Consultation Response

Retirement Outcomes Review: proposed changes to our rules and guidance

Financial Conduct Authority, CP18/17

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About this consultation

This consultation by the Financial Conduct Authority is about potential changes to its rules following the completion of its Retirement Outcomes Review (ROR). The ROR was a two-year project that investigated the impact of the 'freedom and choice' pension reforms on consumers, consisting of an interim report in 2017 and a final report published in June 2018. The research identified a number of issues for consumers, principally the impact on people without access to financial advice who move their savings into income drawdown accounts, often so they can access their 25 per cent tax-free lump sum. This consultation paper makes a series of proposals to amend the regulatory rules to try and improve outcomes for this group.

Key points and recommendations

- Age UK welcomes the FCA's Retirement Outcomes Review and the proposals in the consultation paper. We believe these are a positive step forward for people accessing their pension, in particular non-advised drawdown customers.
- We fully support the proposed investment pathways, and we are optimistic that these will improve outcomes for many disengaged consumers.
- There is, however, a risk that they could further reduce shopping around. If the provider presents the pathways in a particular way, we are concerned that it may act as a barrier towards switching. The FCA should be aware of this and ensure that communications are presented in a way that minimises this risk, and encourages people to look elsewhere.
- However, the investment pathways are one part of the overall solution. It sits alongside other 'nudge' based issues that are not addressed in this consultation:
    - Firstly, savers should be defaulting into impartial, independent pensions guidance on an opt-out basis prior to accessing their pension;
    - Secondly, the FCA should work with government and industry to develop product pathways that go beyond the proposed investment pathways and are designed to smooth people's choices and to help them get the most from the pension freedoms.
- We would also welcome more investigation into the circumstances under which people fully encash their pension, and recommend the FCA undertakes an evidence review in order to fully understand its impact.
- Independent Governance Committees should have their remit extended to cover consumers who have accessed their pension. They are likely to be best placed to understand the customer needs within their respective firm, and to be best placed push for positive change.
- The proposal for a single-page wake-up pack is appropriate. However there is a risk that receiving a wake-up pack will nudge people towards accessing their pension early,

and we urge the FCA to ensure that the language used encourages people to consider their options (including leaving the pension invested) carefully before making any decision.

- Pension communications should begin with the introduction of a ‘Career Review at 50’ (or ‘Mid Life MOT’ as it is sometimes called). This should be tied in with careers advice, and help people understand how much they need to save to achieve an adequate level of income in their retirement. We recommend the FCA supports this concept.
- Age UK is pleased with the suggested requirements for firms to promote enhanced annuities. With many people likely to buy an annuity later than before the reforms, this is important for ensuring that people receive an adequate income from their remaining savings.

1. Introduction

The pension flexibilities introduced in 2015 have significantly changed the private pension landscape. While some consumers have undoubtedly benefited and many welcome the change[i], the reforms have also unearthed a series of concerns about whether many consumers have the knowledge or financial capability to take decisions that are in their long-term interest.

For example research by the Pension and Lifetime Savings Association found that 53 per cent of people thought that drawdown would secure them an income for life.[ii] The well-documented behavioural biases, such as underestimating life expectancy and valuing the present more highly than the future, are also likely to have an impact on decision-making, even if in many cases it will not be possible to measure the detriment for a number of years.

In particular, as the Financial Conduct Authority’s (FCA) research has suggested, many people are keen to access their 25 per cent tax-free lump sum, and as a result are moving the remainder of their pension savings into an income drawdown account. In many cases this may not be an appropriate action, and we welcome the FCA’s investigation into the harm this can cause.

Regulatory action is needed to remedy this harm. We welcome many of the FCA’s proposed responses, which we believe are sensible and proportionate and will help consumers. It is clear that substantive regulatory action is needed, and we hope that those proposed in this consultation paper will be the beginning of an ongoing process to review and improve consumer outcomes post-access.

We particularly welcome the investment pathways proposals, which have the potential to improve outcomes for a significant number of consumers, not least the one-third of drawdown account customers who are holding solely cash, having often been defaulted into this asset class by their provider (para 1.12).

We are also concerned that the large numbers of people who access their pension early are creating future problems for themselves, for example being invested in an inappropriate asset mix for a sustained period of time. Investment pathways should be presented as an alternative to immediate or early access of pension funds. It is an opportunity to make it clear that the Financial Conduct Authority and the pensions industry are genuinely looking after their consumers, and have their long-term interests at heart.

In addition to investment pathways, the FCA, industry and Government need to consider how to create effective defaults into the Pension Wise guidance service, and into suitable product ‘glidepaths’. This combination will help consumers get the most out of the pension flexibilities.

Other issues

Consumers taking all their pension savings as cash is one major issue that we would like to see considered in more detail. While we agree with the approach of making sure positive change occurs in one area rather than tinkering with several, we remain concerned that many consumers who cash out entirely will be putting themselves at a serious long-term disadvantage, and this needs a commitment to investigate further as soon as practicable. Cashing out could lead to several negative outcomes including being scammed, making poor investment choices, or paying excess tax – whatever the reason, we need to understand more about why people choose to cash out, and action to remedy any harms as soon as possible.

The FCA definition of a small pot as having a value of less than £30,000 is problematic – for many consumers that represents their life savings and is a substantial contributor to their future income. We recommend the FCA looks at redefining a ‘small pot’.

We are also concerned by the lack of innovation by providers in the non-advised product marketplace. While we are pleased the FCA recognises this, we do not agree that the best course of action is to sit and wait until defined benefit (DB) provision has declined and there is a clear reliance on defined contribution (DC) income alone. This could take years, decades, or even provide a perpetual excuse for the industry to ignore less profitable customers. The FCA needs to work with Government departments to address this – it is, after all, in the FCA’s remit to “promote competition”, and at present the lack of appropriate products is letting down consumers with small or average size savings. We hope that the FCA's proposals, such as a drawdown comparison tool, will make some inroads, but they are highly unlikely to provide the full solution.

We hope all these issues will progress in the near future, but in the meantime we welcome the FCA's proposals and focus on the non-advised drawdown market.

2. Consultation questions

Chapter 3 – Protecting Consumers from Poor Outcomes

Q1: Do you agree with our current high-level thinking on the key elements of our potential remedy? If not, what would you suggest?

Q2: Does the approach we are considering taking adequately capture the objectives of non-advised consumers entering drawdown who might use the investment pathways? If not, what would you suggest?

Age UK is very supportive of the investment pathway concept as a means to improve outcomes for customers who are defaulted into cash or 'cash-like' funds after entering drawdown.

We are pleased that customers who take their tax-free lump sum, and are then defaulted into cash or 'cash-like' funds by their provider, have been identified as a potentially significant issue by the FCA. We agree that such customers are at particular risk of poor outcomes. The investment pathway concept should help this group in particular achieve improved outcomes.

The Review's findings that a stronger choice architecture – where firms offer different choices to consumers with a clearer explanation/guide of how to take decisions – leads to better outcomes are important in the design of all retirement income pathways. While we agree that implementing investment pathways is important, we believe this can operate most effectively as part of a broader system of 'nudges', also including pensions guidance and retirement income products.

This is not to say that the FCA should not proceed with the current work – on the contrary, it is big step in the right direction, and we applaud the FCA's approach. However there are wider issues affecting consumers that this alone will not resolve.

For example, the lack of shopping around is not considered in the consultation, and, indeed, many of the solutions offered appear predicated on consumers staying with their provider. While it is, of course, perfectly possible to still shop around, we are concerned that the nature of the communications around an investment pathway may provide an additional barrier for consumers to do so. The language used and the style, method, and timing of presentation should all be designed with this in mind, and appropriate messages about shopping around delivered alongside them.

The ‘prescribed objectives’ listed in the consultation paper to which the investment pathways would need to relate, copied here for reference, are:

- I want my money to provide an income in retirement
- I want to take all my money over a short period of time
- I want to keep my money invested for a long period of time and may want to dip into it occasionally

We agree with the FCA that this approach is sensible, and these broadly match the different choices that consumers will take. It is important, however, that people are able to move from the investment strategy into appropriate products. With the lack of innovation in the income product marketplace for non-advised customers, this might be difficult. However, as the marketplace develops over the longer-term, the investment pathways will need to be flexible so as to adjust to savers’ preferences, and remain linked to the real-world choices that individuals are making.

This highlights the importance of the complete package of reforms – guidance services, product pathways and product innovation, all working in tandem to ensure that investment pathways are delivering for consumers.

Q3: Do you agree with our suggestion that firms should only offer one investment solution in respect of each of the objectives? If not, what would you suggest?

While we agree the three listed objectives are appropriate in a broad sense, there are likely to be subgroups of customers who may benefit from a more refined approach. For example, the best investment strategy for someone who wishes to withdraw their savings “over a short period of time” may depend on *when* they want to start the withdrawals. A different investment strategy may be required for someone who wants to wait until State Pension age before spending down their pension, and someone who wishes to do this at age 58.

We recommend that the FCA closely examines the role that IGCs can play in setting or scrutinising firms' investment strategies. They are likely to be best placed to understand the typical needs of a firm's customers.

Q4: Do you agree with our suggestion that firms should not be permitted to provide a single investment solution to cover all of the objectives? If not, what would you suggest?

We agree that firms should not be permitted to provide only one investment solution. Firms should ensure that all customers are given the best possible chance of achieving a good outcome. For larger schemes with a diverse range of customers, offering a limited range of investment pathways will be essential. Even for smaller schemes serving a single occupational group or employer, members will want to meet different saving objectives and so will need different solutions in place to achieve this. Having more than one solutions is the only viable approach.

Q5: Do you think that firms should offer investment solutions for all the investment pathways? If not, what would you suggest? If a firm does not offer an investment solution for a particular investment pathway, should it be required to enter into an arrangement with another firm to provide it?

Q6: Do you agree with the approach we are considering taking on prescription around the investment solution and risk profile of investment pathways? If not, what would you suggest?

Q7: Do you agree with the approach we are considering taking on permitting firms to use pre-existing investment solutions to offer an investment pathway? If not, what would you suggest?

Q8: Do you agree with the approach we are considering taking on allowing firms to offer investment solutions other than investment pathways? If not, what would you suggest?

The default should be that firms offer investment solutions for each investment pathway, which should be agreed with their IGC as a form of quality assurance. There could be an exemption where they can demonstrate that they have few savers who wish to pursue one particular outcome. When this occurs, they must work with other providers to ensure no-one is disadvantaged.

As firms face commercial pressures that are not always aligned with consumer interest, we reiterate the point that IGCs may be better placed than the firms to decide which alternative arrangements are suitable for customers and when these should be offered.

Q9: Do you agree with the approach we are considering taking for the choice architecture to be implemented by firms? If not, what would you suggest?

The structure of the choice architecture appears reasonable, although will need real-world testing to confirm its suitability. Our main concern is that there does not seem to be a built-in mechanism to encourage shopping around to get a better deal – we believe this is an important part of the process and should be included.

Q10: Do you agree that investment pathways should also be made available to advised consumers? If not, what would you suggest?

Q11: Do you agree with the approach we are considering taking on how we should define advised consumers for the purposes of the application of our rules on investment pathways? If not, what would you suggest?

We agree with the FCA's approach on both these points.

Q12: Do you agree with the approach we are considering taking in relation to circumstances where consumers are designating funds to drawdown on multiple occasions? If not, what would you suggest?

Yes, we agree.

Q13: Do you agree with the approach we are considering taking to require firm review [sic] of investment pathways on an annual basis? If not, what would you suggest?

Q14: Do you agree with the approach we are considering taking for ongoing disclosure to consumers about investment pathways? If not, what would you suggest?

We agree this approach is sensible in theory. However, it relates to two real-world issues: firstly, the role of IGCs, where the role they play in working with schemes prior to setting 'annual review' objectives should be clearly defined – it seems sensible that firms would conduct their annual review following their IGCs recommendation, rather than getting IGC recommendations at a less-opportune time.

Secondly, the freedom and choice reforms are relevant. At some point, customers may want to choose a different product, for example purchasing an annuity. This is in line with the essence of the three suggested pathways. It is also an excellent opportunity to nudge consumers towards Pension Wise or regulated financial advice, and the annual communications should reflect this.

Q23: Do you agree that the IGC regime should be extended to investment pathways? If not, what alternative regime would you propose?

Yes. Following the evidence uncovered by the FCA in both the interim Review and the final report, we are concerned that by entering drawdown a significant number of people are exposing themselves to higher charges and inappropriate investment options. It is essential that such people benefit from independent oversight and good governance.

In relation to Self-Invested Personal Pensions (SIPPs), we believe it is entirely proportionate that they also have an IGC. There may, for example, be customers of that SIPP who join the scheme as an advised consumer but subsequently become non-advised; as well as those who join under their own volition. These consumers will need good governance as much as any other.

We recognise that this will increase costs for SIPPs, but believe that it is an entirely proportionate response given the overwhelming importance of good governance of investment pathways.

Q24: Do you consider that a requirement for independent oversight should apply to other decumulation products (ie not only to investment pathways)? If so, why?

Q25: Do you think we should carve out from the requirement those providers which only provide decumulation products for advised consumers, or those in less need of protection? How would this work?

Q26: Do you have any other issues or concerns about the proposals?

We agree that independent oversight should apply to other decumulation products. There should be oversight at all points in the retirement income journey, up until (and including) annuity purchase. This is especially important since consumers rarely shop around in this marketplace.

We are also concerned by the seeming lack of innovation in the retirement income marketplace. It is apparent that there has been little product development in the drawdown space for mass-market consumers, and we believe the Government and the FCA need to act to foster a competitive and innovative culture, which is likely to be best achieving through regulation. In the meantime better oversight of the marketplace may 'encourage' firms to deliver better value and more appropriate products.

We also have a concern, as mentioned in our response to question one, that the investment pathways may result in a further reduction in the number of people shopping around. While no additional practical barrier may be in place, choosing from one or three pathways with the existing provider may feel psychologically like an additional incentive to stay in a well-known, seemingly safe harbour, reducing the incentive to look elsewhere. The presentation of the options, as well as the language and style used, is of crucial importance, while signposting to Pension Wise at all points is imperative. We believe the FCA will need to regulate this presentation to ensure that people do consider all their options from across the wider marketplace.

Q27: Do you agree with our current thinking that a single, default investment pathway is unlikely to be suitable in drawdown? If not, please provide reasons why you disagree.

Yes, we agree the proposed approach focussed on three different pathways is more appropriate.

Q28: Do you agree with the approach we are considering taking to require making investment wholly or predominantly in cash an active choice? If not, what would you suggest?

Q29: Do you agree with the approach we are considering taking in relation to mandating warnings to those making an active choice to invest in cash? If not, what would you suggest?

Q31: Do you think we should require firms to issue warnings to consumers who are invested in cash on an ongoing basis? If not, what would you suggest?

As cash is likely to be inappropriate for the majority of savers, especially where they have no immediate plans to fully withdraw their money, we support the FCA's approach.

We are comfortable with the FCA issuing warnings, although we believe the FCA should also encourage consumers to re-consider the investment pathways alongside the warnings. This may require regulatory supervision as there is a strong financial interest for firms determined to leave customers in cash, often while charging fees as identified in paragraph 4.61 of the final report.

Chapter 4 – Improving consumer engagement with retirement decisions: 'Wake up' packs, retirement risk warnings and reminders.

Q34: Do you agree with our proposals on 'wake-up' packs? If not, how should we change them?

We welcome the proposal for a single-page summary in the wake-up pack, which previous FCA research has demonstrated as being more engaging for consumers.

However we draw the FCA's attention to the wording used to describe the purpose of the packs – they are framed around an individual's "intended retirement date" (Para 4.11). For most DC savers, who are still working at age 55, they will not be retiring, merely accessing their pension because it is available (as borne out by the FCA's interim report). The FCA and the pension industry need to reconsider the rationale for wake-up packs and make it fit for the 21st Century.

Communications at this point should very much steer people away from accessing their savings, and focus on continued saving along with information about the investment pathways. We also agree with the Pension and Lifetime Savings Association that the term 'wake-up pack' should be reviewed for appropriateness.[iii] Instead, the whole process should be part of a 'Career Review by 50' – where access to pension savings guidance is delivered alongside careers advice and tips for remaining active in the labour force. For further information see Age UK's discussion paper on the subject.[iv]

While we continue to support wake-up packs, there is a danger that they will turn accessing DC savings at age 55 into a social norm. While clearly already widespread already, we do not support anything that might exacerbate this, and the FCA should be examining methods that can help people 'hold out' for longer – the investment pathways proposal represents an excellent opportunity.

Accessing guidance: signposting alone as part of the wake-up packs will often be insufficient to persuade people to access Pension Wise. The language in the packs can be tightened to include more active phrasing around using Pension Wise, however even this may not be sufficient.

Under the provisions in the Financial Guidance and Claims Act 2018, the FCA is required to establish a process by which individuals should access guidance. We continue to believe there is a very strong case for creating a 'guidance pathway' for default referral – on an opt-out basis – to Pension Wise. This would complement the new investment pathways and provide consumers

It is also essential that such guidance is delivered "independently" – that is, not by providers themselves, as this would undermine trust and integrity of the system. We are also concerned providers would easily be able to game the process (even if sticking to a script), and persuade their customers not to shop around.

In effect, this means the new Single Financial Guidance Body would be crucial in its delivery. This seems a sensible solution that would at least allow pension savers the opportunity to understand and carefully consider their choices.

Q35: Do you agree with our proposal to mandate specific retirement risk warnings alongside 'wake-up' packs? If not, how should we change it?

Q36: Do you have any further comments on our proposals for retirement risk warnings?

Age UK believes that it is worthwhile to include retirement risk warnings alongside wake-up packs. The research from Citizens Advice, referred to in the consultation paper, found that the risk warnings were ineffective because they were delivered too late in the process to make a difference.[v] It is clear that they need to be delivered up-front at the point when people first enquire about accessing their pension, which is where they are likely to have the most impact.

Providing the right information at the start of the customer journey is essential. We also agree that providing a statement that accessing a pension may not be the best option is important. However as alluded to in our response to Question 34, on its own this may not be enough – the investment pathways proposal represents an opportunity to elaborate on this warning and push people towards longer-term thinking.

Chapter 5 – Improving consumer engagement with retirement decisions: 'Wake up' packs, retirement risk warnings and reminders

Q38: Do you agree with our proposal to require firms to ask consumers questions that will help a consumer determine whether he or she is entitled to an enhanced annuity?

Q39: Do you agree with our proposal to require that firms include information about the consumer's potential eligibility for an enhanced annuity in the quote for comparison?

We are pleased that the FCA has decided to include information about enhanced annuities, something Age UK has previously called for.[vi] Many consumers are unaware of enhanced annuities, and it is incumbent on the industry to steer people towards them when appropriate.

Under the freedom and choice reforms, if people are purchasing annuities later on (for example at age 75) then it is likely that more people will be eligible for an enhanced annuity because a typical 75 year old is likely to be in poorer health than a typical 65 year old. This makes it crucial that everyone who is eligible for an enhanced annuity is fully informed and feels able to make this choice.

Chapter 6 – promoting competition by making the cost of drawdown products clearer and comparisons easier

Q41: Do you agree that key information should be summarised on the front page of KFIs?

Q42: Do you agree that the summary information should show a one-year single charge figure expressed as a cash amount?

We believe Key Features Illustrations are useful for consumers when they contain the appropriate information and are presented in an accessible way. Charges are an integral part of this. However, as the FCA highlights, there are up to 44 different charges applied to drawdown accounts, so it is unclear how it intends to summarise this as a "one-year single charge figure". We recommend that FCA tests a range of different options for calculating a relevant figure (or limited number of cost indicators if a single figure proves too misleading).

With such an array of charges, there may be opportunities arising for providers to game the system – the FCA must be vigilant and if necessary take regulatory action to close down attempts to exploit any loopholes. ensure these 'unknown unknowns' do not come to fruition.

Q44: Do you agree that a KFI should be provided when a client is accessing drawdown as an option or variation under an existing contract or UFPLS option under an existing contract, and also the first time they take an income (where this happens later)?

Yes. It is important to provide customers with the appropriate information at every point in their retirement-income journey, especially where there are long gaps between interactions with the system.

Q45: Do you agree that firms should provide regular client communications for those who have withdrawn tax free cash but not taken an income?

Q46: Do you agree that firms should regularly remind consumers to consider reviewing their decisions, particularly investment choices, rather than reminding them how to obtain advice?

The interim report of the Retirement Outcomes Review found that the most common course of action was for people to access their tax-free lump sum in their late 50s or early 60s, and then leave the remainder in a drawdown account, presumably until they had further need of the money.

We do not disagree with the proposal to provide regular information to such consumers, however we would be very concerned if it increased the likelihood of people dipping into their remaining pots earlier than they otherwise would have. Clear communication about the investment pathways is necessary, and great care must be taken with the framing of any communications.

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[i] Citizens Advice (2016), Life after pension choices: consumer reflections on pension choices and thoughts on the future

[ii] Pension and Lifetime Savings Association (2016), Pension freedoms: no more normal, Understanding Retirement Wave II

[iii] Pension and Lifetime Savings Association (2018), Hitting the Target: a vision for retirement income adequacy

[iv] Full link to the Age UK discussion paper: https://www.ageuk.org.uk/globalassets/age-uk/documents/reports-and-publications/reports-and-briefings/active-communities/rb_oct17_creating_a_career_mot_at_50.pdf

[v] www.citizensadvice.org.uk/Global/CitizensAdvice/Debt%20and%20Money%20Publications/DrawingPension.pdf

[vi] https://www.ageuk.org.uk/globalassets/age-uk/documents/reports-and-publications/consultation-responses-and-submissions/money-matters/crs_feb17_implementing_information_prompts_annuity_market.pdf