government will be setting out in secondary legislation the nature of the advice to be obtained, and the threshold that will be used to determine whether a seller is required to take advice.

### Costs

**1.85** This requirement will oblige sellers to buy advice that they may not otherwise have chosen to purchase and that they may not value. In addition, there are likely to be minor costs for annuity providers and other relevant firms in checking that the compulsory advice requirement has been met before allowing annuity income sale.

### 14-day stop period extension to face-to-face transactions

**1.86** The 14-day stop period requirement already applies under the Distance Marketing Directive (DMD) to e-mail and telephone transactions (and other transactions which are 'distance contracts'). We propose to extend this requirement to face-to-face transactions (and other 'non-distance contracts'), to ensure it applies in all circumstances.

### Benefits

**1.87** The extended 14-day stop period could, in principle, reduce the impact of "present bias" and allow sellers to revise choices which may result from emotional responses to the prospect of achieving a seemingly attractive lump sum. It also allows consumers to consider again the options that they were presented with and previously accepted, and thus also potentially improves consumers' assessments of their options.

**1.88** We consider that when consumers decide not to sell during the 14-day period, this is likely to be due to an improvement in the assessment of the impacts of their choices. Therefore, they will have avoided a transaction which would have brought a detriment of higher magnitude than the potential profits to prospective buyers.

**1.89** As the market is yet to develop, the benefits to consumers of extending the 14-day stop period to face-to-face transactions is inherently uncertain and difficult to estimate. Testing or surveys are unlikely to be able to give useful insights as to how consumers would behave in practice. We therefore conclude that it is not reasonably practicable to estimate the magnitude of benefits of this policy.

### Costs

**1.90** The costs of the extension of the stop period to face-to-face transactions are expected to be minimal. We expect minimal opportunity costs to firms from the transfer of ownership occurring 14 days later. Firms will have to ensure that they have the liquidity to stand behind all the offers they have made for the subsequent 14 days. This may put a cap on how many offers they can make in a given period. Firms may have to borrow money to meet an unexpectedly high level of acceptances from prospective annuity sellers they have made offers to, where they may have made more offers than they could satisfy at once.

### Summary of impacts of measures supporting consumers' decision-making

**1.91** As discussed above, the measures supporting consumers' decision making involve the following types of impacts:

- compliance costs to firms
- transfers from buyers to sellers (as higher transaction prices reduce excess profit to firms)
- avoiding transactions which would create a detriment to consumers and hence a lower excess profit to firms from those transactions
- benefits to firms and consumers, as new transactions take place that would not have done so due to biases in consumer behaviour

**1.92** For each policy we have provided estimates of the first of these impacts. It has not been reasonably practicable to estimate the other impacts, though where possible we have provided illustrations. The following summarises the estimated *costs of compliance*:

<b>Policies</b>	<b>Year 1: One-off costs</b>	<b>Year 1: On-going costs</b>	<b>Year 2: On-going costs</b>	<b>Year 3 and after: On-going costs</b>
<b><i>Small market scenario</i></b>				
Risk warnings and other notices	Minimal	£628,000	£150,000	£39,600
Advice requirement check	Not possible to estimate	Not possible to estimate	Not possible to estimate	Not possible to estimate
Price comparator and quote presentation rules	£294,000	£1,087,000	£387,000	£106,000
Broker remuneration and disclosure	£12,600	£37,500	£11,730	£3,840
14 day stop period for face to face transactions	Minimal	Minimal	Minimal	Minimal
Contingent beneficiary consent	Minimal	Minimal	Minimal	Minimal
Requirement to encourage shopping around	Minimal	Minimal	Minimal	Minimal
<b><i>Large market scenario</i></b>				
Risk warnings and other notices	Minimal	£628,000	£150,000	£39,600
Advice requirement check	Not possible to estimate	Not possible to estimate	Not possible to estimate	Not possible to estimate
Price comparator and quote presentation rules	£294,000	£1,520,000	£474,000	£114,000
Broker remuneration and disclosure <sup>81</sup>	£12,600	£37,500	£11,730	£3,840
14 day stop period for face to face transactions	Minimal	Minimal	Minimal	Minimal
Contingent beneficiary consent	Minimal	Minimal	Minimal	Minimal
Requirement to encourage shopping around	Minimal	Minimal	Minimal	Minimal

**1.93** The price comparator is the main factor in compliance costs. As shown in our illustrations, we expect the impacts on market outcomes in terms of transfers from buyers to sellers from higher prices and the net benefits from avoided transactions which would cause consumer detriment to be much higher than these compliance costs, even considering the price comparator alone.

**1.94** There are also additional incremental costs on top of the compliance costs set out above associated with the additional record-keeping that these new rules will require under existing FCA record-keeping rules. These costs are quantified below.

<sup>81</sup> The figures are the same in the larger and smaller scenario, as these would have to be delivered when consumers enquire about a sale, where the assumptions on volumes are the same in both scenarios.

## Broker charging and disclosure rules

### Benefits

- 1.95** In the absence of our policy, it would be possible for brokers to receive commission from buyers. As a result of such commission, brokers' and sellers' incentives could be widely misaligned, as brokers would not necessarily have an incentive to seek out or recommend the highest buyer bid. For example, buyers could give brokers commission to recommend their bids in preference to other, higher bids.
- 1.96** By aligning incentives between brokers and sellers more closely, brokers' incentives are then to seek out the highest buyer bid and recommend that bid to sellers. Relative to the baseline, this amounts to a **transfer of the gains from trade from buyers to sellers**.
- 1.97** This better alignment and information on the broker panel will also produce effects similar to those discussed in relation to the "shopping-around" behaviour, as brokers will devote more effort to seek the best offers to consumers. As well as the transfer, this may also entail an **expansion in the volume and value of mutually beneficial transactions**, as some consumers may otherwise refrain from selling in the face of low offers.
- 1.98** The market is yet to develop, so the extent to which commission would drive brokers' behaviour in the absence of intervention is inherently uncertain, and testing or surveys would not be able to replicate the market environment. While we believe that this intervention leads to benefits to consumers, in terms of securing higher offers, and to a potential market expansion, we also argue that it is not reasonably practicable to estimate the magnitude of the benefits of this policy.

### Costs

- 1.99** We believe that around six brokers and three adviser brokers will enter the market, and some will have left by the third year. The CBA undertaken for the introduction of the Retail Distribution Review (CP 09/18)<sup>82</sup> estimated that firms implementing the remuneration requirements would face a one-off cost of £500 per firm for devising the tariff system and an ongoing cost of £500 per firm for the disclosure of remuneration.
- 1.100** In applying this to brokers and adviser brokers in the secondary annuity market, we estimate costs of £1,000 per firm for the first year and £500 subsequently. This equates to an estimated £16,500 industry cost for the first three years of the secondary annuity market or approximately £0.16 per annuity sold.
- 1.101** We are also proposing to apply panel disclosure rules to brokers. Brokers will have to disclose upfront the size of their buyer panel and their relationships with buyers. We expect the majority of firms will choose to automate the provisions of these disclosures (e.g. make them available on the broker website). Where this is automated we have estimated 14 hours and £1,000 one-off fixed cost per firm. Where it is not automated we have estimated seven hours and no fixed cost to create this information in an easily accessible form.
- 1.102** In terms of ongoing costs, we have calculated these on the basis of the staff time it would take to deliver the disclosures. If the process is automated we assume this to be zero. If the process is manual we assume it will take one minute and therefore cost £0.33 per enquiry. Based on these estimates we believe the industry cost of the rule will be approximately £49,100 for the first three years (of which £8,100 are one-off costs and £41,070 are labour costs for providing the disclosures). This equates to around £5,456 per firm or £0.13 per enquiry.

<sup>82</sup> [http://www.fsa.gov.uk/pubs/cp/cp09\\_18.pdf](http://www.fsa.gov.uk/pubs/cp/cp09_18.pdf)

## Annuity provider 'cover cost' requirement (additional requirements for annuity providers)

### Benefits

- 1.103** Annuity providers' *de facto* veto power would give them an incentive to use the charge for re-assignment as a way of extracting the gains from annuity sales. Annuity providers will not know the gains from trade in each case, but will still have an incentive to charge their expectation of these gains. In these circumstances, fewer annuity sales take place, as in cases in which annuity providers over-estimate the gains from trade, and the charge for re-assignment will make such trades unprofitable for the buyers and sellers.
- 1.104** Relative to the baseline, depending on the extent to which providers would exploit their *de facto* veto power, annuity providers have reduced profit. This reduction is a transfer from annuity providers to buyers and sellers. As noted above, this transfer is less than the sum of the amount by which buyers and sellers gain from lower re-assignment fees and the welfare gain from an increased number of profitable sales. This is a welfare benefit that accrues to buyers and sellers.
- 1.105** We believe that it is not reasonably practicable to estimate these benefits. In the absence of an existing market, there is no obvious way to estimate the gains from trade from annuity sales, and hence the amount that annuity providers could have an incentive to extract. Surveying potential buyers and sellers is unlikely to generate a reliable estimate, to the extent that it would not justify the costs of such an exercise (FSMA s138I(8)(b)).
- 1.106** We can, however, provide an illustration of the benefits of this policy. Supposing that the gains from trade range between 0 and 5% of the value of a typical annuity and are distributed uniformly. If such an annuity sells for £10,000, annuity providers would have an incentive to charge 2.5% of the value of such an annuity to re-assign, amounting to £250, and half of sales that would otherwise be profitable no longer take place. Imposing the policy results in a transfer from annuity providers to buyers and sellers of £250 for each sale that would have taken place in spite of the higher charges. It results in a welfare gain, equal to the size of the gains from trade for each new sale that takes place as a result of imposing the requirement.

### Costs

- 1.107** We expect that there will be some ongoing resource costs for annuity providers for the record keeping necessary to allow the firm to prove after the fact that it is following this rule. Assuming there are 37 annuity providers involved in buy back or facilitating assignment, and assuming £20,000 per firm per year record keeping costs on average due to the complexity, this gives a per year cost to the industry of £740,000. We would expect this to drop markedly in later years as fewer annuity providers are involved and fewer annuity holders request assignment/sell back.

## Supporting Measures

### Record keeping requirements

- 1.108** We intend to apply existing record keeping requirements<sup>83</sup> to firms in the secondary annuity market. This supporting measure is required to ensure that we can supervise and enforce the rules that we have proposed. Our new rules will involve firms needing to keep some new records, due to the effect of existing record keeping requirements.

<sup>83</sup> SYSC 9.1

**Benefits**

- 1.109** The application of existing record keeping rules to firms in the secondary annuity market will help ensure that firms retain the necessary data, information and intelligence to help us identify and assess risks in the secondary annuity market. The primary benefit of this will be in allowing us to supervise firms according to our rules as efficiently and effectively as possible. In doing so this will help deliver the benefits set out in the other sections of this CBA.

**Costs**

- 1.110** We expect the majority of firms will choose to automate the retention of records for the sale of the annuity income. Where this is automated we have estimated 21 hours and £2,000 one-off cost per firm to create the record keeping processes. Where it is not automated we have estimated 14 hours and no one-off cost.
- 1.111** In terms of ongoing costs, we have calculated these on the basis of the staff time it would take to keep records. If the process is automated we assume this to be zero. If the process is manual we assume it will take five minutes and therefore cost £1.67 per sale. Based on these estimates we believe the industry cost of the record keeping implications of our new proposed rules will be approximately £76,800 for the first three years (of which £39,560 are one-off costs and £37,245 are ongoing staff costs). This equates to around £1.87 per sale based on the smaller market scenario and £0.64 per sale based on the larger market scenario. Based on our estimates the average three year cost for a firm that automates the process would be £2,600. Were a firm to do this process manually we estimate that the average three year cost would be £11,735.

**Compensation and prudential arrangements****Compensation arrangements**

- 1.112** The new regulated activities of buying annuity incomes on the secondary market, buying back annuity incomes on the secondary market and acting as a market intermediary are already possible under existing regulated activities. They are classified as designated investment business. Under existing rules these activities would have fallen within the scope of the Financial Ombudsman Service and FSCS. Our interventions do not change existing substantive requirements for this activity, therefore costs and benefits versus the relevant baseline are zero.

**Prudential requirements**

- 1.113** The new regulated activities are already possible under existing regulated activities. They are classified as designated investment business. Under existing rules a firm that buys, or intermediates the sale, of secondary annuity incomes as its main activity would be subject to IPRU (INV) Chapter 13. A buyer would be classified as a Category B1 Firm (i.e. a Category B Personal Investment Firm whose permissions include dealing in non-MiFID investments as principal). An intermediary would be classified as a Category B2 or B3 Personal Investment Firm.
- 1.114** Our interventions do not change existing substantive requirements for this activity, therefore costs and benefits versus the relevant baseline are zero.

### Supervisory Manual

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**1.115** We propose amending the Supervision manual (SUP) to capture the application of the new regulated activities. We also propose extending the requirement to submit an appointed representatives annual report (SUP 16.9) to firms acting as market intermediaries and firms entering into regulated annuity buyback agreements.

#### Benefits

**1.116** The government has announced that firms will be permitted to engage appointed representatives to undertake these activities. The requirement to submit an appointed representatives annual report will allow us to monitor the use of appointed representatives for these activities.

#### Costs

**1.117** The appointed representatives regime already applies to firms who have an article 25(1) permission to arrange (bring about) deals in investment. We expect most firms who will apply for the new regulated annuity market permissions will already have article 25(1) permissions, and we expect that these changes will only apply additional requirements on between zero and two firms. For such firms, the only additional action that they will have to take to comply is to submit information that they already possess. Therefore, we believe that in most cases this requirement will already apply and additional industry costs will be of minimal significance.

### Other existing requirements that already apply to this market

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**1.118** We intend to continue to apply the existing FCA rules (SYSC, COBS, SUP, etc)<sup>84</sup> that already apply to this market. This does not change existing substantive requirements, so costs and benefits of the proposals versus the relevant baseline are zero.

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<sup>84</sup> Such as COBS 4, Financial Promotions.

## Annex 5

# Compatibility statement

- 1.1** We are required under section 138l(2)(d) of the Financial Services and Markets Act (FSMA) to explain why we believe our proposed rules are compatible with our strategic objective, advance one or more of our operational objectives, and have regard to the regulatory principles in section 3B of FSMA. We are also required by section 128k(2) of FSMA to state whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.
- 1.2** This Annex explains our reasons for concluding that our proposals relating to the Handbook rules in the consultation are compatible with these requirements under FSMA.

### Compatibility with our objectives

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- 1.3** Our proposals are intended to ensure that the secondary annuity market functions well and to advance our operational objective of: (i) securing an appropriate degree of protection for consumers; and (ii) promoting effective competition in the interests of consumers. We consider our proposals to be compatible with these objectives because:
- 1.4** They are based on our assessment of the risks applying to the secondary annuity market and the needs of consumers. The rules we are consulting on are about providing adequate information to help sellers to identify risks and make informed decisions. They are also intended to help the seller understand the value of their annuity.
- 1.5** The Government is changing the tax rules to allow individuals who are already receiving income from an annuity to be able to sell that income to a third party without punitive tax consequences. The Government has stated that, for most people, retaining an annuity will still be the best choice. It provides a regular, guaranteed income for life and many people will continue to value the security annuities provide. If a consumer decides to sell their annuity income our rules are aimed at enhancing the discourse by firms, helping sellers to shop around and make better decisions, and ultimately to drive competition in this market.
- 1.6** If consumers do not know the risks they face or if they get poor value from the market, they may lose faith in the market, allowing the market to lose integrity. We are proposing measures to help consumers understand the risks in the market and the value of their annuity to help mitigate this risk.

## Compatibility with our principles of regulation

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- 1.7 The need to use our resources in the most efficient and economical way:** We have had regard to this principle and do not believe that our proposals will have a significant impact on our resources or the way in which we use them. We have sought to be proportionate and rely on our existing rules where possible, avoiding additional regulatory costs and costs to industry. Due to the potential risks identified in the market, however, we are proposing to introduce additional rules.
- 1.8 The principle that a burden or restriction should be proportionate to the expected benefits:** Where required, in Annex 4, we have set out our analysis of the costs and benefits for relevant proposals. Overall, we believe that our proposals are a proportionate response to our concerns.
- 1.9 The desirability of sustainable growth in the economy of the United Kingdom in the medium and long term:** Our proposals have regard to the desirability of sustainable growth in the medium and long term. We do not expect the proposals to have a material impact on growth in the UK. The proposals set out in this consultation will impact the secondary annuity market. As set out in our CBA, it is difficult to estimate how many consumers will look into and ultimately sell their annuity income in the secondary annuity market but we do not believe that numbers will be significant enough to have a broader impact on UK growth in the medium and long term.
- 1.10 The general principle that consumers should take responsibility for their own decisions:** The secondary annuity market gives people a choice on whether to retain or sell the rights to their annuity income. Consumers need to decide what is best for them in their circumstances. Many of our proposals require firms to give consumers information to help them understand the implications of the decision and the value of their annuity to enable the consumer to make an informed decision.
- 1.11 The responsibilities of the senior management of persons subject to requirements imposed by or under FSMA, including those affecting consumers, in relation to compliance with those requirements:** The sale of annuities incomes falls within the definition of ‘designated investment business’. So they already within the scope of our wider requirements around approved persons. These will continue to apply to the three new regulated activities. As part of the authorisation process firms will have to identify the individuals who will be performing controlled functions, and so must be approved by us.
- 1.12 The desirability where appropriate of the FCA exercising its functions in a way that recognises differences in the nature and objectives of the business it regulates:** We have had regard to this principle and do not believe that our proposals undermine it. In particular, we recognise we are requiring that the annuity provider does not make a profit from facilitating the sale of an annuity income. Therefore, where possible, we have tried to minimise the regulatory burden on annuity providers for these regulated activities.
- 1.13 The desirability of publishing information in relation to persons:** We have had regard to this principle and do not believe our proposals undermine it. We have the power to publish information relating to investigations into firms and individuals. However as set out in the Enforcement Guide we will not normally make investigations or our findings or conclusions public except in exceptional circumstances. We will apply the same principles to the secondary annuity market.

- 1.14 The principle that we should exercise our function as transparently as possible:** We have met with industry and consumer groups to explain our approach during the process of developing these proposals. We are using this consultation paper to seek further input into the approach we adopt. We invite feedback to help shape the final rules to be introduced.
- 1.15 Compatibility with our competition duty:** We have a duty to discharge our general functions in a way that promotes effective competition in the interest of consumers (section 1B(4) FSMA). As noted above, our rules are aimed at enhancing the disclosure by firms, helping sellers to make better decisions and shop around and ultimately to drive competition in this market.
- 1.16 Impact on mutual societies:** Section 138k of FSMA requires us to prepare a statement about the impact of proposed rules on mutual societies. In particular, we are required to set out whether this will be significantly different from their impact on other authorised persons and, if so, give details of the difference. We do not expect the proposals in this paper to have a significantly different impact on mutual societies than other authorised persons or give them with more or less of a burden than other authorised persons.
- 1.17 Legislative and Regulatory Reform Act 2006 (LRRRA):** We are required under the LRRRA to have regard to the principles in the LRRRA and to the Regulator's Compliance Code when determining general policies and principles and giving general guidance (but this duty does not apply to regulatory functions exercisable through our rules). We have regard to the principles in the LRRRA and the Regulator's Compliance Code for the parts of the proposals that consist of general policies, principles or guidance. We have engaged with firms throughout this process, and consider that the proposals are proportionate and result in an appropriate level of consumer protection, when balanced with impacts on firms and on competition.

# Appendix 1

## Draft Handbook text

## SECONDARY ANNUITIES MARKET INSTRUMENT 2016

### Powers exercised by the Financial Ombudsman Service

- A. The Financial Ombudsman Service Limited makes and amends the voluntary jurisdiction rules and fixes and varies the standard terms for voluntary jurisdiction participants as set out in Annexes A and E to this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 227 (Voluntary jurisdiction);
  - (2) paragraph 8 (Guidance) of Schedule 17;
  - (3) paragraph 18 (Terms of reference to the scheme) of Schedule 17; and
  - (4) paragraph 22 (Consultation) of Schedule 17.
- B. The making and amendment of the voluntary jurisdiction rules and the fixing and variation of the standard terms by the Financial Ombudsman Service Limited, as set out in Annexes A and E, are subject to the approval of the Financial Conduct Authority.

### Powers exercised by the Financial Conduct Authority

- C. The Financial Conduct Authority makes this instrument in the exercise of the powers and related provisions in or under:
- (1) the following sections of the Act:
    - (a) section 59 (Approval for particular arrangements);
    - (b) section 137A (The FCA’s general rules);
    - (c) section 137B (FCA general rules: clients’ money, right to rescind etc);
    - (d) section 137FBA (FCA general rules: advice about transferring or otherwise dealing with annuity payments);
    - (e) section 137R (Financial promotion rules);
    - (f) section 137T (General supplementary powers);
    - (g) section 138C (Evidential provisions);
    - (h) section 139A (Power of the FCA to give guidance);
    - (i) section 213 (The compensation scheme);
    - (j) section 214 (General);
    - (k) section 226 (Compulsory jurisdiction);
    - (l) section 234 (Industry funding);
    - (m) paragraph 23 (Fees) of Part 3 (Penalties and Fees) of Schedule 1ZA (the Financial Conduct Authority);
    - (n) paragraph 12 (Funding of the relevant costs by authorised persons) of Part 2 (Funding) of Schedule 1A (Further provision about the consumer protection financial education body); and
    - (o) paragraph 13 (Authority’s procedural rules) of Schedule 17; and
  - (2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.

- D. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.
- E. The Financial Conduct Authority approves the voluntary jurisdiction rules made and amended, and the standard terms fixed and varied, by the Financial Ombudsman Service Limited in this instrument.

### Commencement

- F. This instrument comes into force on [date].

### Amendments to the Handbook

- G. The modules of the FCA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2) below:

(1)	(2)
Glossary	Annex A
Fees manual (FEES)	Annex B
Conduct of Business sourcebook (COBS)	Annex C
Supervision manual (SUP)	Annex D
Disputes Resolutions: Complaints sourcebook (DISP)	Annex E

### Amendments to material outside the Handbook

- H. The Perimeter Guidance manual (PERG) is amended in accordance with Annex F to this instrument. The general guidance in PERG does not form part of the Handbook.

### Citation

- I. This instrument may be cited as the Secondary Annuities Market Instrument 2016.

By order of the Board of the Financial Ombudsman Service Limited

[date]

By order of the Board of the Financial Conduct Authority

[date]

## Annex A

### Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical position. This text is not underlined.

<i>annuity assignment agreement</i>	in accordance with article 52D(2)(b) of the <i>Regulated Activities Order</i> , an arrangement which results in a <i>policyholder</i> selling to a <i>person</i> their <i>annuity income stream</i> .
<i>annuity buyback agreement</i>	in accordance with article 52E(2)(b) of the <i>Regulated Activities Order</i> , an arrangement which results in a <i>policyholder</i> selling back to the annuity provider their <i>annuity income stream</i> .
<i>annuity income stream</i>	the right or rights to payments under a <i>pension annuity</i> (which may include any ancillary rights relating to those payments under the <i>pension annuity</i> ).
<i>entering into a regulated annuity assignment agreement as a purchaser</i>	the <i>regulated activity</i> , specified in article 52D(1) of the <i>Regulated Activities Order</i> .
<i>entering into a regulated annuity buyback agreement as an annuity provider</i>	the <i>regulated activity</i> , specified in article 52E(1) of the <i>Regulated Activities Order</i> .
<i>regulated annuity assignment agreement</i>	in accordance with article 52D(2)(a) of the <i>Regulated Activities Order</i> , an <i>annuity assignment agreement</i> which is not an exempt assignment agreement under article 52D(d) of the <i>Regulated Activities Order</i> .
<i>regulated annuity broking</i>	the <i>regulated activity</i> , specified in article 52F(2)(a) of the <i>Regulated Activities Order</i> , which is in summary any of:  (a) entering into a <i>regulated annuity assignment agreement</i> or a <i>regulated annuity buyback agreement</i> as agent; or  (b) making arrangements for another <i>person</i> (whether as <i>principal</i> or agent) to enter into a <i>regulated annuity assignment agreement</i> or a <i>regulated annuity buyback agreement</i> ; or

- (c) making arrangements with a view to another *person* who participates in the arrangements entering into a *regulated annuity assignment agreement* or a *regulated annuity buyback agreement*.

*regulated annuity buyback agreement* in accordance with article 52E(2)(a) of the *Regulated Activities Order*, an *annuity buyback agreement* which is not an exempt annuity buyback agreement under article 52E(2)(e) of the *Regulated Activities Order*.

*secondary annuities market activities* in relation to arrangements which are intended to result in the purchase of an *annuity income stream* from a *policyholder*, any of the following activities:

- (1) *entering into a regulated annuity assignment agreement as a purchaser*; or
- (2) *entering into a regulated annuity buyback agreement as an annuity provider*; or
- (3) *regulated annuity broking*; or
- (4) when carried on by an annuity provider in relation to the *pension annuity* from which the *annuity income stream* is paid, *arranging deals in investments* or *carrying out contracts of insurance*.

Amend the following definitions as shown.

*arranging* ...

(e) *regulated annuity broking or agreeing to carry on that regulated activity*.

*category B1 firm* a *category B firm* whose *permission* includes *dealing in investments as principal, or entering into a regulated annuity assignment agreement as a purchaser, or both*.

*category B2 firm* a *category B firm* whose *permission* does not include *dealing as principal, or entering into a regulated annuity assignment agreement as a purchaser, or both*; and is not subject to a *requirement* preventing the holding or controlling of *client money* or *custody assets*.

*category B3 firm* a *category B firm*:

- (a) whose *permission* includes only *insurance mediation activity* in relation to *non-investment insurance contracts*, *home finance mediation activity*, *assisting in the administration and performance of contracts of insurances*, *arranging transactions in life policies* and other insurance contracts, *advising on investments (except P2P agreements)* and receiving and

transmitting, on behalf of investors, orders in relation to *securities* and units in *collective investment schemes*, *advising on P2P agreements*, *regulated annuity broking*; and

(b) ...

*controlled activity* ...

(ta) entering into a regulated annuity assignment agreement as a purchaser (paragraph 10L);

(tb) entering into a regulated annuity buyback agreement as an annuity provider (paragraph 10N);

(tc) regulated annuity broking (paragraph 10M);

...

*designated investment business*

any of the following activities, specified in Part II of the *Regulated Activities Order* (Specified Activities), which is carried on by way of business:

...

(lc) entering into a regulated annuity assignment agreement as a purchaser (article 52D(1));

(ld) entering into a regulated annuity buyback agreement as an annuity provider (article 52E(1));

(le) regulated annuity broking (article 52F(1));

...

*personal investment firm*

a firm whose permitted activities include *designated investment business*, which is not an *authorised professional firm*, *bank*, *IFPRU investment firm*, *BIPRU firm*, *building society*, *collective portfolio management firm*, *credit union*, *energy market participant*, *ICVC*, *insurer*, *media firm*, *oil market participant*, *service company*, *incoming EEA firm* (without a *top-up permission*), *incoming Treaty firm* (without a *top-up permission*) or *UCITS qualifier* (without a *top-up permission*), whose permission does not include a requirement that it comply with *IPRU(INV) 3* (Securities and futures firms) or 5 (Investment management firms), and which is within (a), (b) or (c):

...

(c) a firm:

...

(ii) for which the most substantial part of its gross income

(including commissions) from the *designated investment business* included in its *Part 4A permission* is derived from one or more of the following activities (based, for a *firm* given a *Part 4A permission* after *commencement*, on the business plan submitted as part of the *firm's* application for *permission* or, for a *firm* authorised under section 25 of the Financial Services Act 1986, on the *firm's* financial year preceding its *authorisation* under the *Act*):

...

(C) *advising on P2P agreements*; and

(D) *entering into a regulated annuity assignment agreement as a purchaser or regulated annuity broking.*

*regulated activity* ...

(B) in the *FCA Handbook*: (in accordance with section 22 of the *Act* (Regulated activities) the activities specified in Part II of the *Regulated Activities Order* (Specified Activities) which are, in summary:

...

(oc) *entering into a regulated annuity assignment agreement as a purchaser* (article 52D(1));

(od) *entering into a regulated annuity buyback agreement as an annuity provider* (article 52E(1));

(oe) *regulated annuity broking* (article 52F(1));

...

...

*securities and futures firm*

a *firm* whose *permitted activities* include *designated investment business* or *bidding in emissions auctions*, which is not an *authorised professional firm*, *bank*, *BIPRU firm* (unless it is an *exempt BIPRU commodities firm*), *IFPRU investment firm* (unless it is an *exempt IFPRU investment firm*), *building society*, *collective portfolio management firm*, *credit union*, *friendly society*, *ICVC*, *insurer*, *media firm*, *service company*, *incoming EEA firm* (without a *top-up permission*), *incoming Treaty firm* (without a *top-up permission*) or *UCITS qualifier* (without a *top-up permission*), whose permission does not include a *requirement* that it comply with *IPRU(INV) 5* (Investment management firms) or 13 (Personal investment firms), and which is within (a), (b), (c), (d), (e), (f), (g), (ga), or (h):

...

(c) a *firm*:

...

(ii) for which the most substantial part of its gross income (including commissions) from the *designated investment business* included in its *Part 4A permission* is derived from one or more of the following activities (based, for a *firm* given a *Part 4A permission* after *commencement*, on the business plan submitted as part of the *firm's* application for *permission* or, for a *firm* authorised under section 25 of the Financial Services Act 1986, on the *firm's financial year* preceding its *authorisation* under the *Act*):

...

(D) *dealing* (excluding: (i) in the case of a *home finance provider*, *dealing as principal* in *contractually based investments* where this activity is carried out for risk management purposes and would have been excluded under article 16 of the *Regulated Activities Order* if the *firm* were an *unauthorised person* or under article 19 of the *Regulated Activities Order*); and (ii) *regulated annuity broking or entering into a regulated annuity assignment agreement as a purchaser, arranging (bringing about) deals in investments or making arrangements with a view to transactions in investments, in securities or derivatives*);

...

**Annex B**

**Amendments to the Fees manual (FEES)**

In this Annex, underlining indicates new text and striking through indicates deleted text.

**4 Periodic fees**

...

**4 Annex FCA Activity groups, tariff bases and valuation dates**

**1AR**

Part 1	
This table shows how the <i>FCA</i> links the <i>regulated activities</i> for which a <i>firm</i> has <i>permission</i> to activity groups (fee-blocks). A <i>firm</i> can use the table to identify which fee-blocks it falls into based on its <i>permission</i> .	
Activity group	Fee payer falls in the activity group if
...	
<b>A.10 Firms dealing as principal</b>	<p><u>(1)</u> its <i>permission</i> includes:</p> <p>(a) <i>dealing in investments as principal</i>; and/or</p> <p>(b) <i>bidding in emissions auctions</i>; and/or</p> <p><u>(c)</u> <u><i>entering into a regulated annuity assignment agreements as a purchaser</i></u>; and/or</p> <p><u>(d)</u> <u><i>entering into a regulated annuity buyback agreement as an annuity provider</i></u>;</p> <p><u>(2) BUT NOT</u>, except when (1)(c) and/or (d) is applicable, if one or more of the following apply:</p> <p>...</p> <p>its <i>permission</i> includes either:</p> <ul style="list-style-type: none"> <li>- <i>effecting contracts of insurance</i>; or</li> <li>- <i>carrying out contracts of insurance</i>.</li> </ul>
<b>A.13 Advisors, arrangers, dealers or brokers</b>	(1) ...

	<b>OR</b>
	<i>(1A) its permission includes regulated annuity broking;</i>
	<b><u>OR</u></b>
	<i>(2) ...</i>
...	
<p>Part 3</p> <p>This table indicates the tariff base for each fee-block set out in Part 1.</p> <p>The tariff base in this Part is the means by which the <i>FCA</i> measures the amount of business conducted by a <i>firm</i> for the purposes of calculating the annual periodic fees payable to the <i>FCA</i> by that <i>firm</i>.</p>	
Activity Group	Tariff base
...	
<b>A.10</b>	<p><b>NUMBER OF TRADERS</b></p> <p>An <i>employee</i> or agent, who:</p> <p>...</p> <p>as part of their duties in relation to those activities of the <i>authorised person</i>, <u>in the course of regulated activities</u> commits the <i>firm</i> in: <del>market dealings or in transactions in securities or in other specified investments in the course of regulated activities.</del></p>
	<p>(a) <u>market dealings or in transactions in securities or in other specified investments (unless the firm's permission includes effecting or carrying out contracts of insurance); or</u></p>
	<p>(b) <u>transactions related to entering into a regulated annuity assignment agreement as a purchaser or entering into a regulated annuity buyback agreement as an annuity provider.</u></p>
...	

**FEES 6 Financial Services Compensation Scheme Funding**

...

<b>FEES 6 ANNEX 3A Financial Services Compensation Scheme – classes</b>		
		This Table belongs to <i>FEES 6.4.7AR</i> and <i>FEES 6.5.6AR</i>
...		
<b>Class C2</b>	Life and Pensions Intermediation	
<b>Firms with permission for:</b>	Any of the following:	
	...	
	<i>providing basic advice on a stakeholder product;</i>	
	<i>entering into a regulated annuity assignment agreement as a purchaser;</i>	
	<i>entering into a regulated annuity buyback agreement as an annuity provider;</i>	
	<i>regulated annuity broking;</i>	
	<i>agreeing to carry on a regulated activity which is within any of the above;</i>	
...		
<b>Tariff base</b>	...	
	Class C2: <i>annual eligible income</i> where <i>annual eligible income</i> means annual income adjusted in accordance with this table. Annual income is calculated as the sum of (a) and (b):	
	(a) the net amount retained by the <i>firm</i> of all brokerages, fees, commissions and other related income (for example, administration charges, overrides and profit shares) due to the <i>firm</i> in respect of or in relation to <i>class C2</i> activities including any income received from an <i>insurer</i> ; and	
	(b) if the <i>firm</i> is a life and pensions <i>firm</i> , in relation to the <i>class C2</i> activities,	
	(i)	the amount of <i>premiums</i> or commission receivable on its life and pensions contracts multiplied by 0.07, excluding those life and pensions contracts which result from <i>class C2</i> activities carried out by another <i>firm</i> , where a payment has been made by the life and pensions <i>firm</i> to that other <i>firm</i> and that payment is of a type that falls under (a)-; <u>and</u>

	(ii)	<u>in relation to the entering into of regulated annuity buyback agreements, the amount of the annuity income stream that would have been payable by the life and pensions firm if it had not entered into the regulated annuity buyback agreement, for each of the relevant years.</u>
Notes relating to the calculation of tariff base for class C2:		
(1)	...	
...		
(7)	<u>For the purposes of paragraph (b)(ii), the relevant years will be each of the years in which the annuity income stream would have been payable, based upon the longevity assumption applied by the firm in their calculation of the price paid for the purchase of the annuity income stream.</u>	
	...	

Annex C

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

COBS 15 Cancellation			
<b>15.1</b>	<b>Application</b>		
15.1.1	G	This chapter is relevant to a <i>firm</i> that enters into a contract cancellable under this chapter. In summary, this means it is relevant to:	
		...	
		(3)	<i>firms</i> that enter into <i>distance contracts</i> the making or performance of which by the <i>firm</i> constitutes, or is part of, the activity of <i>issuing electronic money</i> ; <del>;</del> <u>and</u>
		(4)	<u><i>firms that enter into regulated annuity assignment agreements or enter into regulated annuity buyback agreements.</i></u>
<b>15.2</b>	<b>The right to cancel</b>		
		Cancellable contracts	
15.2.1	R	A <i>consumer</i> has a right to cancel any of the following contracts with a <i>firm</i> :	
		<b>Cancellable contract</b>	<b>Cancellation period</b>
		<b>Supplementary provisions</b>	
		<b>Life and pensions:</b>	
		...	...
		<b><u>Annuity income streams:</u></b>	
		• a contract to sell an <u><i>annuity income stream</i></u> (by way of a <u><i>regulated annuity assignment agreement</i></u> or a <u><i>regulated annuity buyback agreement</i></u> )	<u>14 calendar days</u>
			<u>Exemptions may apply (see COBS 15 Annex 1 )</u>
		<b>Cash deposit ISAs:</b>	
		...	

<b>COBS 15 Annex 1 Exemptions from the right to cancel</b>		
...		
1.2	G	There is no right to cancel a non- <i>distance contract</i> for a <i>traded life policy</i> <u>except where a <i>policyholder</i> sells an <i>annuity income stream</i> (by way of a <i>regulated annuity assignment agreement</i> or a <i>regulated annuity buyback agreement</i>)</u> . This is because the 30-day right to cancel a <i>life policy</i> (in COBS 15.2.1R) applies at the point of conclusion of the <i>life policy</i> not on its assignment. However, there may be a 14-day right to cancel a <i>distance contract</i> for a <i>traded life policy</i> unless an exemption applies, since that <i>distance contract</i> relates to <i>designated investment business</i> .
...		
<u>Exemptions for <i>secondary annuities market activity</i> (the 'cancellation substitute')</u>		
<u>1.5A</u>	<u>R</u>	<u>There is no right to cancel a <i>regulated annuity assignment agreement</i> or a <i>regulated annuity buyback agreement</i> to the extent that the right to cancel is replaced with a pre-contract right for the <i>consumer</i> to withdraw from the agreement of at least 14 calendar days.</u>
...		

In this part of the Annex, the text is all new and is not underlined.

## **COBS 23 Purchase or buyback of annuity income streams**

### **23.1 Interpretation**

23.1.1 R In this chapter:

- (1) ‘annuity sale information’ is the information specified in COBS 23.3.5R which is provided to assist the *policyholder* to make an informed decision about the option to *sell* their *annuity income stream*;
- (2) ‘appropriate advice’ is advice in relation to the sale of an *annuity income stream* as required by section 137FBA of the *Act*;
- (3) ‘broker’ is a *firm* which carries out *regulated annuity broking*;
- (4) “facilitating”, in relation to a provider is carrying on an activity specified in article 25 of the *Regulated Activities Order* (Arranging deals in investments) or article 10 of the *Regulated Activities Order* (Effecting and carrying out contracts of insurance) in relation to a *sale* by a *policyholder* of an *annuity income stream*;

- (5) 'provider' is the *person* paying the *annuity income stream* to the *policyholder*; and
- (6) 'quotation' is the amount offered to purchase the *policyholder's annuity income stream*.

## 23.2 Application and purpose

### Application

- 23.2.1 R This chapter applies to a firm carrying out *secondary annuities market activity* where the *policyholder* is a *retail client*.
- 23.2.2 G There is a summary of the application of this chapter, where the transaction involves an authorised buyer, broker and provider, in *COBS 23 Annex 1*. [to be added following consultation]

### Purpose

- 23.2.3 G This chapter specifies:
  - (1) the circumstances in which a *firm* communicating with a *policyholder* about the sale of their *annuity income stream* must:
    - (a) provide the *policyholder* with risk warnings;
    - (b) signpost *pensions guidance* and advice; and
    - (c) provide timely and relevant information to enable a *policyholder* to make an informed decision about whether to *sell* their *annuity income stream* on the open market;
  - (2) how a *firm* carrying out a *secondary annuities market activity* can be remunerated for its services;
  - (3) the checks a *firm* must make before a *policyholder* can *sell* their *annuity income stream*; and
  - (4) guidance on how *firms* can meet their obligations in relation to the Mental Capacity Act 2005.
- 23.2.4 G This chapter amplifies *Principles 6* and *7*, but does not exhaust or restrict what those *principles* require. A *firm* will, in any event, need to ensure that its sale processes are consistent with the *Principles* and other *rules*.

## 23.3 Buying, broking or facilitating the sale of, an annuity income stream

Steps to buy, broker or facilitate the sale of, annuity income streams

- 23.3.1 G (1) The purpose of this section is to ensure that *policyholders* are given timely and relevant information to assist them to make an informed decision about the sale of their *annuity income stream* and to encourage them to shop around.
- (2) This section describes the steps to be taken by a *firm* or *firms* before a *policyholder* can *sell* their *annuity income stream*.
- (3) The steps, which are to be taken by the *firm* specified in the relevant *rules*, are in general to:
- (a) give the *policyholder* the annuity sale information;
  - (b) provide the *policyholder* with a quotation to purchase the *annuity income stream*; and
  - (c) complete the checks required so that the *policyholder* can *sell* the *annuity income stream*.
- (4) A *firm* which is involved in the sale of an *annuity income stream* by a *policyholder* will not always be required to take each of the steps.

Annuity sale information

- 23.3.2 R A *firm* must give the *policyholder* the annuity sale information in a *durable medium* at the point when a *policyholder*:
- (1) tells the *firm* that they have decided (in principle or definitively) to *sell* their *annuity income stream*; or
  - (2) requests information or advice from the *firm* about how to *sell* their *annuity income stream*; or
  - (3) requests a quotation from the *firm* for the purchase of their *annuity income stream*; or
  - (4) approaches a provider to facilitate the *sale* of an *annuity income stream*;
- unless the circumstances in *COBS* 23.3.3R apply.
- 23.3.3 R A *firm* is not required to give the *policyholder* the annuity sale information in the following cases:
- (1) where it has already done so and the *firm* has reasonable grounds to believe that the annuity sale information is still accurate and appropriate; or
  - (2) where the *policyholder* has received the annuity sale information from another *firm*; and
    - (a) the *firm* obtains a copy of the annuity sale information in a *durable medium* from the *policyholder*; and
    - (b) the annuity sale information is still accurate and appropriate.

- 23.3.4 R Where a *firm* communicates with a *policyholder* through the internet or other electronic media, the *firm* must treat the *policyholder* as having met one of the conditions set out in *COBS 23.3.2R* where the *policyholder* accesses information produced by the *firm* on the internet or other media which is reasonably likely to assist the *policyholder* in taking any of the actions set out in *COBS 23.3.2R*.
- 23.3.5 R The annuity sale information must include:
- (1) a recommendation that the *policyholder* seeks appropriate guidance or advice to understand their options in retirement;
  - (2) information about the availability of and how to access *pensions guidance*;
  - (3) the risk warnings specified in *COBS 23 Annex 2*; [to be added following consultation]
  - (4) information that the sale of any *annuity income stream* may be conditional upon:
    - (a) the *policyholder* receiving appropriate advice; and
    - (b) *beneficiaries*' written consent to *sell* the *annuity income stream*;
  - (5) a recommendation that the *policyholder* shop around to receive the best possible price for their *annuity income stream*;
  - (6) information that a sale may be subject to other charges and costs (including estimates of those other costs and charges where available); and
  - (7) information that a sale may be subject to the provider recovering their reasonable costs incurred for facilitating the sale of the *annuity income stream* and that these costs may be recovered directly or indirectly from the sale proceeds.
- 23.3.6 R A *firm* must obtain confirmation that the *policyholder* has received the annuity sale information before taking further action in relation to the sale.
- 23.3.7 G When communicating the annuity sale information a *firm* should:
- (1) communicate the information and disclosures clearly and prominently; and
  - (2) deliver the information and disclosures in a form which best supports the *policyholder* in understanding the information and its relevance to any decisions they take in relation to their *annuity income stream*.

#### Quotation

- 23.3.8 R When a firm provides a quotation, the quotation must:
- (1) be provided in a *durable medium* in the relevant form specified in *COBS 23 Annex 3*;

- (2) be presented as a single capital sum in pounds sterling;
- (3) include a comparison between:
  - (a) the amount offered for the *policyholder's annuity income stream* (the offer); and
  - (b) the cost of purchasing a *pension annuity* of equal value with the same characteristics as the *policyholder's pension annuity* on the open market at the date on which the offer is made (the comparator);
- (4) (if prepared by a broker) include details of all the bids received for the *annuity income stream* in descending order of price, with the highest bid being presented first;
- (5) where initially provided as part of a telephone call:
  - (a) not be provided until the *policyholder* has first been provided (on the same call) with details of the comparator produced under (3)(b); and
  - (b) be provided in a *durable medium* in good time before the *policyholder* is bound by the offer;
- (6) be net of the *firm's* estimated charges and costs; and
- (7) not be linked to any other products or services offered by the *firm*.

23.3.9 G A *firm* should use the same details (including any medical details) to determine the comparator as it has used to create the quotation.

23.3.10 R Where a *firm* is unable to identify a comparator for the purposes of COBS 23.3.8R (3)(b) it must:

- (1) use reasonable efforts to estimate what a comparator with similar characteristics to the *policyholder's pension annuity* would cost on the open market;
- (2) make available, on the *policyholder's* request, information about the difference between the comparator used and the *policyholder's pension annuity*; and
- (3) present the quotation on form 2 of COBS 23 Annex 3 [to be added following consultation]

23.3.11 R A *firm* is not required to present a quotation in the format specified in COBS 23 Annex 3 or include a comparator in any quotation where the *policyholder* is 90 years of age or older.

Pre-sale check: appropriate advice

23.3.12 R A *firm* must not:

- (1) enter into a *regulated annuity assignment agreement* (whether as *agent* or as *principal*);
- (2) enter into a *regulated annuity buyback agreement* (whether as *agent* or as *principal*); or
- (3) (where the *firm* is carrying on *regulated annuity broking*) make arrangements for another *person* (whether as *principal* or *agent*) to enter into a *regulated annuity assignment agreement* or a *regulated annuity buyback agreement*; or
- (4) (where the *firm* is a provider) facilitate the sale of an *annuity income stream* by a *policyholder*;

unless the appropriate advice check (see *COBS 23.3.14R*) has been completed.

23.3.13 R The appropriate advice check must be undertaken by:

- (1) where the provider is a *firm*, the provider; or
- (2) where the provider is not a *firm*;
  - (a) where there is a broker, the broker; or
  - (b) where there is no broker, the buyer where the buyer is a *firm*.

23.3.14 R The appropriate advice check is that the *firm* must:

- (1) check whether section 137FBA of the *Act* requires the *policyholder* to obtain appropriate advice; and
- (2) if so, obtain confirmation that the *policyholder* has received it, in the form of a statement in a *durable medium* from the adviser providing the advice confirming:
  - (a) that advice has been given which meets the criteria specified in regulations made by the Treasury;
  - (b) that the adviser has the status required by the regulations; and
  - (c) the name of the *policyholder*.

Pre-sale check: beneficiaries' consent

23.3.15 R A provider which is a *firm* must not *enter into a regulated annuity buyback agreement as an annuity provider* or facilitate the sale of a *policyholder's annuity income stream* unless it has made reasonable efforts to obtain the written consent to the sale from any other *beneficiaries* whose consent is legally required.

23.3.16 E (1) A *firm* may be considered to have made reasonable efforts to obtain *beneficiaries' consent* if it:

- (a) identifies the category or categories of *beneficiaries* whose consent is

legally required;

- (b) asks the *policyholder* (or a *person* acting on their behalf) to obtain and provide to the *firm* the written consent of *persons* who are within the categories of *beneficiaries* identified as a result of (a); and
  - (c) provides the *policyholder* with a written consent form which contains a clear explanation of the rights being given up by the *beneficiaries*.
- (2) Compliance with (1)(a) to (c) may be relied on as tending to establish compliance with *COBS* 23.3.15R.

Sales where the only firm involved is the provider: comparator information

- 23.3.17 R (1) A provider which is asked to facilitate the sale of a *policyholder's annuity income stream* must, before doing so, ask the *policyholder* whether there is a *firm* acting as a buyer or broker in relation to the sale.
- (2) Following the enquiry in (1), where the provider knows or ought reasonably to know that there is no *firm* acting as a buyer or broker in relation to the sale, the provider must:
- (a) require the *policyholder* to give the provider all information relating to the *policyholder's* health which was provided to the *person* who has offered to buy or arrange the sale of the *policyholder's annuity income stream*;
  - (b) warn the *policyholder* that they should do so fully and accurately; and
  - (c) using any information provided as a result of (a), provide the *policyholder* with the information in a *durable medium* on form 3 as specified in *COBS* 23 Annex 3 about the cost of purchasing a *pension annuity* of equal value with the same characteristics as the *policyholder's pension annuity* on the open market.
- (3) *COBS* 23.3.10R applies to a provider in relation to the requirement in (2) (but the provider must still use form 3 of *COBS* 23 Annex 3).
- (4) This rule does not apply where the *policyholder* is 90 years of age or older.

## 23.4 Brokers: panel disclosure, costs and charges

Panel disclosure

- 23.4.1 R A broker must at first contact provide a *policyholder* with details of the number of potential buyers for the *policyholder's annuity income stream* and details of the broker's relationship with the potential buyers.

Requirement to be paid through broker charges

23.4.2 R A broker must:

- (1) only be remunerated for its *secondary annuities market activities* (and any other related services provided by the *firm*) carried on with or for a *policyholder* in accordance with this section;
- (2) not solicit or accept (and ensure that none of its *associates* solicits or accepts) any other commissions, remuneration or benefit of any kind in relation to *secondary annuities market activities* (and any other related services provided by the *firm*) carried on with or for a *policyholder*, regardless of whether it intends to refund the payments or pass the benefits on to the *policyholder*;
- (3) not accept any remuneration for *secondary annuities market activities* carried on with or for a *policyholder* which is paid out or advanced by another party over a materially different time period, or on a materially different basis, from that in or on which its remuneration is recovered from the *policyholder*; and
- (4) agree with a *policyholder* at first contact the charging structure for its *secondary annuities market activities* (and any other related services provided by the *firm*) carried on with or for the *policyholder*.

Broker charging structure

23.4.3 R A broker's charging structure must:

- (1) include details of the type and estimated size of any contingent or conditional costs the *policyholder* may have to pay in order to complete the sale of their *annuity income stream*;
- (2) provide for the broker to be remunerated for their services carried on with or for a *policyholder* in one of the following ways:
  - (a) a set amount which does not vary according to the quotations received; or
  - (b) a percentage of the quotation received for the *annuity income stream*; or
  - (c) a fee determined by reference to the value of the quotation provided to the *policyholder* for any *annuity income stream*; or
  - (d) a combination of the above; and
- (3) not be linked to any other products or services offered by the *firm*.

**23.5 Charges for a provider's costs**

- 23.5.1 R A provider which is facilitating the sale of an *annuity income stream* by a *policyholder* or buying back an *annuity income stream* from a *policyholder* can only charge the *policyholder* the reasonable costs incurred (or reasonably expected to be

incurred) in doing so.

- 23.5.2 G A provider's charges can be imposed directly upon the *policyholder* or can be deducted from the proceeds of sale.

## 23.6 Mental capacity guidance

- 23.6.1 G This section applies to a *firm* in relation to *secondary annuities market activities*.
- 23.6.2 G (1) The Mental Capacity Act 2005 sets out the legal framework concerning mental capacity for England and Wales. The Ministry of Justice has issued the Mental Capacity Act Code of Practice which, among other things, includes information on indications of mental capacity limitations and on how to assist people with making decisions.
- (2) The Adults with Incapacity (Scotland) Act 2000 provides the framework in Scotland for safeguarding the welfare and managing the finances of adults who lack capacity due to mental disorder or inability to communicate.
- (3) References in this section to a *firm's* knowledge, understanding, observation, suspicion, assumption or belief include that of the *firm's* employees, *appointed representatives*, agents and any others who act on behalf of the *firm*.
- (4) When advising a policyholder in relation to *secondary annuities market activities*, a *firm* should consider the customer's individual circumstances.

### Mental capacity

- 23.6.3 G Mental capacity is a person's ability to make a decision. Whether or not a *policyholder* has the ability to understand, remember, and weigh up relevant information will determine whether the *policyholder* is able to make a responsible decision to *sell* their *annuity income stream* based on that information.
- 23.6.4 G A *firm* should assume a *policyholder* has mental capacity at the time the decision has to be made, unless the *firm* knows, or is told by a person it reasonably believes should know, or reasonably suspects, that the *policyholder* lacks capacity.
- 23.6.5 G Where a *firm* reasonably suspects a *policyholder* has, or may have, some form of mental capacity limitation which would constrain the *policyholder's* ability to make a decision to *sell* their *annuity income stream*, the *firm* should not regard the *policyholder* as lacking capacity to make the decision unless the *firm* has taken reasonable steps without success to assist the *policyholder* to make a decision.
- 23.6.6 G Amongst the most common potential causes of mental capacity limitations are the following examples: a mental health condition, dementia, a learning disability, a developmental disorder, a neurological disability or brain injury and alcohol or drug (including prescribed drugs) induced intoxication.
- 23.6.7 G Where a *firm* understands or reasonably suspects a *policyholder* has a condition of a type in COBS 23.6.6G, this does not necessarily mean that the *policyholder* does not

have the mental capacity to make an informed decision to *sell* their *annuity income stream*. See also *COBS* 23.6.15G.

Indications that a person may have some form of mental capacity limitation

23.6.8 G A *firm* is likely to have reasonable grounds to suspect a *policyholder* may have some form of mental capacity limitation if the *firm* observes a specific indication (behavioural or otherwise) that could be indicative of some form of limitation of the *policyholder's* mental capacity. Examples (amongst others) of indications might include:

- (1) where a *firm* has an existing relationship with a *policyholder*, the *policyholder* making a decision that appears to the *firm* to be unexpected or out of character;
- (2) a person who is likely to have an informed view of the matter, such as a relative, close friend, carer or clinician, raising a concern with the *firm* as to the capacity of the *policyholder* to make a decision about *selling* their *annuity income stream*;
- (3) the *firm* understands or has reason to believe the *policyholder* has been diagnosed as having an impairment which led to the *policyholder* not having had mental capacity for similar decisions in the past;
- (4) the *firm* understands or has reason to believe the *policyholder* does not understand what the *policyholder* is proposing to do;
- (5) the *firm* understands or has reason to believe the *policyholder* is unable to understand the information and explanations provided by the *firm*, in particular concerning the key risks of entering into the agreement;
- (6) the *firm* understands or has reason to believe the *policyholder* is unable to retain information and explanations provided by the *firm* to enable the *policyholder* to make the decision to *sell* their *annuity income stream*;
- (7) the *firm* understands or has reason to believe the *policyholder* is unable to weigh up the information and explanations provided by the *firm* to enable the *policyholder* to make the decision to *sell* their *annuity income stream*;
- (8) the *policyholder* is unable to communicate a decision to *sell* by any reasonable means; and
- (9) the *policyholder* being confused about the personal information that the *firm* requires, such as date of birth or address.

Practices and procedures

23.6.9 G A *firm* should not unfairly discriminate against a *policyholder* who it understands, or reasonably suspects, has a mental capacity limitation, in particular, by inappropriately denying the *policyholder* the ability to *sell* their *annuity income stream*.

- 23.6.10 G In accordance with *Principle 6*, *firms* should take reasonable steps to ensure they have suitable business practices and procedures in place for the fair treatment of *policyholders* who they understand, or reasonably suspect, have or may have a mental capacity limitation.
- 23.6.11 G A *firm* should document practices and procedures to set out the steps that it takes when it receives contact from *policyholders* proposing to *sell* their *annuity income stream*.
- 23.6.12 G Where a *firm* understands, or reasonably suspects, a *policyholder* has or may have a mental capacity limitation, the *firm* should use its business practices and procedures to assist the *policyholder*, where possible, to make an informed decision about the sale of their *annuity income stream*:
- 23.6.13 G As stated in the Mental Capacity Act Code of Practice, it is important to balance a person's right to make a decision with that person's right to safety and protection when they are unable to make decisions to protect themselves.
- 23.6.14 G *Firms* should present clear, jargon-free information in explaining *regulated annuity assignment agreements*, *regulated annuity direct buyback agreements* and *regulated annuity indirect buyback agreements* in a way that makes it as easy as possible for the *policyholder* to understand. *Firms* should consider ways to present information in alternative, more user-friendly formats where it appears appropriate to do so, subject to compliance with the relevant statutory requirements.
- 23.6.15 G Where a *firm* knows, or reasonably suspects, that a *policyholder* has or may have one of the conditions in *COBS 23.6.6G* this could justifiably act as a trigger for the *firm* to consider the potential specific steps in giving effect to the *firm's* practices and procedures for assessing whether or not the *policyholder* appears able to understand, remember, and weigh up the information and explanations provided and, having done so, when to make an informed decision to *sell* their *annuity income stream*.
- 23.6.16 G *Firms'* practices and procedures should be designed to assist *policyholders* that *firms* understand have, or reasonably suspect of having, mental capacity limitations to overcome, to the extent possible, the effect of the limitations and place them, to the extent possible, on an equivalent basis to *policyholders* who do not have such limitations, to increase the likelihood of *policyholders* being able to make informed sale decisions.

Allowing sufficient time for decisions

- 23.6.17 G Where a *firm* understands, or reasonably suspects, a *policyholder* has or may have a mental capacity limitation it should consider allowing the *policyholder*:
- (1) sufficient time in the circumstances to weigh up the information and explanations the *firm* has given;
  - (2) sufficient time in the circumstances to make an informed decision about the sale of their *annuity income stream*; and
  - (3) to defer a decision to *sell* to a later date.

23.6.18 G *Policyholders* who have mental health difficulties or mental capacity limitations may fall into the category of particularly vulnerable *policyholders*.

### **23 Annex 1 Summary of the Application of COBS 23**

[The form of the summary is set out in the Consultation Paper]

### **23 Annex 2 Risk Warnings**

[The form of the risk warnings is set out in the Consultation Paper]

### **23 Annex 3 Quotations** **R**

A *firm* must provide the quotation for the purpose of *COBS* 23.8R on form 1 of *COBS* 23 Annex 2 unless a *firm* is unable to identify a comparator with the same characteristics as the *policyholder's pension annuity*, in which case the *firm* must use form 2.

A *firm* must provide the information required by *COBS* 23.317R(2)(c) to a *policyholder* on form 3.

[The various formats in which a quotation is to be provided are set out in the consultation paper (form 1, form 2 and form 3)]

## Annex D

### Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

#### 10A FCA Approved Persons

...

#### 10A.10 Customer-dealing functions

...

Customer function (CF 30)

10A.10.7 R ...

...

(7) in relation to *bidding in emissions auctions*, acting as a 'bidder's representative' within the meaning of subparagraph 3 of article 6(3) of the *auction regulation*; and

(8) carrying on regulated annuity broking.

...

#### 12 Appointed representatives

...

#### 12.2 Introduction

...

Business for which an appointed representative is exempt

12.2.7 G (1) The *Appointed Representatives Regulations* are made by the Treasury under sections 39(1), (1C) and (1E) of the *Act*. These regulations describe, among other things, the business for which an *appointed representative* may be exempt or to which sections 20(1) and (1A) and 23(1A) of the *Act* may not apply, which is business which comprises any of:

...

(b) *arranging (bringing about) deals in investments* (article 25(1) of the *Regulated Activities Order*) (that is in summary, deals in a *designated investment* (other than a *P2P agreement*),

*funeral plan contract, pure protection contract, general insurance contract or right to or interest in a funeral plan);*

(ha) entering into a regulated annuity buyback agreement as an annuity provider (article 52E(1) of the Regulated Activities Order);

(hb) regulated annuity broking (article 52F of the Regulated Activities Order);

...

...

What is an introducer appointed representative?

12.2.8 G ...

(2) The permitted scope of appointment of an *introducer appointed representative* does not include in particular:

...

(b) *arranging (bringing about) deals in investments or arranging (bringing about) regulated mortgage contracts; or*

(ba) entering into a regulated annuity buyback agreement as an annuity provider; or

(bb) regulated annuity broking; or

...

...

...

Introducers and representatives: what do these terms mean and what is the relationship with an appointed representative?

...

12.2.14 G (1) A *representative* is an individual who is appointed by a *firm* or an *appointed representative*, to carry on any of the activities in (1)(a) to ~~(e)~~ (e):

...

(c) *dealing in investments as agent ;*

(d) entering into a regulated annuity buyback agreement as an annuity provider;

(e) regulated annuity broking.

...

...

## 12.5 Contracts: required terms

Required contract terms for all appointed representatives

...

### 12.5.2 G ...

(2) Under the *Appointed Representative Regulations*, an *appointed representative* is treated as representing other counterparties if, broadly, it:

...

(b) *arranges the safeguarding and administration of assets by other counterparties; or*

(ba) enters into a regulated annuity buyback agreement on behalf of an annuity provider; or

(bb) carries on regulated annuity broking with other counterparties; or

...

...

...

## 16 Reporting requirements

### 16.1 Application

...

16.1.3 R Application of different sections of SUP 16 (excluding SUP 16.13, SUP 16.15, SUP 16.16 and SUP 16.17)

(1) Section (s)	(2) Categories of firm to which section applies	(3) Applicable rules and guidance
...		
SUP 16.9	<i>Firm with permission to advise</i>	Entire section

	<i>on investments; arrange (bring about) deals in investments; make arrangements with a view to transactions in investments; <u>carry on regulated annuity broking, enter into regulated annuity buyback agreements as an annuity provider</u> or arrange safeguarding and administration of assets</i>	
...		

...

## 16.9 Appointed representatives annual report

- 16.9.1 G The effect of SUP 16.1.1R is that this section applies to every firm with a Part 4A permission to advise on investments, arrange (bring about) deals in investments, making arrangements with a view to transactions in investments, carry on regulated annuity broking, enter into regulated annuity buyback agreements as an annuity provider or arrange safeguarding and administration of assets.

...

## 16.12 Integrated Regulatory Reporting

...

- 16.12.4 R Table of applicable rules containing *data items*, frequency and submission periods

(1)		(2)	(3)	(4)
RAG number	Regulated Activities	Provisions containing:		
		applicable data items	reporting frequency/period	due date
...				
RAG 3	... <ul style="list-style-type: none"> <li><u>entering into a regulated annuity assignment agreement</u></li> </ul>	...	...	...

	<p><u>as a purchaser</u></p> <ul style="list-style-type: none"> <li>• <u>entering into a regulated annuity buyback agreement as an annuity provider</u></li> <li>• <u>regulated annuity broking (when carried on exclusively with or for professional clients)</u></li> </ul>			
...				
RAG 7	<p>...</p> <ul style="list-style-type: none"> <li>• <u>regulated annuity broking (except when carried on exclusively with or for professional clients)</u></li> </ul>			

...

**SUP 16 Annex 18B Notes for Completion of the Retail Mediation Activities Return ('RMAR')**

...

**Introduction: general notes on the RMAR**

...

## Scope

...

6. The following *firms* are required to complete the sections of the *RMAR* applicable to the activities they undertake as set out in *SUP* 16.12:

...

- (e) other investment firms that have *permission to advise on P2P agreements* and do not carry on that activity exclusively with or for *professional clients*.

For the purposes of completing the *RMAR* in relation to the ~~activity~~ activities of advising on P2P agreements and regulated annuity broking only, 'retail investments' and 'retail investment products' should be understood as including P2P agreements, regulated annuity assignment agreements and regulated annuity buyback agreements, and references to retail investment advising and retail investment activity should be understood as including advice on P2P agreements and regulated annuity broking.

...

...

...

## Annex E

### Amendments to the Disputes Resolution: Complaints sourcebook (DISP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

## 2 Jurisdiction of the Financial Ombudsman Service

...

### 2.5 To which activities does the Voluntary Jurisdiction apply?

2.5.1 R The *Ombudsman* can consider a *complaint* under the *Voluntary Jurisdiction* if:

...

(2) it relates to an act or omission by a *VJ participant* in carrying on one or more of the following activities:

...

(c) activities which (at ~~6 April 1~~ [September] 2016) would be covered by the *Compulsory Jurisdiction*, if they were carried on from an establishment in the *United Kingdom* (these activities are listed in *DISP 2 Annex 1G*);

...

...

### 2.7 Is the complainant eligible?

...

2.7.6 R To be an *eligible complainant person* must also have a *complaint* which arises from matters relevant to one or more of the following relationships with the *respondent*:

(1) ...

(15) the complainant is either a *borrower* or a lender under a *P2P agreement* and the *respondent* is the *operator of an electronic system in relation to lending*;

(16) the complainant sold his annuity income stream to the respondent;

(17) the complainant purchased an annuity income stream from a policyholder pursuant to an agreement arranged, or entered into as agent by, the respondent.

...

**2 Annex 1G Regulated activities for the Voluntary Jurisdiction at ~~6 April 1~~ [September] 2016**

This table belongs to *DISP* 2.5.1R

The activities which were covered by the *Compulsory Jurisdiction* (at ~~6 April 1~~ [September] 2016) were:

...

The activities which (at ~~6 April 1~~ [September] 2016) were *regulated activities* were, in accordance with section 22 of the *Act* (The classes of activity and categories of investment), any of the following activities specified in Part II of the *Regulated Activities Order*:

...

(24A) *entering into a regulated annuity assignment agreement as a purchaser (article 52D(1));*

(24B) *entering into a regulated annuity buyback agreement as an annuity provider (article 52E(1));*

(24C) *regulated annuity broking (article 52F(1));*

...

## Annex F

### Amendments to the Perimeter Guidance manual (PERG)

In this Annex, underlining indicates new text and striking through indicates deleted text.

## 2 Authorisation and Regulated Activities

### 2.3 The business element

...

2.3.2 G There is power in the *Act* for the Treasury to change the meaning of the business element by including or excluding certain things. They have exercised this power (see the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 (SI 2001/1177), the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2003 (SI 2003/1476), the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) (Amendment) Order 2005 (SI 2005/922), the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) (Amendment) Order 2011 (SI 2011/2304), ~~and~~ the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No 2) Order 2013 (SI 2013/1881) and the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) (Amendment) Order 2016. The result is that the business element differs depending on the activity in question. This in part reflects certain differences in the nature of the activities:

...

- (3C) A person who enters into a regulated annuity assignment agreement as a purchaser is to be regarded as carrying on that activity by way of business.
- (4) The business element for all other *regulated activities* is that the activities are carried on by way of business. This applies to the activities of *effecting or carrying out contracts of insurance, entering into a regulated annuity buyback agreement as an annuity provider, regulated annuity broking*, certain activities relating to the Lloyd's market, *entering as provider into a funeral plan contract, entering into a home finance transaction or administering a home finance transaction, operating a dormant account fund, credit-related regulated activities* (subject to the modification for *not-for-profit bodies* in (3B)) and *operating an electronic system in relation to lending*.

## 2.7 Activities: a broad outline

...

### Regulated annuity assignment agreements and regulated annuity buyback agreements

- 2.7.20M G A person (“P”) carries on the regulated activity of entering into a regulated annuity assignment agreement as a purchaser when buying annuity income streams from policyholders.
- 2.7.20N G A person (“P”) carries on the regulated activity of entering into a regulated annuity buyback agreement as an annuity provider when that person is an annuity provider and he buys annuity income streams back from policyholders.
- 2.7.20O G A person (“P”) carries on the regulated activity of regulated annuity broking when:
- (1) entering into regulated annuity assignment agreements or regulated annuity buyback agreements as agent; or
  - (2) making arrangements for other persons (whether as principal or agent) to enter into regulated annuity assignment agreements or regulated annuity buyback agreements; or
  - (3) making arrangements with a view to persons participating in the arrangements entering into regulated annuity assignment agreements or entering into regulated annuity buyback agreements.
- 2.7.20P G In the FCA’s view the actions of an intermediary/broker in relation to the sale of a policyholder’s annuity income stream may in some circumstances amount to the regulated activity of assisting in the administration and performance of a contract of insurance (see PERG 5.7). In the FCA’s view an example of when a person’s activities may amount to assisting a policyholder in both the administration and the performance of a contract of insurance is where the person assists the policyholder:
- (1) to perform or discharge a particular contractual obligation, for example an obligation to notify an annuity provider of an intention to exercise a right to sell an annuity income stream (the substance of the obligation being to notify the annuity provider of the intention to exercise the right of assignment and to provide the details of the assignee); and
  - (2) by undertaking the administrative steps in relation to that contract (for example filling in forms, or corresponding with the annuity provider or assignee).
- 2.7.20Q G A person (“P”) does not carry on the regulated activity of regulated annuity broking where he is only providing means by which one party to a

transaction (or potential transaction) is able to communicate with other such parties.

- 2.7.20R    G    The Regulated Activities Order includes exclusions to avoid (to the extent possible) secondary annuities market activities overlapping with other regulated activities:
- (1)    If an annuity provider is facilitating an assignment or buyback agreement he does not carry on the regulated activities of:
    - (a)    regulated annuity broking; or
    - (b)    effecting a contract of insurance; or
    - (c)    carrying out a contract of insurance (see PERG 2.7.3G and PERG 2.7.4G).
  - (2)    The regulated activity of entering into a regulated annuity assignment agreement as a purchaser is excluded from the regulated activity of dealing in investments as principal (see PERG 2.7.5G to PERG 2.7.6AG).
  - (3)    The regulated activity of entering into a regulated annuity buyback agreement as an annuity provider is excluded from:
    - (a)    dealing in investments as principal (see PERG 2.7.5G to PERG 2.7.6AG);
    - (b)    effecting a contract of insurance (see PERG 2.7.3G and PERG 2.7.4G); and
    - (c)    carrying out a contract of insurance (see PERG 2.7.3G and PERG 2.7.4G).
  - (4)    The regulated activity of regulated annuity broking is excluded from:
    - (a)    dealing in investments as agent (see PERG 2.7.5G to PERG 2.7.6AG);
    - (b)    arranging deals in investments (see PERG 2.7.7AG to PERG 2.7.7CG); and
    - (c)    making arrangements with a view to transactions in investments (see PERG 2.7.7AG to PERG 2.7.7CG).
- 2.7.20S    G    (1)    In the FCA's view an annuity provider who facilitates the sale by a policyholder of their annuity income stream will normally be arranging deals in investments in relation to the pension annuity which is the subject of the transaction. This is regardless of whether the annuity provider is facilitating a regulated annuity assignment agreement or a regulated annuity buyback agreement or is facilitating a sale which is being effected by way of some other

agreement which results in the entitlement to receive the *annuity income stream* being transferred to someone other than the original *policyholder*.

- (2) It is possible that the actions performed by an annuity provider in relation to the *sale* by a *policyholder* of their *annuity income stream* do not amount to *arranging deals in investments*, for example if there is a *broker* in relation to the *sale* and the *broker* performs the majority of tasks to bring about the *sale*. Where this is the case, it is the *FCA*'s view that the provider will most likely be *carrying out a contract of insurance* and, for the purposes of the rules (in *COBS 23*), this will also amount to *facilitating the sale* of an *annuity income stream*.

...

...

## 2 Annex 2 Regulated activities and the permission regime

...

Table 1: Regulated Activities (excluding PRA-only activities [see note 1 to Table 1])	
Regulated Activity	Specified investment in relation to which the regulated activity (in the corresponding section of column one) may be carried on
...	
<b>Designated investment business [see notes 1A, 1B and 1C to Table 1]</b>	
...	
<u>(ea) entering into a regulated annuity assignment agreement as a purchaser (article 52D)</u>	
<u>(eb) entering into a regulated annuity buyback agreement as an annuity provider (article 52E)</u>	
<u>(ec) regulated annuity broking (article 52F)</u>	
...	

...

**5.6 The regulated activities: arranging deals in, and making arrangements with a view to transactions in, contracts of insurance**

...

Exclusion from article 25(2): arrangements for the provision of finance

...

5.6.22A G A person who is carrying on the activity of regulated annuity broking is excluded from *arranging deals in investments* but an annuity provider who is facilitating the *sale of annuity income stream* may fall within article 25(1) or article 25(2) of the *Regulated Activities Order* in relation to the *pension annuity* to which the sale of the *annuity income stream* relates (see *PERG 2.7.20*).

...

**Financial Conduct Authority**



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