Retirement Outcomes Review: Investment pathways and other proposed changes to our rules and guidance

Consultation Paper
CP19/5***

January 2019

How to respond

We are asking for comments on this Consultation Paper by **5 April 2019**.

You can send them to us using the form on our website at: www.fca.org.uk/cp19-05-response-form.

Or in writing to:
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1 Summary

Executive summary: why we are consulting & what we want to change

The Retirement Outcomes Review

1.1 The Government's 2015 pension freedoms provided more flexibility in how and when consumers can access their pension savings. This means consumers have more complicated choices to make about how to invest their pension savings, and when to draw on those savings. Despite this, many choose not to take advice. The proportion of drawdown bought without advice rose from 5% before the freedoms to around 30% now.[1]

1.2 In June 2016 we launched the Retirement Outcomes Review (ROR). We wanted to assess how the retirement income market was evolving following the introduction of the pension freedoms, to address any emerging issues that might cause consumer harm, and to put the market on a good footing for the future. The ROR focused on consumers who choose to draw down their pension savings without taking regulated advice ('non-advised consumers'). It found that many of these consumers were losing out on retirement income because their pension pots in drawdown were invested in cash, even though they did not intend to spend their money in the short term.

1.3 In June 2018 we issued the ROR Final Report and published a Consultation Paper (CP) setting out our proposed remedies in response to our review's findings. In that CP – CP18/17 Retirement Outcomes Review: Proposed changes to our rules and guidance – we consulted on some of our proposals and raised other proposals for discussion. In this further CP we are now consulting on the proposals raised for discussion in CP18/17. These include proposed new rules on 'investment pathways'. Investment pathways will enable non-advised consumers to achieve better outcomes by helping them choose the best way to invest their money in drawdown. These rules form one part of our wider work programme on pensions and retirement income, set out in more detail in Chapter 2.

Investment pathways

1.4 Since the introduction of the pension freedoms, consumers can access their pensions in a number of ways. They can buy an annuity, enter drawdown, take uncrystallised fund pension lump sums (UFPLS) or take all their pension as cash.

1.5 We have already introduced a number of requirements on pension providers to help consumers make decisions about which option – or options – to choose, and have made further changes in the Policy Statement published alongside this CP. Together, the existing and new requirements mean that before they access their pension all consumers will receive:

1 In the period October 2017 to March 2018, 31% of drawdown sales were made to consumers who did not take advice (p.5, FCA Data Bulletin 14 (September 2018)).

- at least one 'wake-up' pack, setting out the different options available at retirement, such as purchasing an annuity or moving into drawdown
- retirement risk warnings, to ensure the consumer is alerted to issues such as the tax and benefit implications of taking cash from their pension
- several prompts to access the free, impartial guidance currently offered by Pension Wise, or to take advice, so consumers get the help they need
- clear information in a Key Features Illustration about the costs and charges associated with moving into drawdown
- a strong nudge to shop around when purchasing an annuity

1.6 Our proposed investment pathways remedy is aimed at consumers who, having received the above prompts to take advice or guidance, decide to access their pensions through drawdown without taking advice. These consumers then need to make a further decision on how to invest the funds that move into drawdown. Our work in the ROR showed that we need to take further action to help consumers with this:

- Many consumers were solely focused on taking their tax-free cash and were insufficiently engaged with the decision around how to invest the remaining funds that moved into drawdown.
- Our research found that around one in three consumers who had gone into drawdown since the introduction of pension freedoms were unaware of where their money was invested. Many others only had a broad idea.
- We also saw that some providers were 'defaulting' consumers into cash or cash-like assets when they moved into drawdown. Overall, 33% of non-advised drawdown consumers are wholly holding cash. Holding cash may suit consumers planning to draw down their entire pot over a short period. But it is highly unlikely to be suited for someone planning to draw down their pot over a longer period. We estimate that over half of these consumers are likely to be losing out on income in retirement by holding cash.

1.7 These findings strongly suggest that a significant number of non-advised consumers are likely to hold their funds in investments that will not meet their objectives for how they want to use that money in retirement.

1.8 In CP18/17 we said that we believe that offering these consumers a range of investment solutions – with carefully designed choice options – is the best way to help them choose investments that broadly meet their objectives. We described these as 'investment pathways'. We set out how we thought investment pathways might work, and asked for feedback on the key elements of the framework. Having analysed the feedback we received to CP18/17, and sought further evidence, we are consulting on proposals in this CP. We set these proposals out in chapters 5 to 8.

1.9 Our current rules don't prevent drawdown providers from offering investment pathways. But our research suggests that very few are doing so. Our proposals will, therefore, change the options available to the vast majority of non-advised consumers entering drawdown. Non-advised consumers will be able to choose how to invest their drawdown pot on the basis of the objectives they have for that money. Larger providers will be required to offer single investment solutions that correspond to each of these objectives, while smaller providers will be able to refer consumers to a drawdown comparator tool provided by the Single Financial Guidance Body (SFGB). Our proposals on choice architecture will ensure that the provider's investment offerings are presented in a clear, structured way.

1.10 We expect our proposals to make a real difference for the many consumers who currently struggle to decide how to invest their drawdown pot. By presenting the decision in terms of their own objectives for retirement, consumers will be more easily able to select an appropriate investment. This should reduce the numbers who fail to make an investment decision, or who select something that doesn't meet their needs.

1.11 We also expect the introduction of investment pathways to increase the choices available to consumers in terms of drawdown products. This is because our proposals will require more providers to develop drawdown investment solutions aimed at non-advised, 'mass market' consumers.

Ensuring investment in cash is an active decision

1.12 In CP18/17, we set out our evidence that many non-advised consumers that invested in cash in drawdown did not actively decide to do so. Effectively, these consumers were 'defaulted' into cash by their provider. Our evidence suggested that for many of these consumers investment in cash was inappropriate to meet their objectives for their pot in drawdown.

1.13 We are now consulting on proposals requiring providers to ensure that consumers invest in cash only if they make an active decision to do so. We propose that these providers must also give consumers warnings about the likely impact of investing in cash on their long-term income, both when they enter drawdown (or transfer funds already in drawdown into a new product) and on an ongoing basis.

Actual charges information

1.14 In CP18/17 we argued that, to ensure a competitive drawdown market, consumers should see the charges they have actually paid. We suggested that firms should be required to tell consumers each year how much in charges they had actually paid in that period, in pounds and pence and inclusive of transaction costs. Following positive feedback on that suggestion, we are now consulting on rules requiring such disclosures.

Who this applies to

1.15 This CP will mainly be of interest to firms providing income drawdown.

1.16 This CP will also be relevant to stakeholders with an interest in pensions and retirement issues, including:

- 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 representative groups
- charities and other organisations with a particular interest in the ageing population and financial services

1.17 Consumers will also be affected by this CP. We welcome views from consumers on all of our proposals.

Outcome we are seeking

1.18 As set out in our Business Plan for 2018/19, in recent years our regulation of the pensions and retirement income market has focused on making adjustments to our rules to support the pension freedoms. Our remedy proposals in this CP are part of that work. They aim to protect consumers from poor outcomes and to promote competition.

1.19 In Chapter 2 we explain how our proposals will deliver the outcomes we are seeking by addressing the harms we've identified.

Measuring success

1.20 Taken together, the proposed remedies we are consulting on in this CP will be a significant intervention in the drawdown market. In particular, a requirement for firms to provide investment pathways will require careful consideration by drawdown providers serving non-advised consumers. Given the significance of the investment pathways proposals, we plan to begin a detailed review of the impact of these proposals one year after implementation. The review will consider various aspects of the policy framework, including analysis of the charges providers are applying to investment pathways.

Next steps

What you need to do

1.21 We want to know what you think of our proposals in this CP. Please send us your comments by 5 April 2019.

What we'll do next

1.22 We will consider the feedback we receive on this CP and publish our finalised Handbook text in a Policy Statement in July 2019.

2 The wider context

How this consultation sits alongside other work in the pensions and retirement income sector

2.1 The pensions and retirement income sector continues to be a priority for us.

2.2 Our work on the ROR is only one part of our work programme in this area. On 18 October 2018 we published a joint regulatory strategy with The Pensions Regulator (TPR). The strategy identifies key issues which contribute to the harm of people not having adequate income, or the income they expected, in retirement. To tackle the main drivers of this harm, we and TPR have set out a vision for the pensions sector for the next 5 to 10 years. This includes being clear about our priority areas and what we are doing to deliver on them.

2.3 Some of the remedies that we are taking forward in ROR have links to other pieces of work we are undertaking:

- Independent governance: In CP18/17 we said that we were minded to extend the existing Independent Governance Committee (IGC) regime to investment pathways. As set out in paragraphs 8.27 to 8.29 of this CP, we intend to extend the IGC regime to investment pathways and plan to consult on draft rules in April. Our work on non-workplace pensions will also assess whether there is a case for independent governance in some or all of this part of the non-workplace pensions accumulation market.

- Cash holdings: In the Final Report we found that a third of non-advised consumers in drawdown were wholly invested in cash. Our analysis of the data collected on non-workplace pensions considers, amongst other things, whether cash investment is commonplace in the non-workplace accumulation market. Similarly, as part of our Investment Platforms Market Study we collected data on cash holdings on platforms, including specifically for platforms providing drawdown. We are analysing the data collected and, if we identify harm, will develop appropriate remedies that we will consult on. We will publish any proposals for consultation coming out of the Investment Platforms Market Study by the end of March.

- Transaction cost disclosure: In Chapter 10 of this CP we are consulting on proposals to require providers to show consumers the charges they have actually paid in drawdown, including transaction costs, on an annual basis. We will also shortly consult on rules to require that consumers in workplace personal pension schemes are given details of the transaction costs they pay within their scheme.

2.4 In CP18/17 we gave a comprehensive summary of the work we're undertaking in the pensions and retirement income sector. Below we give an update on the key work we have not already mentioned:

- Our Defined Benefit (DB) to Defined Contribution (DC) transfer work, following on from pension freedoms, has found high levels of unsuitable advice. We are now analysing data collected from all firms active in this market. We have made rules in PS18/6 and PS18/20 on measures to protect consumers and further improve the quality of pension transfer advice. We are undertaking further work on contingent charging and if we consider changes to our rules are appropriate, we will consult on any new proposals in the first half of 2019.

- In August 2018 we launched our bespoke and targeted pension scams campaign. We joined forces with TPR to urge the public to be on their guard when receiving unexpected offers about their pension and to check who they are dealing with. We launched a new ScamSmart advertising campaign targeting pension holders aged 45-65, the group most at risk of pension scams.

2.5 In the Final Report we also explained that we would hold a pensions TechSprint. This would encourage innovation in the way firms engage with their customers on the decisions they must make when accessing their pension savings. In November 2018, together with TPR, we held the TechSprint in Edinburgh. The event brought together over 100 software developers, subject matter experts and senior executives. Further detail on the event, the award-winning ideas and how you can follow-up with us are on our website.

The harm we are trying to address

2.6 We are concerned that drawdown consumers – and particularly those who don't take advice – could suffer the following harms:

- Buying unsuitable products
  - consumers could lose out on potential investment growth, for example, if invested in cash for long periods, or investing in assets that do not match their needs and objectives
- Prices too high or quality too low
  - consumers could pay too much in fees and charges
  - consumers may not benefit from better products and deals, because of weak competitive pressure on firms

2.7 Our proposals on both investment pathways and to ensure consumers who invest in cash make an active decision to do so, aim to protect them from losing out on potential investment growth. Our proposals to make firms tell consumers the charges they have actually paid, aim to protect consumers from paying too much in fees and charges. We hope increased transparency will increase competitive pressure.

2.8 These harms ultimately lead to the same overarching harm – affected consumers will have a lower income in retirement.

How it links to our objectives

Consumer protection

Both our investment pathways proposals, and those to ensure consumers who invest in cash are making an active decision to do so, aim to protect consumers

2.9 We consider that requiring firms offering drawdown to non-advised consumers to provide a range of investment pathways, will protect non-advised consumers from poor outcomes in drawdown. As set out above, a key poor outcome is losing out on potential investment growth.

2.10 We consider that our proposals to ensure that consumers who invest in cash make an active decision to do so will also protect some consumers from losing out on potential investment growth.

Competition

Our proposals to make firms tell consumers the charges they have actually paid aim to increase competitive pressure

2.11 We believe that, to ensure a competitive drawdown market, consumers should see the charges they have actually paid annually. Drawdown consumers are not locked-in to the product they use for income withdrawals, and can move to a different product. Increasing transparency of charges will help consumers work out whether the product offers good value for them.

2.12 Showing a consumer the charges they have paid is not itself enough to increase competitive pressure. Consumers need to be able to compare the charges they have paid with those they might pay in other products. As mentioned in the Final Report, we are working with the SFGB and the Association of British Insurers to help deliver a drawdown comparator tool to help consumers.

Further work we have undertaken

2.13 Since publishing CP18/17 and the Final Report, we have carried out further work to better understand the harms we identified, and shape our potential remedies:

- We have tested consumers' understanding of the objectives for investment pathways. We have undertaken both qualitative and quantitative testing. The quantitative testing involved 1,480 participants. The results of this testing have informed our approach.
- In CP18/17 we said we wanted to understand more about non-advised drawdown in Self-Invested Personal Pensions (SIPPs) and how we might apply our remedy package to these firms. We collected data from SIPPs operators to gather this information, receiving responses from over 70 firms.
- We have analysed written submissions from over 50 respondents to CP18/17.
- We have met with a range of stakeholders – including providers of drawdown to non-advised consumers – to better understand how our proposals in CP18/17, particularly on investment pathways, will affect them and the challenges they present.

Equality and diversity considerations

2.14 We have considered the equality and diversity issues that may arise from our proposals.

2.15 Overall, we do not consider that the proposals adversely impact any of the groups with protected characteristics under the Equality Act 2010. We expect our proposals to have a positive impact, particularly on older consumers.

2.16 Respondents to CP18/17 did not raise any issues that would cause us to revisit our assessment. But we will continue to consider the equality and diversity implications of the proposals in the light of the feedback we receive during the consultation period, and will revisit them when publishing the final rules.

3 Investment pathways: introduction and executive summary

3.1 In chapters 5 to 8 we consult on proposals to require providers of drawdown to offer non-advised consumers ready-made investment solutions. These solutions meet broad objectives of what these consumers might wish to do with their drawdown pot. We describe these as 'investment pathways'.

3.2 In this chapter, we introduce our investment pathways proposals and in our executive summary we set out the proposals for consultation in chapters 5 to 8.

Introduction

3.3 In the Interim Report, we said we were concerned about the complex decisions consumers have to make to get the most out of their drawdown pot. This could lead to non-advised consumers making poor choices. We explained that a 'poor choice' for a consumer could be choosing an investment that is unsuitable for their needs. This includes not being in line with their risk tolerance and what they intend to do with their pot in the future.

3.4 Before publishing our Final Report and CP18/17, we sought evidence to help us understand what consumers in drawdown were invested in and the charges they were paying. We also undertook a detailed consumer survey to try to understand why consumers were invested as our data showed. Our findings in this work are in Chapters 3 and 4 of the Final Report.

3.5 We found – very broadly – that many non-advised consumers struggled to make investment decisions, or were not engaged enough to do so. This led to them either ending up in their provider's 'default' option or making a poor investment choice.

3.6 In Chapter 3 of CP18/17 we set out a range of proposals to address this harm, for discussion. These included requiring providers to offer their non-advised consumers a range of investment solutions – with carefully designed choice architecture – to help them select investments that met their broad objective for their pot in drawdown. We described these as 'investment pathways'.

3.7 We decided to ask discussion questions, rather than move straight to consultation proposals in CP18/17, as we recognised that the proposals were a major intervention in an evolving market. We believed it was important to give interested parties – particularly providers serving non-advised consumers – an opportunity to comment on the impact and practicality of our proposals before we took any decision to consult. We also said that we wanted to get more evidence to understand how the remedies would apply to the whole of the non-advised drawdown market, in particular SIPPs.

3.8 As set out in paragraph 2.13, since publication of CP18/17 in June 2018 we have carefully analysed over 50 responses to the consultation. We have also carried out detailed consumer testing on the objectives for investment pathways, and received data from over 70 SIPP operators.

3.9 We are now consulting on proposals to introduce investment pathways.

Executive summary: Our investment pathways proposals

<table>
<tr><th>Chapter</th><th>Summary of our proposals</th></tr>
<tr><td>5</td><td>The consumers and providers our requirements will apply to
• The consumers covered by these proposals
Providers must offer investment pathways when:
– a consumer moves all or part of their pension savings into drawdown, or
– a consumer transfers funds already in drawdown into a new drawdown arrangement
unless a consumer has received advice on either of these transactions.
A consumer is an 'advised' consumer under these proposals if they are advised on how to invest all or part of their drawdown pot.
For subsequent investment decisions, consumers will be treated as non-advised if they make the later investment decision:
– more than 12 months after the transaction they were advised on, or
– within 12 months of the transaction they were advised on and have not confirmed that their personal or financial circumstances are unchanged since they received the advice
• How these proposals apply when the consumer enters drawdown in stages
Where the consumer takes only part of their tax-free cash entitlement without an agreement with their provider about how they want to take tax-free cash and move funds into drawdown on an ongoing basis, they must be offered the investment pathways each time they subsequently move funds into drawdown.
• The providers covered by these proposals
All providers of drawdown to non-advised consumers will be required to offer investment pathways. Exactly what they must offer, though, will depend on the number of non-advised consumers they serve. We explain this in Chapter 7.</td></tr>
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Chapter	Summary of our proposals
6	**The choices providers must offer to consumers** • **Investment pathways objectives** The 4 objectives we propose are: – Option 1: I have no plans to touch my money in the next 5 years – Option 2: I plan to use my money to set up a guaranteed income (annuity) within the next 5 years – Option 3: I plan to start taking my money as a long-term income within the next 5 years – Option 4: I plan to take out all my money within the next 5 years • **The number of pathways solutions that providers can offer for each of the objectives** We propose that providers only have 1 investment solution for each investment pathway objective. • **Choice architecture** We do not intend to prescribe the choice architecture providers should use to present investment pathways. We are, however, consulting on some basic rule requirements: – once the consumer meets the application criteria they must be offered investment pathways, as well as the other investment solutions the provider chooses to offer – investment pathways must have at least equal prominence to the non-pathways solutions the provider offers – however, non-pathways solutions must not be presented to the consumer alongside the investment pathways objectives or solutions – before a non-advised consumer selects a non-pathways investment, they must be given a second opportunity to use the investment pathways – when a provider offers a consumer any investment solution they must tell them that they may benefit from shopping around, and that they can receive free, impartial guidance on shopping around from the SFGB We also recognise there will be circumstances where a non-advised consumer explores the investment pathways, but does not select an objective. Or they may select an objective but fail to select the pathways solution. We propose to make guidance that says, in these cases, the provider should prompt the consumer to take advice or guidance, direct them to review the investment pathways again, or give them more information to help them make their investment decision. We propose to amend our Perimeter Guidance Manual (PERG) to include investment pathways examples.

Chapter	Summary of our proposals
7	**Our requirements for providers on the investment solutions** • **Requirements for offering pathways solutions** In summary, our proposed rules: – do not prescribe the pathways solutions or risk profile providers should use for each investment pathway objective – allow providers to offer pre-existing investment solutions for any of the investment pathway objectives where they meet the relevant objective – prevent providers from offering the same pathways solutions for all the objectives – require providers to label pathways solutions clearly with the name of the investment pathways objective they are linked to – prevent providers from labelling any non-pathways solutions in ways that imply they are linked to a pathways solution • **Allowing providers not to offer pathways solutions for all – or any – of the objectives** We propose to allow small providers to choose not to offer pathways solutions. These providers would still have to take non-advised consumers through the choice architecture and present the objectives. Where they chose not to offer pathways solutions they would instead have to refer consumers to either: – another provider's pathways solutions; or – the SFGB's drawdown comparator tool (when operational) Other (larger) providers will have to provide pathways solutions for at least 2 of the 4 objectives. They will have to refer consumers to another provider's pathways solutions for any objectives where they don't provide one themselves. • **Qualifying for the small provider easement** We are proposing that only providers with fewer than 500 non-advised consumers a year entering drawdown can use the easement. Small providers that want to use the easement should assess how many of their consumers are likely to enter drawdown in the next 12 months without taking advice, and repeat this process at least every 12 months.

Chapter	Summary of our proposals
8	**Other key elements of our proposals** • **The product governance requirements that will apply to providers offering pathways solutions** Some providers will already have to meet the product governance requirements in our Product Intervention and Product Governance Sourcebook (PROD). We propose to make rules to ensure that all providers who manufacture or distribute pathways solutions must meet the same rules on product governance. We also propose to create additional rules for manufacturers and distributors of pathways solutions. This will strengthen the protections for investment pathways consumers in some key areas. These include enhanced review requirements for manufacturers and distributors of pathways solutions, and specific requirements on providers referring consumers to pathways solutions provided by other providers. • **The information that providers should give consumers using investment pathways** All consumers in drawdown will receive the existing annual statement set out in our Conduct of Business Sourcebook (COBS). However, we propose that this statement must include the following additional information for investment pathways consumers: – a statement reminding the consumer of the value of their drawdown pot and their investment pathway choice(s) – information on the other investment pathways available to them – a statement reminding the consumer that they can switch their investments or move into another product at any time, and that they should shop around before doing so We also propose guidance that if the consumer has not made any changes to their investment pathway in 5 years since entering it, or after a further 5 years has elapsed, their provider should consider including in the next annual statement they are due to receive: – a statement reminding the consumer that 5 (or 10, as relevant) years has elapsed since they selected the investment pathway – an enhanced prompt to the consumer to review their investment decision • **The records that providers should keep** To help providers meet existing requirements in our Handbook and allow us to assess the impact of our proposals, we propose to set out in guidance a non-exhaustive list of the areas where we believe it is most important that they keep good records. For example, we propose that providers record the numbers of non-advised consumers who were offered each pathways solution, if these consumers selected it, and what action the provider took where a consumer did not select it. • **Implementation timeline** We consider that providers should be given 12 months to implement these proposals from the date we publish our final rules and guidance.

4 Investment pathways: investment pathways and why we are proposing to implement them

4.1 In this chapter, we explain why we're consulting on the investment pathways proposal set out in CP18/17, and why we do not propose to consult on a single, default investment pathway.

Our investment pathways proposal

Points raised for discussion in CP18/17

4.2 In CP18/17 we explained the concept of investment pathways and why we considered they were needed. We explained that an investment pathway comprises a ready-made investment solution – for example, a multi-asset fund – that a provider believes meets a broad objective. These broad objectives would correspond to different ways a consumer might wish to use their drawdown pot. We recognised that investment pathways were meant for consumers who were struggling with, or struggling to engage with, the decision about how to invest the part of their pension that moved into drawdown once they had taken their tax-free cash.

Feedback received

4.3 Most respondents to CP18/17 supported the concept of investment pathways. This included providers, trade associations and consumer groups. Opposition to the concept came primarily from SIPP operators, who argued that the concept was fundamentally at odds with the SIPP business model, and from those respondents who believed that only advised consumers should be able to enter drawdown.

Our view

4.4 Given the positive feedback on the concept of investment pathways from most respondents to CP18/17, we are now consulting on rules on investment pathways.

4.5 We have carefully considered all the feedback we received from SIPP operators on applying investment pathways in their business models. We have also sought further information from many of them to work out whether the harm we found in the ROR review exists across the SIPP market. We set out the headline results of this further evidence, and our conclusions on applying investment pathways in SIPPs, in paragraphs 5.23 to 5.34 below. We give a more detailed summary of the results of this further evidence in Annex 2.

4.6 We do not believe that requiring consumers entering drawdown to get advice would be a better alternative to investment pathways. It would restrict consumers' rights to access the tax-free cash part of their pension. Advice can be expensive, and could be disproportionate for consumers with smaller pots. When Government introduced the pension freedoms, it did not impose a compulsory advice requirement for consumers entering drawdown. Instead, it introduced free, impartial pensions guidance (provided by Pension Wise) to help consumers with decisions about accessing their pension.

No single, default investment pathway

Points raised for discussion in CP18/17

4.7 We proposed that providers should offer several investment pathways. But we recognised that some stakeholders had said that a single, default investment pathway – targeting unengaged consumers who do not make an active investment choice – would be a more appropriate intervention. We explained in CP18/17 that we did not believe this was appropriate, as a single investment pathway could not capture the diverse needs of consumers in drawdown. A single, default investment pathway might reinforce the lack of consumer engagement we had seen, and potentially reduce providers' appetite for innovation.

Feedback received

4.8 Most respondents agreed that a single, default investment pathway is unlikely to be suitable in drawdown. However, some respondents suggested that there was value in having a 'default' investment solution for consumers who didn't want to engage, as well as investment pathways. One respondent suggested that we should give a view on the 'parameters' of this investment solution.

Our view

4.9 The feedback we received to CP18/17 has not changed our view on whether a single, default investment pathway could be appropriate for non-advised drawdown consumers. So we are consulting on requiring providers to offer 4 investment pathways to their non-advised drawdown consumers.

4.10 Many providers responding to the consultation said that they require an active investment decision from the consumer before they move their funds into drawdown (and pay out any tax-free cash element of the pension). We welcome that approach.

4.11 Our rules do not prevent providers from offering an investment solution for consumers who fail to engage with their investment decision. But we do not consider that we are best placed to set the 'parameters' of that investment solution. Providers are better able to understand the needs of their unengaged consumers. We only propose to introduce 1 requirement on the 'parameters' of this solution. This is that, if the consumer is to move into the investment solution without making an active decision, it cannot be wholly or predominantly in cash (unless there is an existing contractual provision or scheme rule in place that provides for this). Please see Chapter 9 for more information.

5 Investment pathways: the consumers and providers our requirements will apply to

5.1 In this chapter, we explain which consumers will be covered by our investment pathways proposals. This includes consideration of those consumers who enter drawdown in stages. We also explain the work we have undertaken to understand the impact of our proposed remedies on SIPPs, and how this has fed in to our proposals for consultation.

The consumers covered by these proposals

Points raised for discussion in CP18/17

5.2 We explained in CP18/17 that investment pathways were primarily intended to help non-advised consumers. But we recognised that there may be rare circumstances where an investment pathway could be suitable for an advised consumer.

5.3 We said we intended to consult on rules to make it clear what we considered to be an 'advised' consumer for the purposes of applying our investment pathways proposals. That is a consumer who is advised on their decision on how to invest their drawdown pot.

5.4 We asked respondents whether they agreed that advised consumers should be able to access investment pathways, and whether they agreed with our proposed definition of an 'advised' consumer for the purposes of our rules.

5.5 In CP18/17 we also asked whether the fact that we did not intend our proposals to apply to UFPLS created a risk that providers, to avoid the cost of implementing our investment pathways proposals, would instead push non-advised consumers towards taking UFPLS.

Feedback received

5.6 Most respondents agreed that investment pathways should be made available to advised drawdown consumers. Some respondents added that the circumstances in which they would be – or form part of – a suitable investment for an advised consumer were limited. This is because advised consumers were usually better served by a more tailored solution. Most respondents also agreed that 'advised' in this context should mean 'advised on the relevant drawdown investment decision'.

5.7 Most respondents did not think there was a risk that our investment pathways proposals could have the unintended consequence of providers pushing more non-advised consumers towards taking UFPLS. However, some suggested that we should monitor the movement of non-advised consumers into UFPLS.

Our proposals for consultation

5.8 Our proposed rules requiring providers to offer investment pathways will apply when:

- a consumer moves all or part of their pension savings into drawdown, or
- a consumer transfers funds already in drawdown into a new drawdown arrangement

unless they have received advice about either of these transactions.

5.9 We propose that a consumer is an 'advised' consumer for the purposes of these proposals if they are advised on how to invest all or part of their drawdown pot. There may be cases when they are advised on one investment decision for their drawdown pot but subsequently make another for the same drawdown pot (or new funds being moved into drawdown from that pot) without taking advice. In these circumstances, we propose they should be treated as non-advised for the later investment decision if it is made:

- more than 12 months after the transaction they were advised on, or
- within 12 months of the transaction they were advised on and they have not confirmed that their personal or financial circumstances are unchanged since they received the advice

It will be the provider's responsibility to ensure that the consumer is categorised correctly.

5.10 Existing requirements in our Handbook will mean that advisers must consider available pathways solutions when they make their suitability assessment for their retail clients who are making a decision about drawdown funds. We are also proposing guidance to remind firms of this obligation; this is set out in Appendix 1. We appreciate that a tailored solution will be more suitable for many advised consumers than a pathways solution. But we also recognise there will be situations where a pathways solution may be more suitable than a tailored solution – for example, where the consumer has a small pot. We do not believe that considering pathways solutions in suitability assessments would be onerous for advisers, or that it should increase the costs of advice for consumers.

5.11 Our proposals will not apply to consumers taking an UFPLS. This is because these consumers will have made a decision to keep their pension savings in the arrangement they have used in the accumulation phase. However, our Retirement Income Data Return enables us to see whether firms are switching consumers to UFPLS. We will review this after our investment pathways proposals have been implemented and take action if we consider it necessary.

How these proposals apply when the consumer enters drawdown in stages

Points raised for discussion in CP18/17

5.12 We recognised in CP18/17 that some consumers put their pension savings into drawdown in stages. Our view was that these consumers should be required to engage with the investment pathways selection process each time they put funds into drawdown. This is because the consumer may have different objectives for different tranches of their drawdown pot. We asked respondents whether they agreed with our suggested approach.

Feedback received

5.13 Most respondents opposed our proposal to require consumers entering drawdown in stages to engage with the investment selection process each time they move funds into drawdown. While some respondents agreed with our proposed approach, others suggested that providers should be able to provide an abbreviated process. Alternatively, providers should be able to simply ask the consumer if their objective remained the same on all subsequent occasions when they moved funds into drawdown.

5.14 Some SIPP operators added that their business model made no distinction between funds that had been moved into drawdown and those that hadn't. These operators suggested that a consumer should be able to decide to apply an investment pathway to all of their pot, regardless of whether the whole pot had been moved into drawdown.

Our proposals for consultation

5.15 Some non-advised consumers are very clear about how they want to move their pension savings into drawdown. These consumers may do what is sometimes described as 'drip-feed drawdown'. This involves taking small proportions of their tax-free cash entitlement on a pre-agreed, regular basis with the relevant amount moving into drawdown each time. A consumer may choose an investment pathway and agree with their provider how they want to move their funds into drawdown on a regular basis in the future. In these cases, we do not consider it is in the consumer's best interests to require them to undertake the full investment selection process each time funds are subsequently moved into drawdown. We believe these consumers are likely to be engaged with the decisions around how to invest their drawdown pot. So, requiring the full investment selection process each time they move funds into drawdown is not going to help their decision-making, but simply act as a barrier to their taking further tax-free cash from their pension savings.

5.16 However, the consumer may select an investment pathway and take only part of their tax-free cash entitlement without agreeing with their provider how they want to take tax-free cash and move funds into drawdown in the future. In these cases, we propose these consumers must undertake the full investment selection process explained in this CP on each occasion they subsequently move funds into drawdown. Some consumers will take only part of their tax-free cash entitlement from their pension savings when they first dip into them, particularly if they want this tax-free cash for a specific purpose. We have no evidence to suggest that these consumers are engaged with how to invest the funds they have moved into drawdown. So we consider that when these consumers take the rest of their tax-free cash entitlement, it is in their interests to be taken through the full investment selection process.

5.17 Some SIPP operators asked us to confirm whether an investment pathway could be applied to the whole of a consumer's pot, so possibly encompassing both funds in drawdown and funds not in drawdown. Our proposed rules do not prevent providers from offering their non-advised consumers investment pathways for both funds in drawdown and funds that remain in accumulation.

Q1: Do you agree with our proposed rules on when a consumer must be offered investment pathways, including how consumers who enter drawdown in stages should be treated, and that those who take an UFPLS are not included?

The providers covered by these proposals

Points raised for discussion in CP18/17

5.18 We said we intended to apply investment pathways to all providers of non-advised drawdown, including SIPPs. We explained the SIPP market had expanded significantly in recent years, with some SIPP operators targeting 'mass market' consumers. We had seen evidence that the potential harms we are concerned about may occur in these SIPPs. However, we also recognised that some SIPP operators focused on advised and sophisticated consumers and might lack the resources, expertise or permissions to implement investment pathways.

5.19 Therefore, in CP18/17 we asked questions about the challenges of applying investment pathways to SIPPs. We also asked whether there should be some form of carve-out for certain types of providers, such as those that only served sophisticated consumers. Options we asked for feedback on included:

- not requiring providers to offer investment pathways to non-advised consumers who are certified as sophisticated or high-net-worth investors, or who pass an appropriateness test to confirm they can select their own investment strategy
- not requiring providers to offer investment pathways to non-advised consumers with an existing self-selected investment strategy
- allowing providers with small numbers of non-advised consumers to refer consumers to another provider for all of the investment pathways

Feedback received

5.20 Most respondents agreed that investment pathways should be applied to SIPPs. They thought all non-advised consumers would benefit from being offered investment pathways, even if many SIPP consumers chose not to use them and select their own investments. However, some respondents, including many SIPP operators, were strongly opposed. They argued SIPP consumers were more sophisticated so would not benefit from investment pathways, and that investment pathways were incompatible with the design of SIPP products.

5.21 Respondents were split on whether SIPP operators who serve only sophisticated or advised consumers should be exempted from our investment pathways proposals, for similar reasons to those above. Responses were also mixed on how providers could identify sophisticated customers:

- Most of those who gave a view thought it would possible for providers to demonstrate that consumers were sophisticated through a certification system.

However, others thought this would be too complex or risked being a tick-box exercise.

- Most of the responses that mentioned high-net-worth certification thought it was not a good way to identify sophisticated consumers, as not all wealthy consumers are knowledgeable.

- Few respondents supported the idea of using an appropriateness test to identify sophisticated consumers.

5.22 Respondents were evenly split on whether providers with small numbers of non-advised consumers should be able to refer these consumers elsewhere, rather than offer investment pathways themselves. Many of those who responded to this point thought this was a pragmatic and proportionate approach. But respondents had different views on where providers should refer these consumers, with some suggesting guidance or the SFGB drawdown comparator tool. Some respondents pointed out that many of these consumers were likely to have previously had an adviser, and such 'orphan clients' should be encouraged to select a new adviser. We summarise and discuss responses on whether providers should refer consumers to other providers' pathways solutions later in this CP in paragraphs 7.14 to 7.22.

Further work we have undertaken

5.23 As well as asking for feedback on our questions, we collected data from SIPP operators on the numbers of non-advised drawdown consumers, particularly on how many are predominantly invested in cash. Our aim was to understand the impact of our proposed remedies on SIPP operators, and to identify potentially unengaged non-advised consumers. This would help us understand if the harm that investment pathways are designed to address is spread through the SIPP market or limited to certain providers.

5.24 We did not send our data request to large life insurers that provide SIPPs. This is because we considered we already had enough data on these types of providers from our earlier data collection. We summarised these findings in the Final Report. Almost all the SIPP operators in our target population sent us responses, and overall the data received were of good quality. We give more detail about the request in Annex 2.

5.25 Our SIPP data request demonstrated that the harms we are seeking to address exist in the SIPP market:

- SIPP operators reported that almost 96,000 plans went into drawdown in the 3 years following pension freedoms, and up to 35,000 (36%) of those plans went into drawdown without the consumer taking advice.

- We found that 6,412 (18%) of these non-advised consumers' plans are highly (80% or more) invested in cash. Smaller pots are much more likely to be invested in cash than larger pots. 62% of those highly invested in cash have been in drawdown for over a year and a third for over 2 years, suggesting that most of these consumers are not temporarily in cash while making an investment decision.

- Consumers who transfer to a SIPP to access drawdown are much more likely to be in cash than those who are existing SIPP consumers before entering drawdown.

This suggests that many consumers are failing to make an investment decision when they transfer.

5.26 However, the data also show that most SIPP operators are small and have few non-advised drawdown consumers. They suggest that the potential harm we have identified is heavily concentrated in the small number of 'mass market' SIPP operators. Of the 71 SIPP operators that provided data, just 5 of them have over 90% of the non-advised plans that were highly invested in cash. In contrast, 24 of the 71 SIPP operators had no plans that were highly invested in cash and another 29 firms had less than 10 such plans.

5.27 In the data request, we also asked SIPP operators what they would do if we required all providers to offer investment pathways to non-advised consumers. 18% said they would implement investment pathways, including the largest SIPP operators by number of non-advised consumers. 39% said they would rather restrict their drawdown offering to advised consumers only, with the remaining 42% being unsure. This suggests that most smaller SIPP operators remain focused on advised consumers.

5.28 However, the 18% who said they would implement investment pathways have 76% of the non-advised SIPP plans that went into drawdown last year. This means that most non-advised SIPP consumers are with SIPP operators that will implement investment pathways. On the other hand, up to 24% of non-advised plans that entered drawdown last year were with the other 82% of SIPP operators that may choose not to implement pathways and only allow advised consumers into drawdown. This means up to 2,650[2] non-advised consumers a year could be forced to transfer or take advice to enter drawdown if we require SIPP operators to implement investment pathways for all non-advised consumers.

Our proposals for consultation

5.29 We have considered the evidence we have gathered on SIPPs carefully, along with the feedback we received to the discussion questions on SIPPs in CP18/17. The harm we are addressing through investment pathways exists in the SIPP market, with 18% of non-advised SIPP consumers highly (80%+) invested in cash. Therefore, we believe that non-advised SIPP drawdown consumers should be offered investment pathways. Most respondents to CP18/17 agreed with this view.

5.30 However, the evidence also shows that there are many small SIPP operators with relatively few non-advised consumers. Most of these SIPP operators have less than 10 non-advised consumers who are highly invested in cash. We understand that most of these SIPP operators would prefer not to implement investment pathways, and would likely require consumers to take advice before going into drawdown.

5.31 As set out in paragraph 5.28, around 1,250 to 2,650 consumers entered drawdown last year with SIPP operators that say they might restrict drawdown to advised consumers. These consumers could be inconvenienced, or incur extra costs, if they are forced to transfer or take advice when they don't want to. So we have considered potential ways of making it possible for SIPP operators to continue to serve these consumers.

2 Our data show that last year 1,250 non-advised consumers entered drawdown with SIPP operators that say they would not implement investment pathways, and 1,400 with SIPP operators who are unsure. There were 8,500 with SIPP operators that said they would implement investment pathways.

5.32 One potential option might have been to exempt sophisticated non-advised consumers from the requirements. This would enable SIPP operators that don't implement investment pathways to allow sophisticated consumers to enter drawdown without having to take advice. However, as set out earlier, none of the methods for identifying more sophisticated consumers received strong support from respondents to CP18/17. Overall, we think the complexity of identifying such consumers, and potential risks that some consumers could be incorrectly exempted, are likely to outweigh the potential benefits.

5.33 Another potential option would be to make it easier for providers with small numbers of non-advised consumers to implement investment pathways, so that more providers choose to do so, and fewer restrict their drawdown to advised consumers only. In CP18/17 we suggested that providers with small numbers of non-advised consumers could refer these consumers elsewhere rather than offer investment pathways themselves. The feedback and the data we have gathered have convinced us that this is the most pragmatic way forward. It ensures that all non-advised consumers will be offered investment pathways, regardless of whether they are a SIPP consumer or not. However, it also enables smaller providers (including smaller SIPP operators) to continue to serve any non-advised drawdown consumers who do not require investment pathways. At the same time, it refers those who do require investment pathways to more appropriate providers.

5.34 We set out our full proposals on how this easement for smaller providers would work in paragraphs 7.15 and 7.16 of this CP, alongside our other proposals on the pathways solutions.

Q2: Do you agree with our proposal that all providers of drawdown to non-advised consumers should be covered by our requirements on investment pathways, including SIPP operators?

6 Investment pathways: the choices that providers must offer consumers

6.1 In this chapter, we describe the consumer research we've undertaken since publishing CP18/17 and explain how this has influenced our proposals on the investment pathways objectives. We explain our proposal that a provider can offer only 1 investment solution for each investment pathway objective and our proposals around the choice architecture that providers will use to offer investment pathways to their non-advised consumers.

Investment pathways objectives

Points raised for discussion in CP18/17

6.2 In CP18/17 we explained that we intended to consult on rules that require providers to offer investment pathways that reflect broad, prescribed objectives. We explained that these objectives would aim to capture the different ways a consumer might want to use their drawdown pot.

6.3 We said that we were, at that time, considering 3 objectives. We asked for respondents' views on these objectives, particularly whether they adequately captured the objectives of non-advised consumers entering drawdown.

Feedback received

6.4 There was high-level support from most respondents for the 3 draft objectives in CP18/17. But there was also widespread concern – particularly from providers – that they may be too ambiguous and/or too broad. This might mean non-advised consumers would struggle to understand the objectives, or that providers would struggle to design pathways solutions to meet them.

6.5 Some respondents suggested that we should amend the objectives to give a clear division between what we mean by 'short-term' and 'long period of time'. Most respondents who suggested a time-frame said that 'short-term' should be classified as 5 years or less.

6.6 Several respondents suggested that some non-advised consumers will have more than 1 objective for how they want to use their drawdown pot. They suggested that these consumers should be able to split their drawdown pot across more than 1 objective.

6.7 There was limited support from respondents for the additional objectives we set out in paragraph 3.20 of CP18/17. However, some respondents suggested that there should be an objective for those non-advised consumers who want to use their drawdown pot to buy an annuity, either immediately or in the short-term. Additionally, several respondents suggested that if we mandated our draft objective – 'I want my money to provide an income in retirement' – we would need to ensure that consumers selecting it know that they are not buying an annuity (and so are not buying a guaranteed income).

Further work we have undertaken

6.8 Since publication of CP18/17 we have tested consumers' understanding of different versions of investment pathway objectives. We have undertaken both qualitative and quantitative testing of potential objectives and the information that might be provided alongside them to enhance consumer understanding.

Qualitative research

6.9 Our qualitative research aimed to assess consumer understanding of the proposed investment pathway objectives and help us assess whether consumers can select the objective that is most appropriate for their needs.

6.10 Our provider undertook 15 in-depth interviews with participants aged 54 to 66. None had used – or was planning to use – a regulated adviser for their drawdown investment decision.

6.11 The participants were presented with the investment pathways objectives and asked to make, and explain, a choice for their own situation. The participants were then asked questions about the objective they chose, to assess whether they had understood it.

6.12 The headline findings are summarised below:

- All participants suggested that taking the tax-free cash was an 'obvious' thing to do. Most knew what they wanted to do with the money and said that they preferred having it within their control.
- But most were less sure about what happens to the rest of their pension savings, and of what their options are. For many, this was clearly a secondary and less immediate concern.
- Participants welcomed the proposal to introduce investment pathways. They said they were helpful and relatively easy to use.
- But there were problems with detailed interpretation and understanding the investment pathway objectives presented to participants. These revolved around:
  - poor knowledge of how pensions work
  - not understanding the link between their objectives for their pot in drawdown and their investment strategy for that pot
  - complexity in the detail
  - poor understanding and misinterpretation of some of the language used
- In nearly all cases, participants were relatively easily able to select the investment pathway objective that was the most appropriate for their circumstances.
- But there were some clear failures in understanding. For example, participants equated the 'long-term income' objective with annuities, rather than drawdown. As a result, these participants did not understand that they had to withdraw all their money from their drawdown pot to buy an annuity. Further, while participants

understood the principle behind splitting their drawdown pot between investment pathways objectives, they were less clear about the benefit and rationale of doing so. Participants therefore avoided splitting their pot across investment pathways objectives.

Quantitative research

6.13 The main aim of our quantitative online experiment was to consider how presenting the investment pathways objectives differently affected consumer comprehension. Comprehension was primarily defined as whether respondents could apply the information by correctly choosing an investment pathway objective for specific consumer profiles. A secondary outcome measure was respondents' comprehension of key messages. These messages included, for example, the option to split their drawdown pot across different investment pathways objectives and that they're not locked-in after they have made a choice.

6.14 We used the results of our qualitative research and relevant existing literature to inform the different presentations of the investment pathways tested in this research. We tested with 1,468 participants aged 54 to 70 and with at least one DC pension. We have published the report prepared for us by our external research provider – The Behavioural Insights Team – alongside this CP. In summary, we find a detailed description of the investment pathways objectives significantly increases comprehension by 4 percentage points relative to a minimal information baseline (the control). In the section below we explain how the report's findings have informed our policy approach.

Our proposals for consultation

6.15 The feedback we received on our proposed investment pathway objectives, and the evidence from our qualitative and quantitative research, has convinced us that the approach we set out in CP18/17 is the right one. Our proposed objectives received high-level support from respondents. Participants responded positively to the framing of the objectives as individual personal outcomes. However, we have carefully considered the detailed feedback we have received, and revised the wording of the objectives. We tested this revised wording in our qualitative research, making further small revisions as a result. We made further small revisions following our quantitative testing.

6.16 A key change we have made is to give all the objectives a clear time horizon of 5 years. We believe this gives helpful clarity both to consumers selecting an objective, and to providers designing pathways solutions. Respondents to CP18/17 gave a clear consensus in favour of 5 years, and research participants also responded positively too.

6.17 One key consideration has been whether to include a fourth objective for consumers who plan to buy an annuity at a later date, after entering drawdown. In CP18/17 we did not include such an objective in our main proposal, but did suggest this as a potential additional objective. Respondents gave this some support. Consumers who want to buy an annuity at the same time as taking their tax-free cash do not need to enter drawdown or be offered investment pathways. However, some consumers will want to take their tax-free cash and then buy an annuity later, and a specific investment pathway for this group would enable providers to give them an appropriate investment solution.

6.18 We know that adding another objective adds to consumers' available options, potentially making their decision more complicated. Results from the quantitative experiment show that adding an annuity objective significantly increases accuracy for the annuity consumer profile, but reduces the proportion of correct answers for the non-annuity scenarios. However, on balance, we believe that mandating an objective for consumers who want to buy an annuity within the next 5 years will benefit consumers. We take this view for the reasons set out below:

- Our research shows that including an annuity objective increases consumers' understanding of the difference between an annuity and taking an income through drawdown. When we added an annuity objective, there was a significant increase in the proportion of participants who correctly answered our comprehension question about whether annuities or drawdown offer a guaranteed income. The proportion of participants who incorrectly chose a drawdown income when given a scenario where they required a guaranteed income also reduced.

- Although the numbers of consumers who may pick an annuity pathway may currently be limited, numbers may increase in the future as DC pot sizes increase and consumers have less DB income to rely on, or if annuity rates improve. Consumers may also start to consider annuities later in their retirement, when they review their original investment pathway choice in later years.

6.19 Following the consideration set out above, the 4 objectives we propose are:

- Option 1: I have no plans to touch my money in the next 5 years

- Option 2: I plan to use my money to set up a guaranteed income (annuity) within the next 5 years

- Option 3: I plan to start taking my money as a long-term income within the next 5 years

- Option 4: I plan to take out all my money within the next 5 years

6.20 We remain of the view that we should mandate the wording of the objectives. We also consider that we should mandate the numbering of the objectives. Mandating both the wording and numbering of the objectives will ensure consistency across the industry, together with our clear labelling requirements on pathways solutions. This will have a range of benefits for both consumers and providers:

- ensuring consistency for consumers who have several pots with different providers

- enabling consumers to compare different providers' pathways solutions more easily

- allowing guidance providers to give consumers consistent information and guidance about how investment pathways work

6.21 In our quantitative research, we also tested whether providing more informative text alongside the objectives helped or confused consumers. The text we used across a number of the scenarios is in Table 1 below. The research found that that our extra text caused a small but significant increase in both the proportions of participants that picked the correct objective, and who correctly answered our comprehension questions. This highlights the importance of the information that providers give alongside the objectives, and how this can help consumers understand the objective. We do not propose to mandate the information that providers should give alongside the objectives. This is because we do not want to hinder providers' ability to refine and improve this information in the light of their own knowledge of consumers, their own consumer testing and their experience of implementing investment pathways.

Table 1: Text used across a number of scenarios tested in our quantitative research

Option 1: I have no plans to touch my money in the next 5 years	**Option 2: I plan to set up a guaranteed income (annuity) within the next 5 years**	**Option 3: I plan to start taking a long-term income within the next 5 years**	**Option 4: I plan to take my money within the next 5 years**
• I don't want to withdraw money in the next 5 years. • I want to invest my money for at least 5 years. • If my plans change, I can still make withdrawals but I'll have to consider if this Option is still the right choice.	• I want to buy an annuity within the next 5 years. • I want a guaranteed income for life or a set period. • Once you buy an annuity you cannot usually change your mind.	• I want to set up regular or occasional withdrawals straight away or within the next 5 years. • I want to take these withdrawals over a longer time period or through retirement. • This income is not guaranteed. If I want a guaranteed income I can buy an annuity. • If my plans change, I'll have to consider if this Option is still the right choice.	• I want to take out all my money within the next 5 years. • If my plans change, I do not have to take all my money out within the next 5 years, but I'll need to consider if this Option is still the right choice.

6.22 Our research suggested two further ways for increasing consumers' understanding of the objectives. First, the quantitative research found that the more scenarios a participant saw the more likely they were to select the correct objective. So providers may want to consider how the way they design their consumer journey can help increase understanding, for instance by increasing exposure to information about the investment pathways. Second, our qualitative research suggested that giving consumers fictional case studies of how consumers might choose investment pathways may help them understand and engage with the objectives. Our proposed Perimeter Guidance, in our Perimeter Guidance Manual (PERG), gives an example of how firms can use case studies that, in general, do not involve them providing regulated advice or a personal recommendation.

6.23 One area of feedback we have considered carefully is how to enable those consumers who have more than 1 objective for their pot to split their pot. As more consumers come to retirement with larger DC pots (which make up a higher proportion of their overall pension wealth), this could become more common. However, in both our qualitative and quantitative testing, participants have struggled with the complexity of splitting their pot across more than 1 objective. So we will not mandate that providers must facilitate pot-splitting. We believe that providers will be in the best position to decide, with their knowledge of their consumers, whether to enable them to split their pot, and how best to help them with the decision.

6.24 Our results show that consumers find it much harder to identify the most appropriate objective for some scenarios than for others. For example, respondents were much more likely to pick the most appropriate objective if they did not want to touch their pot for at least 5 years, compared to if they had more than one objective for their pot. This suggests that some consumers with less straightforward needs or objectives are likely to need more support, and that providers should consider this when designing their consumer journey.

6.25 Our research highlights how some consumers may struggle to select the most appropriate objective. The help and information that providers give to consumers will be crucial to ensuring they choose an objective that matches their needs. We believe that by sharing consumer insight and industry good practice, we will enable all providers to give their customers more effective help and information. So we want to work with providers as they implement investment pathways, to explore how we might help create a shared understanding of what is effective, particularly around helping consumers select objectives. This might include collaboration around consumer testing conducted during the implementation period. Following publication of this CP, we will be discussing with providers and industry trade bodies how we can work to facilitate the development of industry good practice in this area. Our post implementation review will also give us an opportunity to evaluate the effectiveness of information provided to help consumers select appropriate objectives.

Q3: **Do you agree with our proposed 4 objectives, and mandating all providers to use our prescribed wording when presenting these objectives?**

The number of pathways solutions that providers can offer for each of the objectives

Points raised for discussion in CP18/17

6.26 We said in CP18/17 that providers should only offer 1 pathways solution for each of the objectives, to keep the selection process simple for the consumer. Our concern was that introducing another choice for non-advised consumers would make the investment selection process more complex and, potentially, less engaging for them.

Feedback received

6.27 A small majority of respondents disagreed with our proposal to require that providers offer just 1 investment solution for each of the investment pathways objectives. Many of these respondents argued that consumers' appetite for risk needs to be considered, and that providers should be able to offer different risk-rated funds for each objective (as consumers' capacity and appetite for risk differed).

Our proposals for consultation

6.28 We appreciate that, particularly for longer-term investing, some non-advised consumers might benefit from being offered lower or higher risk alternatives that match their appetite – and capacity – for risk. However, our intervention is intended to benefit some of the most unengaged consumers entering drawdown. We have concerns that presenting these consumers with a secondary choice could make them more disengaged with the process of selecting an investment pathway objective. On balance, we consider it is more appropriate to consult on a rule that limits providers to 1 pathway solution for each investment pathway objective.

Q4: **Do you agree that providers should only be able to offer 1 pathway solution for each investment pathway objective?**

Choice architecture

Points raised for discussion in CP18/17

6.29 In CP18/17 we set out an example choice framework which showed how providers might offer investment pathways. We called this the 'choice architecture'. We explained that, in our view, the choice architecture adopted by providers was key to ensuring that the consumer chose the investment pathway that best met their objectives for their drawdown pot. But we also recognised that there were competing priorities for providers. For example, we said that while providers should not use the choice architecture to steer consumers away from the investment pathways, they should also ensure there are no unnecessary hurdles for consumers that want to invest elsewhere. We asked respondents to comment on the approach we suggested and asked them to provide alternatives if they chose.

6.30 We said that we believed that providers could provide the choice architecture described without giving a personal recommendation.

6.31 We recognised that some providers will want to offer their non-advised consumers access to investment solutions other than those within the investment pathways. We also recognised that there are situations where providers will have no choice but to offer a particular investment solution.[3] We said that we did not propose to prevent providers from offering investment solutions to their consumers outside the scope of investment pathways.

Feedback received

6.32 While respondents had different views, most providers preferred a less prescriptive approach to rules around the choice architecture. Many of these providers said it was important they had flexibility so they could integrate investment pathways within their current presentation of the consumer journey. Flexibility would also enable them to identify and cater for consumers with more complex needs.

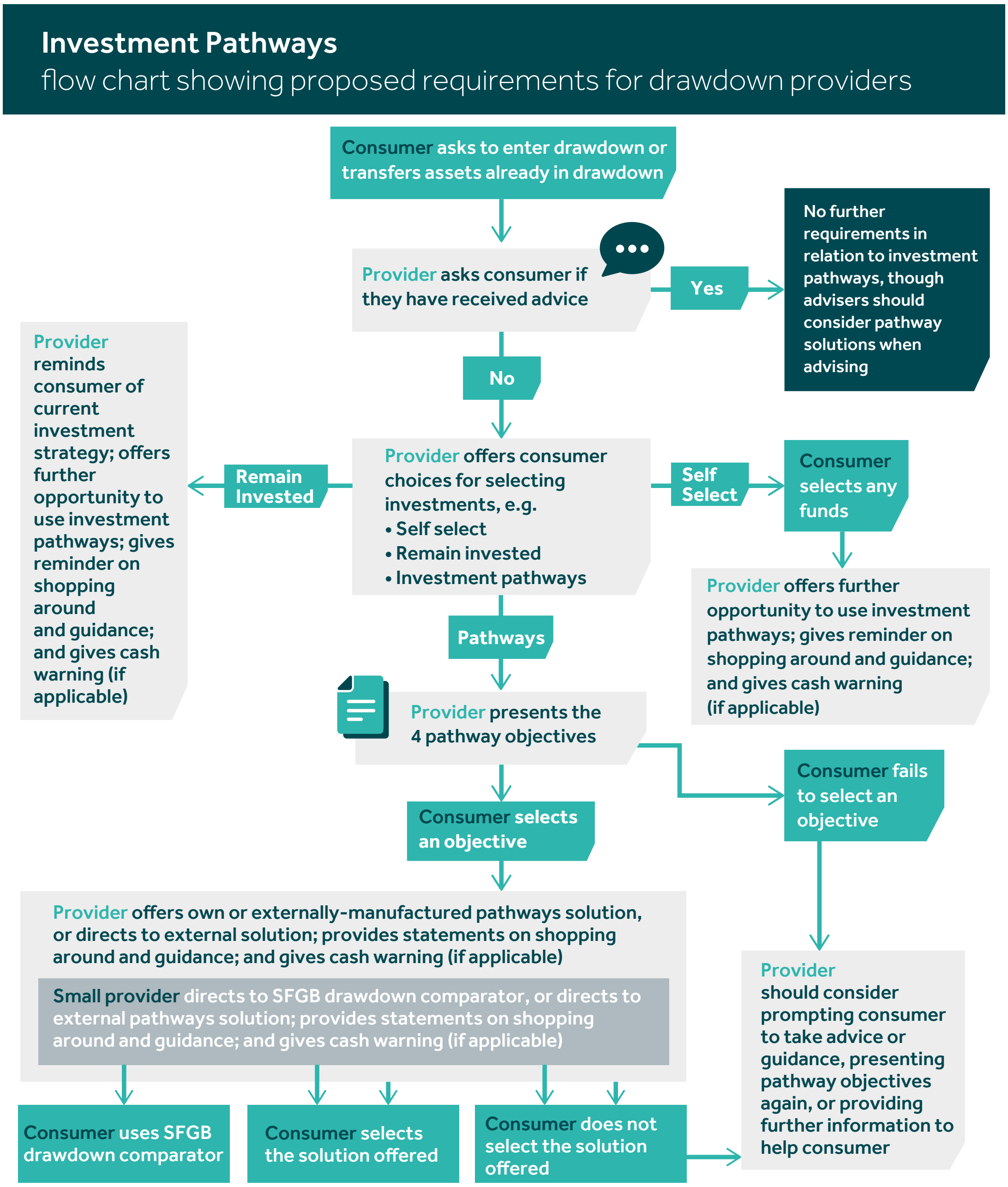
6.33 Some respondents were concerned about giving non-advised consumers an option to 'stay in their current asset allocation' at the outset, before they had viewed investment pathways. They were concerned that this could become the path of least resistance for the most disengaged consumers. However, other respondents – in particular, SIPP operators – suggested that this option should be included, as many thought that their non-advised consumers would want to stay in their current allocation.

6.34 Despite our view in CP18/17 that providers can follow the choice architecture without giving a personal recommendation, some respondents remained concerned that consumers might think they had been advised. This would therefore expose providers to some legal risk. Some respondents asked for further guidance on how providers could deliver investment pathways without giving a personal recommendation.

6.35 Finally, almost all respondents agreed that providers should be able to present investment solutions other than those within the investment pathways, to non-advised consumers. Some respondent providers wanted us to clarify whether these investment solutions could be presented alongside the investment pathways.

3 For example, where the consumer moves into drawdown in their existing contract and that contract provides that they will move into a particular investment solution if they do not make an active investment decision to invest elsewhere.

Our proposals for consultation



6.36 Having carefully considered the feedback, we do not intend to prescribe the choice architecture providers should use to present investment pathways and other investment options they may offer to their non-advised consumers.

6.37 We agree with providers that it is important that they can integrate the investment pathways in their existing consumer journey. We also agree they need to have the necessary flexibility to ensure that non-advised consumers with complex needs can find an appropriate investment solution from outside the prescribed investment pathways. However, we consider that there should be some requirements set out in rules to ensure that providers give investment pathways a prominent place in the non-advised consumer journey.

6.38 We are consulting on the following rule requirements:

- once a provider has confirmed that a non-advised consumer meets the application criteria, they must offer the consumer the investment choices that are available to them, which must include the option of investment pathways
- the presentation of the consumer's option to use investment pathways must have at least equal prominence to the consumer's option to, where applicable:
  - choose other investment options that the provider offers, or
  - stay in their current asset allocation
- if a provider offers investment options for non-advised consumers outside the investment pathways, they must not present these to the consumer alongside the investment pathways objectives or solutions
- before a non-advised consumer finalises an investment selection from outside the investment pathways, they must be given a second opportunity to use the investment pathways
- when providers offer any investment solution to a consumer they must tell the consumer that they may benefit from shopping around, and that they can use the SFGB drawdown comparator

6.39 We want non-advised consumers to be able to access the whole range of potentially appropriate options that their chosen provider offers. We recognise that some non-advised consumers might be looking for a more bespoke offering than the investment pathways. However, our proposed rules mean that the provider will present investment pathways to the consumer with at least the same prominence as non-investment pathways options and, if relevant, the consumer's option to remain invested in their current asset allocation.

6.40 We also want providers to ensure that it is clear to the non-advised consumer that the investment pathways options are separate from the other investment options that their provider might offer. We consider that our proposed rules on the choice architecture for investment pathways, combined with our proposed labelling requirements in paragraph 7.6, will ensure that the distinction is sufficiently clear to the non-advised consumer.

6.41 Our proposed rules will not prevent providers from allowing non-advised consumers to stay in their current asset allocation, where this option is available to them. We recognise that the consumer's current asset allocation could become the 'path of least resistance' for some. But our rules for choice architecture aim to ensure that, if a non-advised consumer chooses to remain in their current asset allocation, then they have made an informed decision to do so. As covered in Chapter 9, if the consumer's current asset allocation is wholly or predominantly in cash then the consumer will have to make an active decision to move into it, unless their contract or the relevant scheme rules mean they will move into it if they make no decision. They will also receive a warning about the risks of cash investment.

6.42 We know there will be situations where a non-advised consumer explores the investment pathways, but does not select an objective or selects one but does not transact. This might happen if, for example, the consumer considers that the risk profile of the pathway solution does not match their capacity for – or attitude to – risk. We propose guidance that says that, if this happens, the provider should prompt the non-advised consumer to take advice or guidance, direct them to review the investment pathways again or give them more information to help them make their investment decision.

6.43 We have considered respondents' concerns that the choice architecture could lead non-advised consumers to believe they have been given advice. We continue to believe that providers can offer investment pathways without giving a personal recommendation. However, we recognise that further guidance might help providers design their consumer communications and choice architecture in a way that avoids this risk. So we propose to amend PERG to include investment pathways examples. Our examples apply both to providers that manufacture investment pathways and those that distribute them. The examples are in Appendix 1.

Q5: **Do you agree with our proposed rule requirements for the choice architecture, and do you agree that providers can offer investment pathways without giving the consumer a personal recommendation?**

7 Investment pathways: our requirements for providers on the pathways solutions

7.1 In this chapter, we give our proposals for how providers should offer pathways solutions to consumers. We also set out our proposal to allow providers not to provide pathways solutions for all investment pathway objectives, including our proposed easement for small providers.

Requirements for offering pathways solutions

Points raised for discussion in CP18/17

7.2 In CP18/17 we set out for discussion the following proposals on how providers should offer pathways solutions to consumers:

- We would not prescribe the investment solution or risk profile that providers should use for each investment pathway objective. This would give providers freedom to design investment solutions using their knowledge of their consumers, and to allow innovation.
- If a provider thinks it appropriate, it could offer pre-existing investment solutions for any of the investment pathway objectives.
- Providers should not offer the same pathways solutions for all the objectives.

7.3 We suggested that a pathways solution should have a clear description, with a name that clearly reflects its objective.

Feedback received

7.4 Most respondents strongly agreed that we should not be prescriptive about the pathways solutions, as providers were in the best position to design appropriate investment strategies. However, some respondents argued for a level of standardisation or for a consistency in labelling that would enable comparisons and aid shopping around.

7.5 Almost all respondents agreed that providers should be allowed to use pre-existing investment solutions to provide pathways solutions. They also agreed that providers should not be allowed to provide a single pathway solution to cover all objectives.

Our proposals for consultation

7.6 Most of our proposals on investment solutions received strong support from respondents, and we are now consulting on their introduction. In summary, consistent with our discussion ideas, our proposed rules:

- do not prescribe the investment solution or risk profile providers should adopt for each investment pathway objective
- allow providers to offer pre-existing investment solutions for any of the investment pathway objectives as long as they meet the relevant objective
- prevent providers from offering the same pathways solutions for all the objectives
- require providers to label pathways solutions clearly with the name of the investment pathways objective they are linked to
- prevent providers from labelling any other investments in ways that imply they are a pathways solution

7.7 While we do not plan to prescribe the investment solution or risk profile providers should adopt for each investment pathway objective, we do expect providers to carefully consider their approach when designing pathways solutions (or selecting pathways solutions designed by other providers). For instance, providers will need to consider the level of investment risk that is appropriate for each pathways solution. When considering these issues, providers will need to take a wide range of relevant factors into account, and consider the kind of consumer they expect to choose that particular objective.

7.8 Providers will also need to make consumers aware of the key risks and features of the pathways solution that they have chosen. A key risk for all consumers in drawdown is withdrawing too much money and emptying their pot too quickly. The communications consumers receive in the run-up to retirement should already warn them about this risk, and consumers who enter drawdown will receive a projection that shows if the amount they are withdrawing from their pot is sustainable. These are provided in their Key Features Illustration when they enter drawdown, and every year in their annual statement, and will include a projection of when the consumer will run out of funds given their proposed or current pattern of withdrawals.[4]

7.9 Our Handbook requirements mean that where a provider has designed the pathways solution with a particular rate of withdrawal in mind, this will need to be clearly communicated to the consumer, with some explanation of the risks of withdrawing at a faster rate. Our rules allow providers flexibility as to the rate at which consumers actually take their income.

Q6: Do you agree with our proposed rule to prevent providers from offering the same pathways solution for all the objectives?

Q7: Do you agree with our proposed rules on labelling of pathways solutions?

4 In PS19/01 we have published final rules making changes to the Key Features Illustration and annual statement. For example, we have mandated the inclusion of a summary in the Key Features Illustration. This summary will – amongst other things – show the consumer the age at which their fund is projected to run out (on the basis of the rate of withdrawal they have selected).

Allowing providers not to offer pathways solutions for all – or any – of the objectives

Points raised for discussion in CP18/17

7.10 To enable more firms to offer investment pathways, in CP18/17 we proposed that providers should not have to offer pathways solutions for all the objectives if they do not want to. For 1 or 2 objectives, they could choose not to offer their own pathways solutions, but would instead have to refer consumers to another provider's pathways solutions.

7.11 We also recognised that some SIPP operators may not have the resources, expertise or permissions to set up pathways solutions, and asked for feedback on how SIPPs would be affected by our proposals.

Feedback received

7.12 Respondents were split on whether providers that did not offer pathways solutions for all the investment pathway objectives should have to come to an arrangement with another provider and refer consumers to that provider's pathways solutions:

- Many respondents, including some large and most small providers, argued that forcing providers to come to this kind of arrangement was anti-competitive, or placed too many burdens or risks on the ceding providers. They argued that consumers who pick an objective their provider does not offer a pathways solution for, should be urged to shop around for the best solution, or referred to a guidance provider.

- Many other respondents supported the proposals as a pragmatic solution for when providers are unable to offer a full range of pathways solutions. These respondents included some providers who were happy to come to arrangements with other providers where needed. They said these arrangements might take many forms, such as 'buying in' an externally-manufactured fund to offer in-house, rather than referring consumers to go to another provider.

- Some respondents argued that providers should be required to offer pathways solutions for all the investment pathways objectives. These respondents said this would not be hard for providers and would make it simpler for consumers to select an investment pathway.

- A few respondents also argued that if providers provided in-house pathway investment solutions for only some investment pathway objectives, then the consumer could be easily tempted to change the objective they selected to avoid having to transfer to another provider.

7.13 As set out in paragraphs 5.20 to 5.22, most smaller SIPP operators which responded were strongly against implementing investment pathways. One of the main reasons was that developing pathways solutions, or referring consumers to another provider's pathways solutions, was not part of their existing business model. As we recognised in CP18/17, these SIPP operators do not have the expertise or permissions to design or refer consumers to specific investment solutions.

Our proposals for consultation

7.14 We have considered the mixed feedback to our proposal. The differing responses to this question seem to partly reflect the different sizes and capabilities of providers and their different business models. This is supported by the feedback from smaller SIPP operators about how difficult it would be for them to offer, or refer to, investment solutions.

Allowing an easement for small providers

7.15 Therefore, we propose to allow smaller providers to choose not to offer pathways solutions to any of the objectives. We explain the threshold for qualifying for this easement in paragraphs 7.20 to 7.22. Smaller providers that use this easement would still have to take non-advised consumers through the choice architecture and present the objectives. However, if they choose not to offer pathways solutions they would instead have to refer consumers who select an investment pathways objective to either:

a. another provider's pathways solutions, or

b. the SFGB's drawdown comparator tool, which we expect to be operational before our investment pathways proposals are implemented

7.16 We believe this is a pragmatic and proportionate proposal for a number of reasons:

- It reduces the risk that smaller providers choose not to implement investment pathways at all, and instead restrict drawdown to advised consumers.
- Developing pathways solutions, or coming to an arrangement with another provider may be more difficult for smaller providers given their more limited resources. They will also have fewer consumers across which to spread development or search costs. These costs may be disproportionate for providers whose non-advised consumers are mostly engaged and happy to select their own investment strategy, which may be the case for many small SIPP operators.
- The vast majority of consumers going into drawdown are customers of larger providers, so only a small proportion of consumers will be affected by this proposal (we provide figures later in this chapter).

Proposals for larger providers

7.17 We are not changing our proposal for larger providers. They will have to provide pathways solutions for at least 2 of the 4 objectives, and will have to refer consumers to another provider's pathways solutions for any objectives for which they don't themselves provide a pathways solution. This means that, unlike smaller providers, they cannot refer to the SFGB, and can only refer to other providers for a maximum of 2 objectives. This is because we want as many consumers as possible to be able to access the pathways solutions easily. Our evidence suggests that the harm that investment pathways is addressing is most likely to exist at larger providers, which have more consumers who struggle to make investment decisions, and higher proportions of consumers invested in cash.

7.18 The responses to CP18/17 suggest that few larger providers want to refer consumers to other providers, as they would prefer to keep them. But we believe that requiring all larger providers to offer pathways solutions for all the investment pathways could have a negative impact on some providers who, because of their business model or for other reasons, don't want to offer certain types of investment solutions.

7.19 We have noted concerns that if providers provide in-house investment solutions for some but not all the objectives, then some consumers could potentially be tempted to change their stated preference to avoid having to transfer to another provider. The evidence we have seen of consumers following the 'path of least resistance' to get their tax-free cash does suggest this is a potential risk. But we believe the benefits of allowing providers to refer to other providers' pathways solutions outweigh this potential risk. This is particularly the case given the product governance requirements we set out later in this CP, in paragraphs 8.8 and 8.9. These requirements mean that both the referring and receiving providers must consider consumers' needs and objectives, and make sure they are correctly targeting investment solutions. If a pattern developed of consumers switching objectives to avoid transferring to another provider, this would suggest that the providers' distribution strategies are ineffective at targeting solutions to the correct market. Providers would then need to correct this problem, for instance, by making the process of moving to an external solution more seamless for the consumer.

Q8: Do you agree with our proposed rules requiring larger providers to provide pathways solutions for at least 2 of the 4 objectives and to refer consumers to another provider's pathways solutions for any objectives where they don't provide a pathways solution?

Qualifying for the small provider easement

7.20 To set the threshold for the small provider easement, we have reviewed data from our regular retirement income data request and from our recent SIPP operators data request. These data show that almost all the SIPP operators that do not plan to, or are unsure if they will, implement investment pathways had fewer than 500 non-advised consumers enter drawdown last year. Currently, over 90% of non-advised consumers go into drawdown at providers who have, in total, 500 or more non-advised consumers entering drawdown with them each year. So we propose that only providers with fewer than 500 non-advised consumers a year entering drawdown can use this small provider easement.

7.21 We want the process for providers to assess whether they qualify for this easement to be simple and not create burdens for them. We propose that smaller providers that want to use the easement, should assess how many of their consumers are likely to enter drawdown in the next 12 months without taking advice. When making this assessment they should consider how many non-advised consumers entered drawdown in the previous 12 months, and the potential impact on that number of their business plans over the next 12 months. They should make this assessment at least every 12 months to be able to use the easement, and must keep a record of that assessment. Through the Retirement Income Data Return, we already collect regular data from all pension providers on the number of non-advised consumers entering drawdown, so we should be able to identify if providers are trying to get around this threshold.

7.22 If a provider who has been using the easement identifies that it no longer qualifies, we want it to have sufficient implementation time before it has to comply with the full rules on pathways solutions. In these cases, providers will need time to design or select pathways solutions. So we propose that a provider has a 12 month implementation period if it has been using the easement, but makes an assessment that it is likely to exceed the threshold in the next 12 months. We propose that this 12 month period will begin from the date of the provider's assessment. Conversely, if a provider makes an assessment, as set out above, that it now qualifies for the easement, it can apply the easement straight away with no implementation period.

Q9: Do you agree with our proposed easement for smaller providers, including our proposals for the operation and level of the threshold for qualifying for this easement?

8 Investment pathways: other key elements of our proposals

8.1 In this chapter, we explain the other key elements of our investment pathways proposals. This chapter includes proposals for consultation on product governance for investment pathways, the information that providers should give consumers using investment pathways and the records that providers should keep.

The product governance requirements that will apply to providers offering pathways solutions

8.2 We believe that good product governance will improve consumer outcomes. We want consumers to have confidence that, when they buy financial products without taking advice, those products are designed in their interests and work in the way they expect.

8.3 Our product governance and oversight rules and guidance are in the Product Intervention and Product Governance sourcebook (PROD). PROD aims to improve consumer outcomes by ensuring that firms improve their systems and controls for the design, approval, marketing and ongoing management of products throughout their lifecycle.

8.4 Our rules and guidance in PROD 4 – which came into force on 1 October 2018 – apply to insurers and intermediaries that manufacture or distribute any insurance product for sale to consumers. PROD 4 implements the Insurance Distribution Directive ((EU) 2016/97) (IDD) and delegated acts adopted in accordance with the IDD.

8.5 In PS18/1 we explained that where a pension takes the legal form of an insurance contract, such as an insurance-based group personal pension or a contract-based pension scheme, it will be within scope of the IDD. We also explained that firms carrying on distribution activities will have to meet certain requirements of the IDD. So the requirements in PROD 4 will apply to a number of drawdown providers who will manufacture or distribute pathways solutions.

8.6 However, other drawdown providers give their consumers access to drawdown through an arrangement that does not take the legal form of an insurance contract. These drawdown providers may already be covered by guidance, including our regulatory guide, 'The Responsibilities of Providers and Distributors for the Fair Treatment of Customers'.

8.7 We want to ensure that manufacturers or distributors of pathways solutions are subject to broadly equivalent rules on product governance. We believe that this is in the interests of consumers who will use investment pathways. This is because the consumer is highly unlikely to know about the different product governance requirements that apply to the different arrangements through which they can access drawdown.

8.8 Most drawdown providers manufacturing or distributing pathways solutions will already have to comply with PROD 4. To help ensure consistency, we propose to extend the application of PROD 4 to capture, in relation to the manufacturing or distributing of pathways solutions, providers of arrangements that do not take the legal form of an insurance contract.

8.9 We also propose that all manufacturers or distributors of pathways solutions will be subject to a new chapter in PROD. In this chapter, we propose to create additional rule provisions for manufacturers and distributors of pathways solutions, to improve the protections for investment pathways consumers in some key areas:

- We propose that manufacturers must review the pathways solutions used to provide the investment pathway at least annually.
- We also propose that distributors of pathways solutions who refer consumers to a pathways solution provided externally must:
  - when having regard to the needs, characteristics and objectives of their consumers, have regard to the price, complexity of the product, the financial strength of the provider consumers are referred to, and how efficiently and reliably that provider will deal with consumers
  - review their choice of the pathways solution they refer to at least every 2 years
- As set out in paragraph 7.19, we also propose that manufacturers and distributors of pathways solutions must amend their distribution strategies and take any other appropriate action where they become aware of a pattern of consumers changing their objective selection to avoid having to transfer to another drawdown provider.

8.10 For clarity, please note that if a drawdown provider uses our small provider easement and chooses to refer consumers to the SFGB for all investment pathways objectives, we do not consider they will be manufacturing or distributing a pathways solution for the purposes of PROD.

Q10: Do you agree with our proposed approach to product governance for firms manufacturing pathways solutions used to provide investment pathways? Do you agree with our proposed approach for distributors?

The information that providers should give consumers using investment pathways

Points raised for discussion in CP18/17

8.11 In CP18/17 we set out what information we thought providers should give to consumers in investment pathways on an ongoing basis. Although there were existing requirements in COBS 16.6.8R and COBS 16.6.9G, we considered we might need to introduce specific requirements for investment pathways. We suggested this information could include a reminder of the consumer's chosen pathways solution and that they could switch investment solutions or products. We said that the main purpose of the annual disclosure would be to ensure that the consumer considers whether their current investment pathway is still appropriate for them.

Feedback received

8.12 Most respondents agreed that providers should give consumers this information every year. Many agreed with the fundamental principle that consumers should be regularly reminded of their investment pathway choice and that they can switch to a different investment solution – not limited to investment pathways – at any time.

8.13 Some respondents were concerned that consumers already received too much paperwork and that adding extra information could have the effect of disengaging them. Others suggested that we should go further and ensure that the annual disclosure sets out the rate at which the consumer has drawn income from this pot, with an estimate of how long the pot would last if the consumer continued to draw at that rate.

Our proposals for consultation

8.14 In CP18/17 we consulted on other changes to the information provided in the annual statement to consumers. We have published amendments to the relevant Handbook provisions – COBS 16.6.8R and COBS 16.6.9G – in the Policy Statement published alongside this CP.

8.15 As well as the information provided under the amended Handbook provisions, we propose that consumers using investment pathways must also receive the following within the annual statement:

- A statement reminding them of the current size of their drawdown pot, in pounds and pence, and their investment pathway choice. If the consumer has split their drawdown pot across investment pathways, the statement should show their investment pathways choices and how their drawdown pot is split between these, in pounds and pence.

- Information on the other investment pathways available to the consumer. If the consumer has not split their pot, a reminder of their ability to split their drawdown pot across these (where this option is available).

- A statement reminding the consumer that they can switch their investments at any time (for example, by selecting another investment pathway) or move into another product at any time and that they should shop around before doing so.

8.16 As set out in paragraphs 6.16 and 6.19, the investment pathways objectives ask the consumer to think about their objectives for their pot in drawdown in 5 year periods. Our proposed guidance says that if the consumer has not made any changes to their investment pathway in 5 years since entering the investment pathway, or after a further multiple of 5 years, their provider should consider including in the next annual disclosure the consumer is due to receive:

- a statement reminding the consumer that 5 (or 10, as relevant) years has elapsed since they selected the investment pathway

- an enhanced prompt to the consumer to review their investment decision

8.17 Our additional disclosure requirements for investment pathways will be triggered if the consumer has any proportion of their drawdown pot in a pathways solution.

8.18 We will not prescribe a template for the annual statement specific to investment pathways. However, we expect providers to comply with the relevant product governance requirements for post-sale disclosure. Providers must also comply with other Handbook requirements about how they communicate with consumers, for example, the requirement in COBS to ensure that a communication is fair, clear and not misleading.

8.19 On the issue of sustainability of withdrawals raised in feedback, existing guidance in COBS 16.6.9G (3) says that firms may provide information about the sustainability of the consumer's income over time, to comply with the requirement in COBS 16.6.8R (1). COBS 16.6.8R (1) requires the provider to give the consumer the information they need to review their choice to make income withdrawals.

Q11: Do you agree with our proposed approach for ongoing information to consumers using investment pathways? Do we go far enough, or is there anything further that providers could do to ensure that consumers carefully consider their investment choice on a periodic basis?

Independent governance of investment pathways

Points raised for discussion in CP18/17

8.20 In CP18/17 we said our view was that less engaged, non-advised consumers were most likely to use investment pathways. As a result, we believed that independent oversight of the appropriateness, quality and charges of the investment solutions in investment pathways might be in the interests of these consumers.

8.21 We explained that we intended to introduce independent oversight by extending the existing IGC regime to cover investment pathways. However, we explained that we could also mandate governance arrangements separate from the IGC regime. For example, a potential alternative would be to require the provider's Board to consider and attest to the value for money of the investment solutions it used to provide investment pathways.

8.22 We added that we knew that extending the IGC regime to cover investment pathways would involve more than extending the remit of existing IGCs. This is because most SIPP operators did not operate workplace personal pension schemes and so would not have an IGC. We said we were aware that we needed to carefully consider whether requiring IGCs for all providers' investment pathways was appropriate and proportionate.

8.23 We asked for views on whether the IGC regime should be extended to investment pathways, and whether there should be a requirement for independent oversight of other decumulation products. We also asked respondents whether they thought there should be a carve-out for firms only serving advised consumers, or those in less need of protection, and how this might operate in practice.

Feedback received

8.24 Responses to CP17/18 were mixed. Most providers were opposed to extending the IGC regime to investment pathways, because of the cost and because they thought that governance should be the sole responsibility of the firm. Many also said that they were concerned that extension into the decumulation phase would distract from the IGC's primary focus on the accumulation phase. Consumer and professional bodies were generally supportive. A small number of providers were also supportive, while others said that we should consider further the impact on smaller providers. Other respondents said that we should consider deferring a decision until we have findings from our work on non-workplace pensions.[5]

8.25 Most providers also opposed extending independent governance to decumulation products more generally, as opposed to just investment pathways. As before, many of them were concerned that extension into the decumulation phase would distract from the IGC's primary focus on the accumulation phase. Some SIPP operators also had practical concerns. For example, some said that they operate a wide range of investment portfolios and that it is difficult to see how the IGC could effectively oversee them all. Professional bodies also opposed an extension as a disproportionate and unnecessary response. However, a small number of providers were supportive, saying that new investment solutions that are not provided through the investment pathways framework should have the same level of scrutiny.

8.26 Providers were evenly split on whether there should be a carve-out for providers that only offer decumulation products for advised consumers. Some recommended that independent governance requirements should apply to all consumers, and that there should be a level playing field throughout the market. Others said that advised consumers did not need the same level of protection and extending oversight to them would incur an unnecessary expense. Some providers also cited the practical difficulties in distinguishing between advised and non-advised providers, as consumers change between advised and non-advised throughout their investment life.

Next steps

8.27 After careful consideration, we still intend to extend the IGC regime to cover investment pathways. Many of the larger providers who will offer investment pathways already have IGCs to provide independent oversight of the value for money of workplace personal pensions. These larger firms will account for most consumers in investment pathways.

8.28 As an alternative to IGCs, we already permit Governance Advisory Arrangements (GAAs) for smaller and less complex workplace personal pension schemes. We intend to allow GAAs for providers with smaller numbers of non-advised consumers in investment pathways. We are considering further a proportionate approach for providers with smaller numbers of non-advised consumers. Providers will not need to provide investment pathways if they require that all their consumers take advice before entering drawdown.

8.29 We intend to consult on our proposals for independent governance of investment pathways in a future consultation on IGCs, due for publication in April. This will include a more detailed response to the feedback. Our planned consultation will also include proposed new rules requiring IGCs to report on firms' policies on environmental, social and governance considerations, member concerns, and stewardship, for the products IGCs have oversight for.

5 Referred to in paragraph 2.3 of this CP

Charges

8.30 We said in CP18/17 that we want to make sure that investment pathways offer value for money.

8.31 As set out in CP18/17, we expect providers to challenge themselves on the level of charges they impose on investment pathways, using the charge cap on default arrangements in accumulation of 0.75% as a point of reference.

8.32 We also – as set out in the previous section – still intend to extend the IGC regime to cover investment pathways. A provider's IGC would have independent oversight of the value for money their investment pathways provided. While charges are only one factor in determining value for money, they are a key component.

8.33 In this CP, we are also consulting on rules to ensure that robust product governance obligations apply to investment pathways (see paragraphs 8.8 and 8.9). These require manufacturers of pathways solutions to carefully consider their charging structure for them. Manufacturers will be required to examine the compatibility of the pathways solutions' cost and charges with the needs, objectives and characteristics of the target market. They will also need to assess the transparency of the charging structure and whether the charges undermine consumers' expectations of the returns from the investment pathway.

8.34 Finally, in CP18/17 we explained that – if we implemented our proposals – we would begin a review one year after implementation. This review would assess the charges providers were applying to investment pathways. If the evidence we gather in the review suggests there are problems, it is highly likely we will move towards imposing a charge cap on investment pathways.

Post-implementation review & supervising our proposals

8.35 We will conduct a robust post-implementation review of investment pathways and remain of the view that it should begin one year after our rules and guidance come into force.

8.36 Our post-implementation review of investment pathways would look at the charges providers were applying. While charges will be the main focus of our review, it will not be the only aspect the review will consider. For example, the review will also look more closely at how providers are offering investment pathways (ie how their choice framework operates) and how they are complying with the relevant product governance requirements.

8.37 We will supervise investment pathways in accordance with the FCA Mission: Our Approach to Supervision. This may include meetings with management, on-site assessments, desk based reviews and reviews covering clusters of firms. We will coordinate our future supervision in this area with the planned post-implementation review.

The records providers should keep

8.38 Our rules and guidance on record-keeping are set out in the section of our Handbook titled 'Senior Management Arrangements, Systems and Controls' (SYSC), at SYSC 9.1.

8.39 In summary, they say that firms must keep orderly records which are sufficient to enable us to monitor firms' compliance with our rules, and to work out whether they have met all their obligations to consumers. Good record-keeping will be important for providers implementing investment pathways so they can demonstrate that they have met all their requirements, particularly around communicating with consumers. It will also help them demonstrate that they are complying with product governance rules.

8.40 We want both to help providers to meet these SYSC requirements and to ensure that they can give us the information we need to assess the impact of our proposals. So we propose to set out in guidance a non-exhaustive list of the areas where we believe it is most important that they keep good records. Examples of areas we are proposing to include are set out below:

- The numbers of non-advised consumers who choose to use investment pathways, self-select their investment strategy without using pathways, or remain in their current investments. Also, how the provider presented and identified that choice.
- The numbers of non-advised consumers offered each pathway solution, if these consumers selected the solution offered, and what action the provider took where a consumer did not select the solution offered.
- Where a provider manufactures pathways solutions, the product approval process the provider undertook for each solution, and the annual review they conducted for each solution.

8.41 We will make regular data requests to providers about investment pathways to inform our post-implementation review. Providers will find it easier to meet these requests if they can easily extract relevant data from their systems. The list above shows where we think record-keeping is important and gives an indication of the areas where we may collect data. We may consider regularising our data requests on investment pathways in the future, for instance, by creating a new data return or adding extra questions to an existing one.

> **Q12: Do you agree with our proposed approach for the records providers should keep?**

Implementation timeline

8.42 We recognise that this package of proposals is detailed and will require firms to make material changes to their systems and processes.

8.43 However, we are introducing these proposals to address consumer harm identified in our evidence gathering. The package of proposals includes concessions for drawdown providers with small numbers of non-advised drawdown consumers. Our data suggest that the providers who will be able to use these concessions are smaller providers, who would otherwise have needed a longer time to implement.

8.44 On balance, we consider that providers should be given 12 months to implement these proposals from the date we publish our final rules and guidance. In CP18/17 we said that we would publish our final rules and guidance by the end of July.

Q13: Do you agree with our implementation timeline?

9 Ensuring investment in cash is an active decision

9.1 In this chapter, we consult on proposals to require providers to:

- ensure that non-advised consumers moving funds into drawdown – or transferring-in assets from another fund in drawdown – who are investing wholly or predominantly in cash, make an active decision to do so
- give a warning to non-advised consumers making an active decision to invest wholly or predominantly in cash on entering drawdown or transferring-in assets from another fund in drawdown
- give an annual warning to all their non-advised consumers (including where the provider is unsure whether they are advised or non-advised) already in flexi-access drawdown who are wholly or predominantly invested in cash

Introduction

9.2 In CP18/17 we explained that our evidence shows that many consumers enter drawdown as a consequence of taking their 25% tax-free cash. For many of these consumers, taking their tax-free cash is their only aim at this stage. These consumers are engaged with the decision to take their tax-free cash but not the important decision around how they should invest the remaining funds that move into drawdown.

9.3 Our evidence suggests that after the pension freedoms were implemented, a significant proportion of non-advised consumers were invested wholly or predominantly in cash or cash-like assets when they entered drawdown.

9.4 Some of these consumers made an active decision to invest in cash, because they wanted to draw down their fund quickly, or they had a very low appetite or capacity for investment risk.

9.5 However, our evidence also suggests that many other consumers did not make an active decision to invest in cash, but rather were 'defaulted' there by their provider. There are several ways that consumers can end up 'defaulted' into cash without making a decision, such as where the provider:

- operates a default investment fund invested in cash or cash-like assets for drawdown consumers who don't make an investment decision
- pre-populates an online or paper form so that a cash or cash-like fund is pre-selected if the consumer does not choose an alternative
- allows consumers to remain invested in a cash account if they do not make an investment decision – this often happens where consumers transfer to a SIPP to enter drawdown

9.6 According to our evidence, over half of the consumers 'defaulted' into cash have longer-term aims for their drawdown pot and so would likely be better off if invested in a fund that aims to provide greater returns than cash investment. These consumers will likely lose out on income in retirement by holding cash. In CP18/17 we estimated that someone who wants to draw down their pot over a 20-year period could increase their expected annual income by 37% by investing in a mix of assets rather than cash.

9.7 Our discussions with providers before publishing CP18/17 suggested that some providers who 'defaulted' consumers into cash immediately after the pension freedoms were implemented no longer do so. But our evidence suggests that other providers have not taken this approach and that a significant number of consumers are still being 'defaulted' into cash. Providers do not necessarily have a financial incentive to end 'defaulting' to cash, as they may not pass on to consumers all or any of the interest they earn on cash investments. In the Investment Platforms Market Study we found that some firms make a significant proportion of revenue from interest earned on cash, with the average for firms who keep this interest being between 11% and 14% of revenue (see paragraphs 27 to 31 (inclusive), Annex 4 of the Investment Platforms Market Study Interim Report).

9.8 So in CP18/17 we asked for feedback on a package of remedies to address this problem. We have carefully considered the responses to CP18/17 and collected further data on the cash holdings of non-advised drawdown consumers in the SIPP market. In the section below we set out the feedback we've received – and the evidence gathered from the additional work we've done – to explain how this insight has informed the proposals we are now consulting on.

Cash investment to be an active decision

Points raised for discussion in CP18/17

9.9 In CP18/17 we concluded that many of these consumers had been effectively 'defaulted' into cash by their provider. To address this issue, we said we intended to consult on rules to ensure that, if a non-advised consumer moving into drawdown is to invest wholly or predominantly in cash, their provider must ensure that they make an active choice to do so.

Feedback received

9.10 Most respondents supported this proposal. This included a significant proportion of providers, although many of these said that they did not consider that non-advised consumers were 'defaulted' into cash in the products they provided.

9.11 SIPP operators and related trade bodies, however, largely opposed this proposal. Most suggested that the proposal was incompatible with the SIPP business model, where consumers usually transferred in cash to the SIPP wrapper. The operator usually has no power within the scheme's underlying documentation to invest monies without the consumer's formal instruction.

9.12 Conversely, other respondents said that they thought this proposal should apply to SIPP operators as we have found that the harm also exists in this business model. One argued that SIPPs were now a 'mass market' offering. This meant some consumers were using SIPPs as if they were standard contract-based personal pensions, and so should benefit from the protections these proposals aim to introduce.

9.13 Some respondents asked that we clearly explain what we mean by 'predominantly' invested in cash. Others asked that we clearly explain what we mean by 'cash' for the purpose of this proposal. Some of these suggested that it should only apply to consumers invested in cash – rather than in other cash-like, low growth assets – as any diversity in asset allocation beyond the scope of cash suggested that the consumer had already made an active choice.

Further work we have undertaken

9.14 Our SIPPs data request aimed to identify if non-advised consumers who were highly (80% or more) invested in cash were common in all SIPPs or whether they were concentrated in certain types of schemes.

9.15 As set out in paragraph 5.25, our data request showed that across all SIPPs, 18% of non-advised consumers are highly invested in cash. This is much lower than the proportions of non-advised consumers invested in cash at some large 'mass market' providers, as identified in the Final Report. Data on seven large providers, including two large SIPP operators, were published in the Final Report and found that 32% of non-advised consumers with these providers were invested wholly in cash. The 18% of non-advised SIPP consumers highly invested in cash are heavily concentrated in a small number of larger, 'mass market' SIPP operators.

Our proposals for consultation

9.16 We are consulting on the proposals we set out in CP18/17 without material amendment. We propose that providers ensure that their non-advised consumers entering drawdown – or transferring in assets from another fund in drawdown – who are investing wholly or predominantly in cash, make an active decision to do so. We do not propose to define an 'active decision'. But – in reaction to some practice we've seen in this sector – we propose to set out that where a pre-populated form is used by a provider, whether in paper form or online, this is not an active decision.

9.17 Our proposal does not seek to push non-advised consumers away from investing in cash if they want to. The value of non-cash investments is likely to fluctuate, in contrast to the value of cash deposits. Some consumers may not wish to take this risk. The purpose of this proposal is to make sure that non-advised consumers make an active decision to invest in cash and, as we explore later in this chapter, that they do so from an informed position.

9.18 We consider that our proposals should apply to SIPP operators. While we recognise that the business model of most SIPP operators requires the consumer to give an instruction to invest funds, we do not consider that this proposal places any particularly burdensome requirements on them. This proposal requires providers to seek confirmation from the consumer that they are content with being invested wholly or predominantly in cash and, as explained in the next section in this chapter, provide a warning if they say they are content.

9.19 Our proposals will apply to non-advised consumers choosing to invest 'wholly or predominantly' in cash. We propose that 'predominantly' invested in cash should mean anything above 50% of the total value of the consumer's pot in drawdown. While most of the consumers we are concerned about will be 100% invested in cash or cash like assets, our evidence shows that some consumers are invested between 51% and 99% in cash. These consumers are at risk of suffering the same harm as those wholly invested in cash.

9.20 We consider that our proposals should cover consumers investing in cash and in 'cash-like' assets such as money market funds or money, deposits or investments that are defined as 'near cash' in our Handbook. This is because we have seen examples of providers defaulting consumers into cash-like assets, and the risks faced by these consumers are very similar to those invested in cash.

Q14: Do you agree with our proposals to ensure cash investment is an active choice?

Warning around investment in cash: moving into drawdown or transferring funds in drawdown to a new provider

Points raised for discussion in CP18/17

9.21 In CP18/17 we explained that when a non-advised consumer makes an active decision to invest wholly or predominantly in cash, their provider should give them simple, generic warnings around doing this.

9.22 We suggested that providers could be required to remind consumers that, if they want to invest their drawdown pot for the long-term, some exposure to investment risk is sensible – not least to try to make sure that the capital value of the fund is protected from the effects of inflation.

Feedback received

9.23 Most respondents agreed that those non-advised consumers actively choosing to invest in cash should be given a warning.

9.24 However, some respondents were concerned that providing the consumer with a warning could constitute advice. Another suggested that the warnings could trigger the application of a MiFID appropriateness test.

9.25 Other respondents suggested that these warnings could have the effect of pushing consumers who want to invest in cash towards riskier investments. This might not be in these consumers' interests – especially if their decision to invest in cash was an informed one based on their needs and objectives.

9.26 On what the warning should include, some respondents suggested that it should explain – in simple terms – the impact of inflation on cash investment, but also the risk of market volatility and the difference in approach for short and long-term needs.

9.27 Some respondents suggested that a warning should not be provided as we have suggested, but instead the risks around cash investment should be covered in the retirement risk warnings. One respondent suggested that these risk warnings could be wider in scope than cash investment, covering all aspects of potential investment.

Our proposals for consultation

9.28 We propose to make rules requiring providers to give non-advised consumers actively choosing to invest wholly or predominantly in cash a warning about the potential risks of cash investment. For the purposes of this proposal 'predominantly' and 'cash' are defined as we've set out in paragraphs 9.19 and 9.20, respectively.

9.29 The proposed rules will apply to all of a provider's investment options that are comprised wholly or predominantly of cash, including any pathways solutions.

9.30 We do not propose to prescribe the precise wording of the warning providers must give consumers. But we propose that the warning must inform the consumer that:

- more than half of their pot in drawdown is invested in cash or investments that are similar to cash
- their drawdown pension is at risk of being eroded by inflation
- if they plan to invest for the longer-term, they should consider whether their current investment (% in cash) is likely to grow sufficiently to meet their objectives

9.31 We have also suggested, in guidance, some additional content that the warning should cover. We propose that providers should:

- provide an explanation of how inflation affects the consumer's drawdown pension, with a comparison of:
  - the interest/yield currently being paid to the consumer on their cash holding, expressed as a percentage
  - the current rate of inflation, also expressed as a percentage (with inflation being calculated using a recognised measure)
- if appropriate, provide a statement to the effect that the provider offers investment pathways and other, non-pathway, investment solutions
- if appropriate:
  - inform the consumer that this warning is not advice
  - remind the consumer that the value of any investment can fall as well as rise
  - remind the consumer that different investments will have different risks, so the consumer should consider their attitude to – and capacity for – risk when they choose investments
- remind the consumer that if they need more help they can take advice, or review information on the SFGB's website

9.32 We do not consider that our proposals will have the effect of pushing consumers towards riskier investments where this might not be in their interests. The warning will prompt the consumer to think about whether cash investment is right for them, bearing in mind their objectives for their pot in drawdown. It will also point them towards advice or guidance if they need further help to make a decision.

9.33 We do not consider that a warning around cash investment would be better provided in the retirement risk warnings process. Given our evidence, we believe it is important that the warning around cash investment is given when the consumer is looking to enter an investment solution. This is the most opportune time for them to consider the other options that may be available to them (including shopping around). Our rules in COBS 19.7 do not prevent providers from also including warnings around cash investment in the retirement risk warnings.

9.34 We do not consider that providing a warning in the manner that our rules and guidance envisage constitutes advice. Providers may want to consider the proposed examples set out in PERG in Appendix 1.

9.35 Finally, in feedback to CP18/17, 1 respondent said they were concerned that any requirement on providers to warn consumers about the possible drawbacks of investing in cash could trigger the application of appropriateness rules. These are in COBS 10 and COBS 10A (for MiFID and insurance-based investment products) of our Handbook. Providing a warning about cash investments in a pension wrapper would not involve one of the services that triggers the application of appropriateness rules.

Q15: **Do you agree with our proposals on the warning about investment in cash that the non-advised consumer will get when they enter drawdown or transfer-in funds in drawdown to a new provider?**

Warning around investment in cash: ongoing

Points raised for discussion in CP18/17

9.36 In CP18/17 we recognised that some consumers already in drawdown will have been 'defaulted' into cash by their provider, and will still be invested in cash now.

9.37 Our evidence suggested that, at least within some of the providers in our sample, 'defaulting' into cash was an historical problem. Some had 'defaulted' consumers into cash shortly after the pension freedoms were implemented, but had now stopped doing so. We said in CP18/17 that we expected providers to have a strategy for dealing with these consumers, and asked them to let us know what they had done – or planned to do – about them.

9.38 We suggested that we wanted to make rules to require providers to give regular warnings about cash investment to consumers who stayed invested wholly or predominantly in cash, regardless of whether they were 'defaulted' into cash or made an active decision. We said that we thought warnings should be repeated every year if the consumer remains invested wholly or predominantly in cash. Our view was that these requirements should apply to all of a provider's non-advised consumers in drawdown, ie those already in drawdown and those who will enter drawdown in future.

Feedback received

9.39 A number of respondent providers explained what they had done – or planned to do – about non-advised drawdown consumers invested in cash. For example, 1 respondent said they had written to their non-advised consumers invested in cash, and planned to monitor their behaviour to see if their communications resulted in the consumers taking action.

9.40 Most respondents agreed that warnings around cash investment should be provided to consumers wholly or predominantly invested in cash on an ongoing basis.

9.41 Some respondent SIPP operators providing drawdown to non-advised consumers argued that they should be outside the scope of these rules. This was because the way their business model operated gave no rationale for them to provide these warnings.

9.42 Some respondents suggested that we tie-in these reminders with the annual disclosure that consumers in drawdown receive, or other regular communications. Another respondent suggested that these warnings were insufficient – these consumers clearly needed help and so should be referred to free, impartial guidance from the SFGB.

Our proposals for consultation

9.43 We propose that providers must provide consumers invested in cash with a warning if they remain in cash after a period of 12 months. We propose that the warning should be in the same form as set out in paragraphs 9.30 and 9.31 above, and the key terms should be defined in the same way.

9.44 There are two different scenarios that our proposed rules cover. The first is those non-advised consumers entering drawdown – or transferring in funds already in drawdown – after these rules come into force. The second is those consumers that entered drawdown before these rules came into force. The requirements on providers will differ depending on which of these categories the consumer falls into:

- Non-advised consumers entering drawdown – or transferring in funds already in drawdown – after these rules come into force, and who actively decide to invest wholly or predominantly in cash. As set out previously, we propose that the provider must give them a warning when the consumer makes their decision. The provider must then review the consumer's asset allocation 12 months after their initial decision to invest in cash. If the review shows that the consumer remains invested wholly or predominantly in cash, we propose that the provider must give the consumer a warning. We propose that the provider continues to monitor the consumer's asset allocation and send a warning each year until the consumer is not wholly or predominantly invested in cash.

- Consumers who entered drawdown before these rules came into force, and who are invested wholly or predominantly in cash. We propose that the provider has 6 months from the date our rules come into force to assess which of its existing drawdown consumers need a warning and to provide them with one. Our proposed rules do not require a warning to be given to consumers advised on their drawdown investment decision. Consumers will only be treated as advised where the provider can positively confirm that they were advised. We propose that the provider must review the consumer' s asset allocation 12 months after the warning was provided. If the consumer remains invested wholly or predominantly in cash, the provider must give the consumer a further warning. We propose that the provider must continue to monitor the consumer's asset allocation and send a warning where required each year until the consumer is not wholly or predominantly invested in cash.

9.45 Some respondents said that the warning for consumers invested wholly or predominantly in cash on an ongoing basis may fall due during the same period in which their provider is required to send them an annual communication under COBS 16.6.8R.

Our proposed rules will not prevent a provider from giving the warning as part of the annual communication.

9.46 We consider that the proposed warning is sufficient. However, we have proposed in guidance that providers can include in the warning a statement to the effect that the consumer may consider taking advice or looking at the information provided on the SFGB website.

9.47 Finally, as set out above, we were pleased to receive feedback showing that some providers are already taking steps to consider and address the needs of their existing consumers invested in cash.

Q16: Do you agree with our proposals on the ongoing warning around investment in cash? If no, what would you suggest?

Potential exceptions: Minimum limits and cooling-off

Points raised for discussion in CP18/17

9.48 In CP18/17 we invited views on whether a minimum pot size limit on the application of our package of proposals to address 'defaulting' into cash – of £30,000 – was appropriate.

9.49 We also said that we thought that providers should be able to hold consumers' drawdown pots in cash during cooling-off periods without the consumer making an active choice for them to do so.

Feedback received

9.50 Many respondents rejected the concept of a minimum pot size limit. Some said that pot size was a relative concept, so it would not be possible to decide an appropriate limit. Others warned that consumers will often have many small pots, so a minimum limit could result in less engaged consumers being 'defaulted' into cash across all or most of their pots. Even those respondents who supported the concept of a minimum limit had no broad consensus on what the limit should be.

9.51 Many respondents did not support the proposal to enable providers to hold consumers' drawdown pots in cash during cooling-off periods without the consumer making an active choice to select cash. One said it was concerned that staying in cash during the cooling-off period could become the 'path of least resistance' for non-advised consumers, which could mean more consumers holding cash for longer periods. Another said it was concerned that this could place an additional and heavy administrative burden on providers. This is because providers may believe they have to give the consumer information to enable them to make an investment decision both when they moved into drawdown or transferred in funds already in drawdown, and then before the cooling-off period ends.

Our proposals for consultation

9.52 Having considered the feedback received, we do not intend to introduce either of these proposals and so are not consulting on them.

The records providers should keep

9.53 As with investment pathways, we expect providers to keep records which are sufficient to enable us to monitor their compliance with our requirements, as set out in SYSC 9.1, and to enable us to assess their impact. We also propose to set out in guidance a non-exhaustive list of the areas where we believe it is most important that providers keep good records. Examples of areas we propose to include in this list are:

- The number of non-advised drawdown consumers who were already wholly or predominantly in cash or cash-like assets when these requirements came into force, and who therefore had a cash warning within 6 months.
- The number of consumers who, 12 months after receiving a warning, remained wholly or predominantly in cash or cash-like assets, and who therefore received a further warning. Also, the numbers who were no longer invested in this way and who therefore did not get a further warning.

9.54 As set out in Chapter 8, we will make regular data requests to providers as part of our post-implementation review of investment pathways. Providers will find it easier to meet these requests if they ensure they can easily extract relevant data on consumers making active choices to invest in cash, and on cash warnings, from their systems. The list of areas above where we think record-keeping is important, gives an indication of the areas where we may collect data.

Q17: Do you agree with our proposed approach for the records providers should keep?

Implementation timeline

9.55 We did not consult on this package of remedies in CP18/17 because we wanted to understand more about how these remedies – and our investment pathways proposals – might be applied to SIPPs.

9.56 We consider that these remedies would be best introduced at the same time as our investment pathways proposals. Consumers who benefit from the warning about cash investment would seem likely also to benefit from the availability of investment pathways.

9.57 We consider that providers should also be given 12 months to implement these remedies.

Q18: Do you agree with our implementation timeline? In particular, do you agree with our view that these remedies should be implemented at the same time as investment pathways?

10 Actual charges information

10.1 In this chapter, we consult on proposals to require firms to provide information on the actual charges consumers are paying for their pensions post-sale, during the decumulation phase. In this chapter, reference to consumers in the decumulation phase includes both consumers in drawdown and consumers who have withdrawn at least one UFPLS payment.

Introduction

10.2 In Chapter 6 of CP18/17, we asked discussion questions about whether consumers in decumulation should get information on actual charges paid, expressed as a cash amount. Given the feedback received and the potential for consumer benefits, we are now consulting on these proposals, with adjustments made to reflect some of this feedback. The aim of these proposals is to aid transparency and help consumers understand the charges they are paying so they can make more informed decisions post-sale. By increasing consumer awareness of the actual charges applied, consumers will be more likely to shop around, and so firms in the decumulation pension market will be incentivised to be more competitive.

Points raised for discussion in CP18/17

10.3 There is no specific requirement for firms to disclose actual charges in monetary terms for pension products. This contrasts with MiFID requirements for periodic (at least annual) post-sale costs and charges disclosure in relation to MiFID financial instruments and services. We do not consider these MiFID requirements apply to firms acting as an operator of a stakeholder or personal pension scheme. But we have made it clear that we expect pension providers to regularly communicate the impact of fees and charges in their communications to consumers, in line with Principle 7. (Principle 7 requires firms to pay due regard to the information needs of their clients, and communicate information to them in a way which is clear, fair and not misleading.)

10.4 To inform our retirement outcomes disclosure policy, in CP18/17 we asked whether respondents agree that consumers should get information on the actual charges they pay on their decumulation pensions, including transaction costs, expressed as a cash amount. We also asked respondents how they thought this disclosure might best be achieved, and what they would estimate the cost of these changes to be.

Feedback received

10.5 Most respondents supported the proposal to require disclosure of actual charges paid. Several respondents raised concerns about the complexities, costs and difficulties in providing post-sale charges information. Issues were raised about:

- the availability of adviser charges information, if paid for outside the pension wrapper
- the difficulty in disclosing charges built into the price of a product, as is the case with fixed term annuities

10.6 Some firms said they will find it relatively easy to comply, as they already provide post-sale information on costs and charges in their annual statements. Other firms said they would need time to make the necessary changes to their systems.

10.7 Some respondents said that calculating transaction costs may be difficult in certain circumstances, and for some assets.

Our proposals for consultation

10.8 We propose that providers of personal or stakeholder pension schemes should provide decumulation consumers with annual information on all the costs and charges, including transaction costs, that the consumer has paid on their pension pot. These should be expressed as a cash amount. We propose that this information on charges should be aggregated and provided in pounds and pence to help consumer understanding.

10.9 We know this means that consumers could receive information that shows the actual charges are higher than those disclosed at the point of sale. This is because point of sale charges disclosures (in Key Features Illustrations) do not require transaction costs to be included. However, as PS17/20 explained, the Pensions Act 2014 placed a duty on the FCA to make rules requiring governance bodies to disclose information about transaction costs to workplace pension scheme members and to publish it. We expect to consult on how we will implement this duty shortly.

10.10 We know that some firms will have readily available information on actual transaction costs incurred and can disclose it easily. Feedback shows that it may be difficult for other firms to calculate transaction costs for some assets. This is because calculating the actual transaction costs attributable to each member may be complex, given that they are incurred at fund level and the allocation to members depends on the timing of purchases and sales of units. So we appreciate that some transaction costs may need to be estimated, in the same way as they are in point of sale disclosures for some other products. We do not propose any particular methodology that firms should use when calculating transaction costs. So firms will be able to use the same systems and data on transaction costs that they use when complying with MiFID disclosure requirements.

10.11 When disclosing actual pension charges, we will require firms to clarify if any actual adviser remuneration has been paid out of the product. Where there is no known adviser remuneration, we will require firms to state that adviser remuneration is not included in the charges figure provided.

10.12 We propose that this disclosure requirement does not apply to products such as fixed term annuities, where the cost of the product is built into the price.

10.13 We propose that there is a 12-month implementation period for these proposals. This will give firms time to ensure they can get any necessary data from third parties and identify the post-sale information on costs and charges they need to disclose. The 12-month implementation period will also give firms time to make changes to their disclosure systems and controls in the most cost-effective way, perhaps as part of periodic reviews.

Q19: **Do you agree that, in relation to their decumulation pensions, unless charges are built into the disclosed price of the product, consumers should receive information at least annually on all the actual charges they have paid, aggregated and expressed as a cash amount?**

Q20: **Do you agree that our rules should require disclosure of transaction costs, but not specify how transaction costs should be calculated?**

Q21: **Do you agree that firms should disclose the adviser charges paid out of the product, or clarify that adviser charges are not included in the annual pension charges figure they disclose?**

Q22: **Do you agree with our implementation timeline?**

Annex 1
Questions in this paper

Chapters 3 to 8: Investment pathways

Q1: **Do you agree with our proposed rules on when a consumer must be offered investment pathways, including how consumers who enter drawdown in stages should be treated, and that those who take an UFPLS are not included?**

Q2: **Do you agree with our proposal that all providers of drawdown to non-advised consumers should be covered by our requirements on investment pathways, including SIPP operators?**

Q3: **Do you agree with our proposed 4 objectives, and mandating all providers to use our prescribed wording when presenting these objectives?**

Q4: **Do you agree that providers should only be able to offer 1 pathways solution for each investment pathway objective?**

Q5: **Do you agree with our proposed rule requirements for the choice architecture, and do you agree that providers can offer investment pathways without giving the consumer a personal recommendation?**

Q6: **Do you agree with our proposed rule to prevent providers from offering the same pathways solution for all the objectives?**

Q7: **Do you agree with our proposed rules on labelling of pathways solutions?**

Q8: **Do you agree with our proposed rules requiring larger providers to provide pathways solutions for at least 2 of the 4 objectives and to refer consumers to another provider's pathways solutions for any objectives where they don't provide a pathways solution?**

Q9: **Do you agree with our proposed easement for smaller providers, including our proposals for the operation and level of the threshold for qualifying for this easement?**

Q10: **Do you agree with our proposed approach to product governance for firms manufacturing pathways solutions used to provide investment pathways? Do you agree with our proposed approach for distributors?**

Q11: **Do you agree with our proposed approach for ongoing information to consumers using investment pathways? Do we go far enough, or is there anything further that providers could do to ensure that consumers carefully consider their investment choice on a periodic basis?**

Q12: **Do you agree with our proposed approach for the records providers should keep?**

Q13: **Do you agree with our implementation timeline?**

Chapter 9: Ensuring investment in cash is an active decision

Q14: **Do you agree with our proposals to ensure cash investment is an active choice?**

Q15: **Do you agree with our proposals on the warning about investment in cash that the non-advised consumer will get when they enter drawdown or transfer-in funds in drawdown to a new provider?**

Q16: **Do you agree with our proposals on the ongoing warning around investment in cash?**

Q17: **Do you agree with our proposed approach for the records providers should keep?**

Q18: **Do you agree with our implementation timeline? In particular, do you agree with our view that these remedies should be implemented at the same time as investment pathways?**

Chapter 10: Actual charges information

Q19: **Do you agree that, in relation to their decumulation pensions, unless charges are built into the disclosed price of the product, consumers should receive information at least annually on all the actual charges they have paid, aggregated and expressed as a cash amount?**

Q20: **Do you agree that our rules should require disclosure of transaction costs, but not specify how transaction costs should be calculated?**

Q21: **Do you agree that firms should disclose the adviser charges paid out of the product, or clarify that adviser charges are not included in the annual pension charges figure they disclose?**

Q22: **Do you agree with our implementation timeline?**

Annex 3 Cost benefit analysis

Q23: **Do you have any comments on our cost benefit analysis?**

Annex 2
Data collection from SIPPs

Background

1. In CP18/17 we said we wanted to collect further evidence to work out how some of our Retirement Outcomes Review remedies could be applied to SIPPs. In July 2018, we sent a data request to relevant SIPP operators, with a deadline for responses at the end of August 2018.

2. We did not send our data request to large life insurers that provide SIPPs. This is because we considered we already had enough data on these types of drawdown providers from our earlier ROR data collection, the findings of which were summarised in the Final Report. We received responses from 71 SIPP operators, which was almost all the SIPPs in our target population. Overall, we received good quality data.

Overview of data requested

3. Our request sought to identify potentially unengaged non-advised consumers to help us understand if the harm that investment pathways are designed to address is spread through the SIPP market, or limited to certain drawdown providers.

4. We therefore asked for data on the numbers of pension plans that had entered drawdown since the pension freedoms were introduced in April 2015, and who remained in drawdown at the start of April 2018. The request focused on the plans where the consumer did not receive advice and which were predominantly (50% or more) or highly (80% or more) invested in cash.

5. We also asked questions to help us understand the impact that implementing investment pathways would have on SIPP operators and their consumers. In particular, we asked SIPP operators whether they would be likely to implement investment pathways, or instead require consumers to take advice before entering drawdown.

Results

6. The results suggest the potential harm we are seeking to address with the remedies in this CP does also exist in the SIPP market:

- SIPP operators reported that almost 96,000 plans went into drawdown in the 3 years following pension freedoms, and up to 35,000 (36%) of these plans went into drawdown without the consumer taking advice.[6]

- We found that 7,638 (22%) of those non-advised consumers' plans were predominantly invested in cash. Most of these plans – 6,412 (18%) – were highly invested in cash.

- Smaller pots were much more likely to be invested in cash than larger pots. 39% of plans under £10,000 were highly invested in cash, compared with only 5% of plans over £500,000.

- 62% of the plans which were highly invested in cash had been in drawdown for over a year, and a third for over 2 years. This suggests that most of these consumers were not in cash only temporarily while they were making an investment decision.

- Consumers who transferred to a SIPP to access drawdown were much more likely to be invested in cash. 37% of these new SIPP consumers were highly invested in cash, compared with 16% of those who were existing SIPP consumers before entering drawdown. This suggests that many consumers are failing to make an investment decision when they transfer to a SIPP.

7. The results also suggest that non-advised consumers, and the potential harm we have identified, are both heavily concentrated in the small number of 'mass market' SIPPs:

- 87% of the non-advised plans that had entered drawdown in the previous year were held by the 5 largest SIPP operators (by numbers of non-advised plans) which provided data.

- The same 5 large SIPP operators held 93% of the non-advised plans that had entered drawdown in the previous year and were highly invested in cash.

- In contrast, 24 of the 71 SIPP operators had no non-advised plans that had entered drawdown in the previous year and were highly invested in cash. Another 29 SIPP operators had fewer than 10 such plans.

8. The results further suggest that SIPP operators are divided about whether they would implement investment pathways if these were required to be offered to non-advised consumers, or whether they would instead require consumers to take advice before entering drawdown:

- 18% of SIPP operators said they would implement investment pathways (including the largest SIPP operators by number of non-advised consumers). 39% of SIPP operators said they would rather restrict their drawdown offering to advised consumers only. The remaining 42% of SIPP operators were unsure. This suggests that most smaller SIPP operators remain focused on advised consumers.

- The 18% of SIPP operators who said they would implement investment pathways have 76% of the non-advised SIPP plans that went into drawdown last year (around

6 A small number of SIPP operators, including some larger SIPP operators, were unsure whether or not advice was received when some of their plans went into drawdown, because of the way data were recorded at the time. We believe the vast majority of these plans are likely to have gone into drawdown without advice being received, and so we have included them with the non-advised plans in our analysis.

8,500 plans). This means that most non-advised SIPP consumers are with SIPP operators that will implement investment pathways.

- The 39% of SIPP operators that may choose not to implement pathways and only allow advised consumers into drawdown, and the 42% who are unsure, together have up to 24% (2,700) of non-advised plans that entered drawdown last year.
- This means up to 2,650 non-advised consumers a year could be forced to transfer or take advice to enter drawdown if we require SIPP operators to implement investment pathways for all non-advised consumers. This total is made up of 1,250 non-advised consumers who entered drawdown with SIPP operators that say they would not implement pathways, and 1,400 with SIPP operators who are unsure whether they would do so.

9. In Chapter 5 of the CP we set out how these research results have informed our policy thinking on investment pathways. In Chapter 9 we set out how they have informed our thinking on our proposals around making sure that investment in cash is always an active decision for consumers.

Annex 3
Cost benefit analysis

Section 1: Introduction

1. FSMA, as amended by the Financial Services Act 2012, requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'.

2. This analysis presents estimates of the significant impacts of our proposals. We provide monetary values for the impacts where we believe it is reasonably practicable to do so. For others, we provide analysis of outcomes in other dimensions. Our proposals are based on carefully weighing up these multiple dimensions and reaching a judgement.

Problem and rationale for intervention

3. The ROR highlighted that in many cases consumers, particularly those focused on taking their tax-free cash, typically follow the 'path of least resistance' when they enter drawdown and stay with their incumbent provider. The low level of shopping around by consumers for pension products means they do not seek the best offers to meet their needs.

4. When entering drawdown, consumers also face a range of complex decisions. We found that many consumers who do not take advice struggle with these decisions, and many as a result end up in investments that may not be right for them. Consumers may purchase unsuitable products (which are not aligned to their retirement objectives) that may lead them to take on excessive levels of investment risk or, conversely, miss out on investment growth if they have invested in overly-cautious assets or are paying fees which are too high. For example, consumers could lose out on potential investment growth if invested in cash for extended periods.

5. We recognise that many consumers who buy drawdown without taking advice are susceptible to the following harms:

- Buying unsuitable products
  - Consumers could lose out on potential investment growth (for example, if invested in cash for extended periods, or if investing in assets that do not match their needs and objectives)
- Prices too high or quality too low
  - Consumers could pay too much in fees and charges
  - Consumers may not benefit from better products and deals, due to low competitive pressure

6. We consider that the drivers of these harms consist of a combination of market failures, namely: asymmetric information, behavioural biases affecting consumers' choices, and market power derived from incumbency advantage.

7. **Asymmetric information** arises when consumers know less than their provider about the investment solution they are invested in:

- Providers are likely to have better knowledge of the investment and the associated charges, and charges can be unclear. Our research[7] found that around 1 in 3 consumers who have gone into drawdown recently are unaware of where their money was invested; others only had a broad idea.

- Drawdown charges can be complex and hard to compare. Products can have as many as 44 charges linked to them. This makes it difficult for consumers to compare products, and identify which investment solution would be best for them.

8. **Behavioural biases** can exacerbate the impacts of asymmetric information and **complexity** and can affect consumers' choices. Qualitative consumer research for assessing the non-advised journey found that a number of behavioural biases and framing issues are likely to be affecting current decision making to the possible detriment of consumers. In particular, the framing of tax-free cash and the use of a consumption frame (which presents the retirement income available to consumers for consumption) in annual statements are strong drivers of early encashment behaviour. Low understanding and engagement, particularly around life expectancy and the amount of money needed for retirement, are often incorrectly resulting in an over-confidence, and in the decision to cash in and spend the pot rather than drawing it down over time.

9. **Market power** arises from the incumbency advantage enjoyed by drawdown providers which already sell accumulation products to consumers. Such providers have the advantage of being the first to present decumulation products to those same consumers. There are lower costs to the provider, in comparison to its competitors, as the consumer is an existing customer. This also provides greater convenience for consumers, who would otherwise need to spend time finding other products when entering decumulation. Hence, providers with a strong consumer base in accumulation may have limited incentives to make information on charges and quality of drawdown products more accessible to consumers, who would then be empowered to compare them with alternative offers. This could curb effective competition and result in consumers paying too much in charges.

Our intervention

10. We recognise that non-advised consumers need further support and protection. Our proposals are aimed at addressing the harm identified in paragraph 6. Our proposals are explained in more detail below.

11. Our investment pathways proposals, and our proposals to ensure consumers make an active decision to invest in cash, are aimed at protecting consumers from choosing unsuitable investment strategies and losing out on potential investment growth.

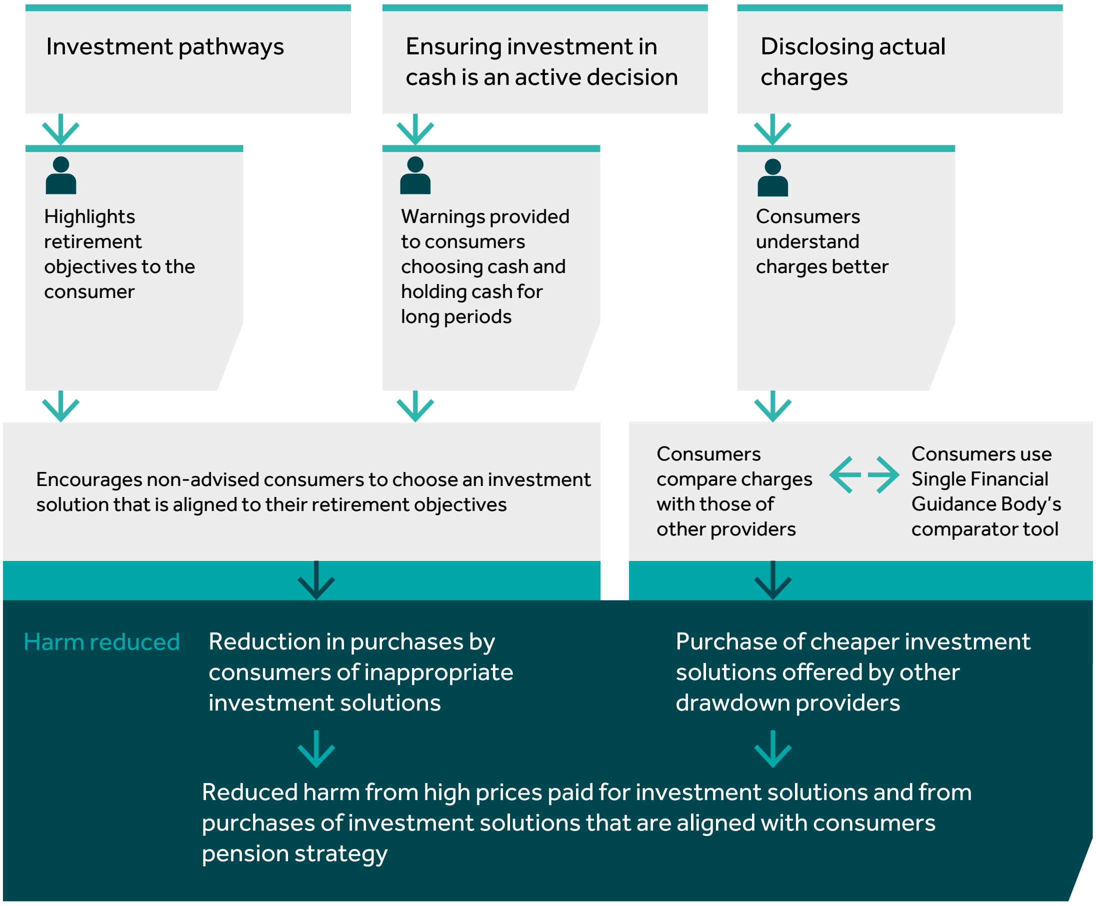
7 CP18/17, p.6

12. Drawdown consumers are not locked-in to the product they are utilising to take income withdrawals. They can move to a different product when they like. Our proposals to require providers to disclose the charges consumers have actually paid in decumulation will increase transparency of charges and will enable consumers to make a more informed assessment of the charges they are paying in drawdown, to help them work out whether the product offers good value to them.

13. Of course, showing the consumer the charges they have paid is not – of itself – enough to increase competitive pressure. Consumers need to be able to compare the charges they have paid with the charges they might pay in other products and act upon this information. This will assist in facilitating a competitive drawdown market. As mentioned in the Final Report, we are working with the SFGB and the Association of British Insurers to facilitate the introduction of a drawdown comparator tool to assist consumers.

14. The following diagram illustrates the chain of effects of our proposed interventions, leading to the intended outcome of reducing harm to consumers.

Figure 1: How our intervention tackles harm to consumers



- Section 2 sets out our CBA for our investment pathways proposals
- Section 3 sets out our CBA for our proposals to ensure that investment in cash is an active decision
- Section 4 sets out our CBA for our proposal to require firms to disclose actual charges

Baseline and key assumptions

15. Our baseline is that, without our intervention, consumer behaviour and prices would remain unchanged.

16. Our proposals will apply to around 180 providers with permission to establish, operate and wind-up personal pension schemes and/or stakeholder pension schemes. Provider size was identified using evidence gathered from our retirement income market data. There are 10 large providers with over 500,000 policyholders each, 12 medium providers with over 50,000 policyholders each and around 160 small providers with fewer than 50,000 policyholders each.

17. Most of the figures in the CBA have been rounded to the nearest £1,000, £10,000 or £100,000.

Summary of costs and benefits

18. The following table sets out the costs and benefits of the proposals detailed in this CP.

	Total estimated direct costs	
	One-off	**Ongoing**
Investment pathways		
Costs	£32.5 – £33m	£4.6 – £4.7m p.a.
Potential Benefits	-	£25.9m p.a. (Partially quantified for illustrative purposes)
Ensuring investment in cash is an active decision		
Costs	£7.8m	-
Potential Benefits	-	Not quantified
Actual cost disclosure		
Costs	£40.5m	£1.2 – £2.4m p.a.
Potential Benefits	-	£12.8 – £25.7m p.a.

19. Overall we expect our remedies to be net beneficial. We only need to see a small change in consumer behaviour for the savings to consumers to exceed the compliance costs. Using the indicative benefit estimates we have provided, it would become net beneficial within 2 to 4 years.

Section 2: investment pathways

20. An investment pathway is the process through which a consumer selects a ready-made investment solution – for example, a multi-asset fund – that a provider considers meets a broad objective when they designate funds to drawdown. These 4 broad objectives correspond to different ways a consumer might wish to use their drawdown pot. We think that this choice-based architecture will help those consumers engage with their investment decision, consider their retirement objectives, and match their drawdown investment solution to their retirement objectives.

21. We propose that:

- Non-advised consumers entering drawdown, or transferring assets already in drawdown, will be presented with 4 objectives about how they might want to use their drawdown pot.
- Providers will offer 1 ready-made investment solution (a 'pathways solution') for each of the 4 objectives. We expect most providers will want to provide pathways solutions for all 4 objectives within their own drawdown product.[8]
- Providers will be given the flexibility to design pathways solutions. Providers could potentially offer the same pathways solution for more than one objective, but providers will not be able to offer the same pathways solution for all the objectives.
- We will not prescribe the choice architecture around the pathways in detail. Providers should think carefully about the design of their choice architecture, ensuring that it helps consumers to engage with investment pathways, while filtering out those receiving advice and those who want to self-select investments or stay in their current asset allocation.
- Providers will not have to take consumers who have been advised on their drawdown investment decision through the investment pathways choice architecture and present them with the objectives. However, providers must make any pathways solutions they provide available to advised consumers, and pathways solutions must be considered by advisers when assessing suitability.
- Providers will be required to review their pathways solutions annually to ensure they continue to deliver against the relevant objective. Consumers will also be given an annual disclosure to prompt them to review whether their investment pathway objective is still appropriate for them.

22. These proposals are designed to address the harm of consumers choosing an unsuitable investment strategy. We believe that investment pathways will help non-advised consumers select investments that broadly meet their objectives for their pot in drawdown.

23. Our survey of 71 SIPP operators that were not connected to an insurer indicated that 39% would not implement investment pathways, instead choosing to restrict access to drawdown to advised consumers. The remaining SIPP operators said that they would implement investment pathways, or were unsure whether they would. As most SIPP

8 Some smaller providers which fall below a designated threshold may refer consumers to the SFGB instead of offering an investment solution against one or more of the broad objectives.

operators are also small providers, we have used these survey responses to estimate that the proposal will affect 97 small providers (61%). We estimate the proposal will affect all medium and large providers.

24. From information supplied in response to the retirement income data regulatory return, and using the above assumption of the number of small providers implementing the approach, we estimate that investment pathways will be offered to approximately 111,600 non-advised DC pension plan holders entering drawdown or transferring assets already in drawdown each year. Of these, we estimate there are approximately 83,700 who will use investment pathways to select a pathways solution.[9] We expect this figure to rise over the next ten years in line with the increased uptake of DC pensions, because of automatic enrolment.

25. We are also proposing to allow smaller providers to choose not to offer investment solutions to any of the objectives. Smaller providers would still have to take non-advised consumers through the choice architecture and present the objectives. However, if they choose not to offer pathways solutions they would instead have to refer consumers who select an investment pathways objective to either:

- another provider's pathways solution; or
- the SFGB's drawdown comparator tool, which we expect to be operational before our investment pathways proposals are implemented

26. To set the threshold for this small provider exemption, we have reviewed data from our regular retirement income data request, and from our recent SIPP operator data request. These data show that almost all the SIPP operators that are reluctant or unwilling to implement investment pathways had fewer than 500 non-advised consumers enter drawdown last year, and that over 90% of non-advised consumers go into drawdown at providers above this threshold. We are therefore proposing that providers with fewer than 500 non-advised consumers a year entering drawdown will be able to take advantage of this easement for small providers. From our survey of SIPP operators, we estimate that around 40 of the 97 small providers will take advantage of this provision.

27. We have estimated that that small providers that choose to take this exemption will not incur the additional cost of designing pathways solutions and the related product governance costs, but that all other costs will still apply.

Costs

One-off costs

Familiarisation and gap analysis

28. We expect providers to incur familiarisation costs reading the new rules and undertaking a gap analysis. We use standard assumptions to estimate these costs based on the standardised cost model, of which further details can be found in Annex 1 of "How we analyse the costs and benefits of our policies". We assume

9 This estimates that 75-80% of non-advised consumers will choose investment pathways. This is based on the results of our one-off information request which we received from 7 life insurers and SIPP platform providers. This research informed the findings of M16/1.3.

that there will be approximately 40 pages of policy documentation which relate to investment pathways that providers will need to familiarise themselves with. We assume that it would take around 2 hours to read the document. It is further assumed that 20 compliance staff at large providers, 5 compliance staff at medium providers and 2 compliance staff at small providers will read the document. Finally, using data on salaries from the Willis Towers Watson UK Financial Services survey, the hourly compliance staff salary, including 30% overheads, is assumed to be £60 at the larger providers and £43 at small providers.

29. We also estimate the cost for providers of conducting a legal review of these proposals given they constitute a new requirement. There are around 15 pages of legal instrument. It is assumed that 4 legal staff at large providers, 2 legal staff at medium providers and 1 legal staff at small providers will review the legal instruments associated with investment pathways. Finally, using the same source as above, the hourly legal staff salary, including 30% overheads, is assumed to be £66 at large and medium providers and £52 at small providers.

30. Using these assumptions, we expect a total industry wide cost of £90,000 for familiarisation and gap analysis.

Designing and implementing investment pathways

31. Providers who do not fall within the exemption referred to in paragraph 26 will need to provide a pathways solution for at least one of the overarching objectives. For the other objectives, providers can either provide a solution themselves or will have to refer consumers to another provider's investment solutions. We assume that some providers will have existing solutions that can be re-used or adapted for some or all of the objectives. However, other providers may also have to design one or more new investment solutions against the objectives. The introduction of investment pathways will also require providers to make one-off IT systems changes.

32. We assume that all large providers will already have an existing solution for each objective that can be adapted, so they will not need to design new solutions.

33. For small and medium providers, we have used data collected from SIPP operators to estimate the costs of designing and implementing a pathways solution. In response to our survey to 71 SIPP operators, small providers indicated that these costs would range from £15,000 to £475,000,[10] and medium providers indicated that they could range from £65,000 to £300,000. We have estimated, using a simple average of responses to our survey, one-off costs of £95,000 for small providers and £182,500 for medium providers.

34. We assume that all small providers will be required to design and implement a pathways solution from scratch (albeit some may be able to take advantage of the exemption), and between 30% and 70% of medium providers will also be required to do so.[11]

35. For those firms that already have a suitable investment solution, they would be required to adapt their IT systems to implement investment pathways. We have assumed this will apply to all large providers and between 30% and 70% of medium

10 One provider indicated that it would cost between £350,000 and £600,000 to design and implement investment pathways. However, we consider the upper bound estimate to be disproportionately above other estimates provided by small and medium providers, so we have used the mid-point.

11 We do not expect any medium providers to incur costs, so we have adopted a percentage range to provide a reasonable assumption of the number of firms that might be affected.

providers. Small providers costs are already captured in the costs above as they do not have existing investment solutions to adapt.

36. We have estimated the costs associated with adapting IT systems using the assumptions in the standardised cost model. Adapting IT systems to implement investment pathways will require one-off IT development costs which consist of the following elements: business analysis, design, programming, project management, testing and involvement from senior management. Based on FCA data, we estimate that the IT project length is likely to comprise 80 days for medium providers at a cost of £112,000 per provider and 120 days for large providers at a cost of £410,000 per large provider.

37. We estimate the combined impact on the industry for designing and implementing investment pathways is a total cost of between £14.8m and £15.3m.

Updating and sending consumer communications

38. We expect all providers to refer to investment pathways within their existing written communications, for example in their marketing material. To estimate the cost of including an extra paragraph within these materials, we used the Financial Services Authority's 2006 survey on 'Compliance costs of proposed changes to the investment product disclosure regime', which identified potential industry costs from a range of investment product disclosures by firm size. These data were updated using the consumer price index (CPI).

39. We estimate that the cost of adding an extra paragraph and logo to all written communications is £2,900 per small provider, £114,000 per medium provider and £1.3m per large provider. We estimate the total cost to industry would be £15.3m.

Training

40. We also consider that providers will need to train employees on how to give consumers information relating to investment pathways and to continue to engage with consumers after the point of sale. Based on FCA data, we estimate that 435 staff at large providers, 99 staff at medium providers and 97 staff at small providers will be trained over the course of a day. We have estimated the costs associated with training using the assumptions in the standardised cost model. So we assume that all large providers and 5 medium providers will undertake in house training, and 7 medium providers and all small providers will use external training providers. From FCA data, we anticipate external training costs are £208,900 for medium firms and £26,400 for small providers.

41. Using data on salaries from the Willis Towers Watson UK Financial Services survey, the hourly employment cost for staff undertaking training, including overheads, is assumed to be £32 at the large and medium providers and £29 at small providers. For in-house training, we have estimated that 2 days is required to formulate the training in large and medium providers, with an hourly wage including overheads of £44 at large providers and £39 at medium providers. We have assumed that large providers will need 290 training sessions at £308 per session, and medium providers will need 32 training sessions at a cost of £276 per session.

42. Using these assumptions, we expect a total industry wide cost of £2.3m for training.

Ongoing costs

Review and operation of investment pathways

43. Under our proposals, providers will be expected to review the investment solutions which they provide via the investment pathways model on an annual basis. From survey data collected from SIPP operators, the additional cost of reviewing and operating investment pathways is £14,400 per annum for small providers, £52,500 per annum for medium providers, and £250,000 per annum for large providers.

44. We therefore estimate an on-going cost to industry of £4.5m per year.

Consumer engagement

45. We expect the length of the sales process to increase, and the number of consumer queries to rise, because of these proposals. We have estimated the costs associated with an increase in consumer engagement using the assumptions in the standardised cost model. To calculate this cost, we assume that an extra 10 minutes would be required to explain investment pathways to the consumer during a sales telephone call. Based on FCA data, we have estimated that the number of completed sales each year is 36,500[12] and the wage cost per minute, plus 30% overheads, is 29p, 46p and 33p for small, medium and large providers respectively.

46. It is estimated that the on-going cost to industry from a longer sales process is £110,000 per year.

47. We assume that between 40% and 60%[13] of providers will communicate with their consumers about investment pathways by post, rather than via the internet (which we assume to have minimal costs). We assume that initial contact about investment pathways will be incorporated into the provider's 'business as usual' communications to the consumer. However, we assume that the provider will send two additional letters to follow-up with the consumer on their investment pathway choice. We estimate that this communication will be sent to around 111,600 non-advised consumers who enter drawdown each year, and would cost the industry between £67,000 and £100,400 per year.

48. Please note that we have not included the cost of introducing IGCs for the investment pathways. These proposals will be consulted on separately, including the costs and benefits of the proposal.

Consumer costs

49. We recognise that the investment pathways could capture consumers with quite different circumstances and needs. It follows that the ready-made investment solutions a provider offers may not provide optimal outcomes for all consumers. However, we recognise that providing a larger number of more bespoke alternatives at this stage in the decision process could have the effect of disengaging some consumers with their investment decision. We do not consider it reasonably practicable to estimate these costs.

50. To estimate the costs of engaging with providers, we value an individual's leisure time based on the Department for Transport's analysis and modelling. This provides an hourly value of £5.70 per hour (2018 prices). We assume that all non-advised consumers entering drawdown each year spend 10 minutes engaging with providers

12 We recognise that there may be also be an increase in the length of uncompleted sales but do not consider it reasonably practicable to estimate these costs.

13 This assumption is based on FCA research which examined the existing consumer journey of 6 providers.

(see paragraph 45). It is estimated that the total on-going cost to consumers is £79,500 per year.

51. We recognise that there may be also be a cost to consumers in the time they spend considering the issue for themselves, but do not consider it reasonably practicable to estimate these costs.

Potential for provider exit

52. There is a possibility that requiring investment pathways for non-advised consumers could cause providers to exit the market in the future. As mentioned in paragraph 25, we therefore propose to allow smaller providers to choose not to offer pathways solutions.

53. We note from our survey of 71 SIPP operators that some indicated that it is likely they would not implement the remedy in relation to the non-advised segment of their business. We are proposing that only providers with fewer than 500 non-advised consumers a year entering drawdown may take advantage of this easement for small providers. We have set this easement to enable providers to continue to exist in the non-advised segment of the market.

54. 1 provider, who is above the threshold, also indicated that it is likely they would not implement this remedy in relation to their non-advised consumers, and would exit this segment of the market.

Benefits

Consumers purchase more suitable investment solutions

55. We expect the introduction of investment pathways to reduce the probability of financial losses from consumers making unsuitable purchases which fail to meet their retirement objectives. Our Final Report showed that a significant number of non-advised consumers are likely to be holding their drawdown funds in investments that will not meet their needs. In particular, we found that 33% of non-advised consumers hold their whole drawdown pot in cash accounts, or exclusively in 'cash like' funds. The Final Report also found that consumers in cash could get an income from their pot up to 37% higher over 20 years by investing in a mix of assets rather than just cash.[14]

56. We therefore expect investment pathways to benefit a proportion of the 75% of non-advised consumers that use the remedy, by enabling consumers in cash to select an investment solution better suited to their needs. Conversely, we also expect that investment pathways will benefit those non-advised consumers who might otherwise have taken on more investment risk than they intended.

57. Illustratively, we have considered the benefits to those consumers with money in 'cash like' funds. We estimate that around 111,600 non-advised consumers enter drawdown each year, of which we estimate that 75% will utilise investment pathways, and of which approximately 13,900 are at risk of losing out by being in cash. Conservatively

14 This assumes an asset mix of 50% equities, 20% government bonds, 20% corporate bonds, 7% property and 3% cash – for a consumer with a pot of £100,000 they would receive an extra £1,500 a year.

assuming an average pot size for these consumers of £10,000,[15] the total amount at risk each year is £139m. Assuming that all pots increase by 37%[16] more over 20 years than they would have if the funds were invested in 'cash like' funds, then the benefits to consumers each year would be £25.9m (using a discount rate of 3.5%).[17]

Improved consumer engagement with their choice of drawdown

58. Our proposals should improve consumer engagement when consumers enter drawdown and enable more consumers to make an informed choice which is better suited to their objectives in retirement. We therefore expect investment pathways to promote greater confidence in the financial planning arrangements of non-advised consumers. The Final Report also showed that the way in which the choice architecture is presented when a consumer enters drawdown has a significant influence on the investment outcomes for the consumer. This is consistent with the other evidence presented in the Final Report, which showed that choice architecture has a significant impact on choices and outcomes.

59. In addition, in the qualitative analysis conducted for our Final Report, some consumers expressed a lack of trust with the pensions industry, and cited the wish to control their money as an important trigger for withdrawing their money.[18] Improved consumer engagement and consumer understanding through the provision of a transparent choice architecture is likely gradually to improve trust in the market, restore market confidence and encourage more investment within the market. It is not reasonably practicable to estimate this in monetary terms.

60. The table below summarises the costs and benefits of the proposals set out in this section.

	Estimated direct costs and benefits	
	One-off	**Ongoing**
Direct costs (£)		
Familiarisation	£90,000	-
Training	£2.3m	
IT system changes	£14.8 – £15.3m	-
Updating customer communications	£15.3m	-
Review of investment pathways	-	£4.5m p.a.
Customer engagement	-	£100,400 p.a.
Circulating customer communications	-	£67,000 – £100,400 p.a.
Costs to consumers	-	£79,500 p.a. (partially quantified)
Illustrative benefits (£)		

15 From the Retirement Income Data Request, around 6% (7,000) of consumers entering drawdown have a pot size of less than £10k and approximately 20% (18,000) of consumers starting drawdown are likely to have pot sizes between £10,000 and £30,000. We estimate around 14,000 consumers each year are at risk of losing out by holding cash like investment solutions. Presuming customers with cash-like investments hold smaller pots, then they would fall into these brackets. So, on a prudent basis, we have used £10,000 to estimate benefits for those holding cash like investments.

16 The range of 20 – 37% is based on the findings of MS 16/1.3 (p.5) which noted that consumers in cash could get an income from their pot of up to 37% higher over 20 years by moving to a mix of assets.

17 This provides an upper bound estimate for these benefits

18 MS 16/1.3 p.21.

	Estimated direct costs and benefits	
	One-off	Ongoing
More suitable investment decision	-	£25.9m p.a.
Improved consumer engagement	-	Not quantified

61. By requiring investment pathways, assuming that they enable more consumers to make an informed choice which is better suited to their objectives in retirement, we estimate the consumer benefits will offset the costs to firms after between 2 and 3 years.

Section 3: ensuring investment in cash is an active decision

62. Our proposal aims to ensure that non-advised consumers actively choose to invest in cash or cash-like assets, and that they are made aware of the potential risks of doing so if they have longer-term objectives for their drawdown pot.

63. We propose that:

- providers ensure that non-advised consumers entering drawdown – or transferring-in assets from another fund in drawdown – who are investing wholly or predominantly in cash, make an active decision to do so
- providers give a warning to non-advised consumers making an active decision to invest wholly or predominantly in cash on entering drawdown or transferring-in assets from another fund in drawdown
- providers give a warning on an annual basis to all their non-advised consumers – and consumers in respect of which the provider is unsure whether they are advised or non-advised – already in flexi-access drawdown who are wholly or predominantly invested in cash

64. The data received from our information request to providers (which surveyed 7 providers), and our separate information request to SIPP operators, both suggest a proportion of consumers are still being automatically defaulted into a cash or cash-like solution by some providers. Providers do not necessarily have a financial incentive to end 'defaulting' to cash, as they may earn a return on cash investments but do not pass it on to consumers. By requiring a non-advised consumer to make an 'active choice' to invest in cash, we believe that more consumers will choose an appropriate investment solution.

65. As with investment pathways, our proposals will affect around 180 providers with permission to establish, operate and wind-up personal pension schemes and/or stakeholder pension schemes.

66. We estimate that these proposals will affect 27,900 non-advised DC pension plan holders entering drawdown or transferring assets already in drawdown per year,[19] and

19 As noted in paragraph 20, we anticipate that approximately 20-25% of non-advised consumers will opt out of investment pathways based on our CP data request to providers.

at least another 400,000 consumers who are predominantly holding cash already in drawdown.[20]

One-off costs

67. We expect providers to incur familiarisation costs reading the new rules and undertaking a gap analysis. We consider that there will be approximately 20 pages of policy documentation that providers will need to familiarise themselves with, and 5 pages of legal text. Using the same approach and assumptions set out in our investment pathways section, we estimate the total industry costs to be £45,200.

68. Training costs are also anticipated as part of compliance costs. Using a similar approach and set of assumptions for training to that set out in our investment pathways section, we estimate the total costs as £2.3m.

69. The introduction of a notification system to ensure that non-advised consumers make an active decision to invest in cash will require providers to make one-off IT systems changes to notify the consumer when they first enter drawdown, and to monitor those consumers already in drawdown that are predominately in cash. We have estimated the costs associated with adapting IT systems using the assumptions in the standardised cost model. Adapting IT systems to ensure compliance with these proposals will require one-off IT development costs which include the following elements: business analysis, design, programming, project management, testing and involvement from senior management. We assume that the IT project length will comprise 50 days for small providers, 80 days for medium providers and 120 days for large providers. Using FCA data, we estimate that there is a cost of £13,588 per small provider, £112,000 per medium provider and a cost of £410,000 per large provider. The combined impact on the industry is a total cost of £5.4m.

70. We acknowledge that a minority of providers may make a profit from holding consumers in cash. We anticipate that some of these consumers may transfer to other providers which offer more suitable investment solutions, who will profit accordingly, so we have therefore not assumed a net cost to the industry. We do not consider it reasonably practicable to estimate the rate of transfer.

On-going costs

71. Under our proposals, providers will be expected to give warnings to their drawdown consumers sitting in cash for extended periods.[21] We expect these warnings to be included in the provider's annual statement and have therefore treated this as a 'business as usual' cost.

20 Based on providers' responses to the retirement income data request we estimate that 2.4 million consumers already in drawdown. The Final Report, notes that of those consumers already in drawdown, one-third have not taken advice of which over half of these consumers are predominantly holding cash.

21 Consumers holding cash or cash-like assets which comprise over 50% of their total investment pot.

Benefits

Consumers make more suitable investment choices

72. It is not reasonably practicable to estimate the benefits to those non-advised DC pension plan holders entering drawdown, or transferring assets already in drawdown, as it is unclear what proportion would no longer choose cash.

73. As stated above, we estimate that at least 400,000 non-advised consumers will be prevented from defaulting into cash. In our Final Report, we estimated that just over half of consumers wholly or predominantly in cash are likely to be losing out on their income in retirement by holding cash. As a result of these proposals, we expect more consumers to benefit from an investment choice which is better suited to their retirement objectives. This may result in increased consumer trust in the pensions market.

74. We consider that the improved consumer engagement and consumer understanding through responding to our remedies is likely gradually to improve trust in the market, restoring market confidence and encouraging more investment within the market. We do not consider it reasonably practicable to estimate this benefit.

The table below summarises the costs and benefits of the proposals set out in this section.

	Estimated direct costs and benefits	
	One-off	**Ongoing**
Direct costs (£)		
Familiarisation	£45,200	-
Training	£2.3m	-
IT system changes	£5.4m	-
Benefits (£)		
More suitable investment choices	-	Not quantified
Increased trust in the pensions market	-	Not quantified

75. The one-off costs incurred by firms would be offset by the benefits to consumers switching away from cash like investments, even if only a relatively small number do so. Conservatively assuming the average pot size for each of these consumers is £10,000, and that all pots invested in 'cash like' funds will increase by 37% more over 20 years than they would have otherwise done so, then these costs would be offset by 4,200 consumers switching away from 'cash like' funds. [22]

Section 4: actual charges information

76. Our proposals expand on the existing reporting requirements and improve the information that consumers receive about charges.

77. We propose in relation to plan holders who are in the decumulation phase:

22 This is an upper bound estimate.

- to require firms to provide post-sale information, at least annually, on all the actual costs and charges
- to require that this disclosure includes transaction costs incurred in relation to consumers' pension pots

78. As with investment pathways and cash defaulting, our proposals will affect around 180 firms with permission to establish, operate and wind-up personal pension schemes and/or stakeholder pension schemes. We estimate that these proposals will affect approximately 10m pension plan holders who are currently in the decumulation phase, and the plan holders who will enter the decumulation phase in future years, which we estimate to be approximately 335,000 each year.

One-off costs

79. We expect firms to incur familiarisation costs reading the new rules and undertaking a gap analysis. We consider that there will be approximately 3 pages of policy documentation that firms will need to familiarise themselves with and 2 pages of legal text. Using the same approach and assumptions set out under investment pathways, we estimate the total industry costs to be £11,000.

IT system change costs

80. Requiring firms to ensure that actual costs are disclosed to customers in drawdown, would require system changes to (i) obtain costs from third parties and (ii) aggregate the necessary information per customer before disclosing it. Adapting IT systems to implement pathways will require one-off IT development costs which consist of the following elements: business analysis, design, programming, project management, testing and involvement from senior management.

81. Many firms will already have all the necessary costs and charges information available to them, as these are required to be disclosed in relation to MiFID business,[23] but other firms will not. We estimate that between 30 and 70% of firms may need to introduce system changes to obtain this information.[24] In CP16/37, pension providers suggested that firms will incur an up-front cost of between £21,000 and £200,000 per firm to amend systems to retrieve personalised annuity quotes from the open market. We consider the costs incurred to retrieve personalised annuity quotes to be comparable to those associated with retrieving transaction costs. We have used the mid-point (£110,500) in this range to estimate the costs of these system changes to firms, which would result in one-off industry-wide costs of £14.1m.

82. In addition to any costs that may be incurred when obtaining costs from third parties, we also anticipate that firms would need to change their IT systems so that costs can be aggregated per consumer before they are disclosed. We assume all affected firms will need to undertake this system change, and using the assumptions in the standardised cost model and FCA data, we consider that the IT project length will comprise approximately 150 days for small firms at a cost of £41,000 per firm, 220 days

23 See COBS 16A.4.1 EU (MiFID Org Regulation Article 60(2)(d)).

24 We do not expect none or all medium providers to incur costs, so we have adopted a percentage range to provide a reasonable assumption of the number of firms that might be affected.

for medium firms at a cost of £308,000 per firm and 300 days for large firms at a cost of £1m per large firm.[25] This amounts to a cost for changing IT systems of £20.4m.

83. The combined impact of IT system changes on the industry is a total one-off cost of £34.4m.

84. The cost of identifying and calculating certain transaction costs, such as when the underlying pension assets are property, have not been estimated. We consider these costs to apply to a relatively small sector of the market, and in relation to a relatively small number of pension plan holders. Firms indicated that it may be difficult to calculate these transaction costs and did not provide an indication as to these costs, so we do not consider it reasonably practicable to estimate these.

Disclosing the information

85. We expect all firms to disclose actual costs and charges within existing annual statements. Following a similar approach to that used in investment pathways information, we estimate the one-off cost of adding an extra paragraph is £1,300 per small firm, £66,000 per medium firm and £512,000 per large firm.[26]

86. The total cost to industry would be £6m.

Ongoing costs

87. We expect that the disclosure of information about actual costs and charges paid may increase the number of customer queries. To calculate this cost, we assume that between 2% and 4%[27] of approximately 10m pension plan holders will contact their firm, such that the industry will need to deal with an extra 200,000 to 400,000 contacts. Using the assumptions from the standardised cost model and FCA data, we estimate the wage cost per minute, plus 30% overheads, are 29p, 46p and 33p for small, medium and large firms respectively. Assuming a 15-minute call, it is estimated that the on-going cost to industry from a longer sales process is between £900,000 and £1.8m per year.

Consumer costs

88. As above, to estimate the costs to consumers of engaging with firms, we value an individual's leisure time based on the Department for Transport's analysis and modelling, which provides an hourly value of £5.70 per hour (2018 prices). We assume that consumers contacting their firm spend 15 minutes engaging with providers. It is estimated that the on-going cost to consumers is between £285,000 and £570,000 per year.

25 This is not too dissimilar to the estimate used in CP16/37, where the costs for updating systems to deliver disclosures (that include information prompts) in the annuity market was £397,000 per medium-sized firm.

26 This estimate differs from the one under investment pathways as firms are required to include one additional paragraph to existing correspondence under this intervention. Whereas, investment pathways require firms to also include a graph.

27 In CP18/17 we noted that streamlining the 'wake-up' packs resulted in an increase in calls to Pension Wise of 3 to 4 percentage points. In CP16/37 we noted that the information prompt disclosure would result in a 5-percentage point increase in switching. We have assumed that the disclosure of actual charges would lead to an increase in customer contacts of between 2 and 4 percentage points.

89. We recognise that there may be also be a cost to consumers in the time they spend considering the issue for themselves. And that some consumers may contact the SFGB to discuss their charges or opt to use the drawdown comparator tool provided by SFGB when it is operational. But, we do not consider it reasonably practicable to estimate these costs.

Benefits

Improved consumer engagement

90. Requiring this post-sale disclosure on an annual basis, in cash terms, should benefit consumers as it will make the impact of costs clearer and easier to understand. Consumers who are made aware of the charges they are paying, if presented in terms they understand, should be more likely to consider reviewing, researching and re-visiting their options.

91. We expect the disclosure of actual charges will reduce the likelihood of consumers purchasing products which have fees that are much higher than those applying to other similar products on the market. The price variation we identified in our Final Report shows the potential for savings that could be made by consumers, as nearly a quarter of non-advised consumers are paying 1.5% or more of the value of their pots in charges every year. For some consumers, moving to a better deal could result in a larger pension pot, that lasts longer and provides for a more financially secure retirement.

92. As highlighted in CP18/17, our data analysis on the charges imposed by a subset of pension providers, covering approximately 60% of the market, indicates that total charges vary across providers with average total charges ranging from 0.4% to 1.6%. By switching from a higher cost provider to a lower cost provider, consumers could save approximately £65 on average.[28] This would indicate potential savings of between £12.8m and £25.7m per year.

93. We estimate that these savings could be realised if 200,000 and 400,000 consumers respectively were to choose the cheapest provider out of 10m consumers.

94. The table below summarises the costs and benefits of the proposals set out in this section.

	Estimated direct costs and benefits	
	One-off	Ongoing
Direct costs (£)		
Familiarisation	£11,000	-
IT system changes	£34.4m	-
Disclosure	£6m	-
Query handling	-	£900,000 – £1.8m p.a.

28 This estimate is based on the weighted average size of funds under management and takes into account the different levels of charges applying to different fund sizes.

	Estimated direct costs and benefits	
Costs to consumers		£285,000 – £570,000 p.a. (partially quantified)
Potential benefits (£)	-	£12.8 to £25.7m p.a.

95. By requiring the disclosure of these actual costs, assuming that these will motivate competition and shopping around by around 2-4% of consumers to find the best deal, we estimate the consumer benefits will offset the costs to firms after between 2 and 4 years.

Q23: Do you have any comments on our cost benefit analysis?

Annex 4
Compatibility statement

Compliance with legal requirements

1. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).

2. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is (a) compatible with its general duty under s. 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, and (b) its general duty under s. 1B(5)(a) FSMA to have regard to the regulatory principles in s. 3B FSMA. The FCA is also required by s. 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

3. In addition, this Annex explains how we have considered the recommendations made by the Treasury under s. 1JA FSMA about aspects of the economic policy of Her Majesty's Government to which we should have regard in connection with our general duties.

4. This Annex includes our assessment of the equality and diversity implications of these proposals.

5. Under the Legislative and Regulatory Reform Act 2006 (LRRA) the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRA.

The FCA's objectives and regulatory principles: Compatibility statement

6. The proposals set out in this consultation are primarily intended to advance the FCA's operational objective of securing an appropriate degree of protection for consumers. They also advance the FCA's operational objective to promote competition in the interests of consumers.

7. We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well because they aim to ensure that non-advised consumers make investment choices that better reflect their needs and

objectives for their drawdown pot. Our proposals also aim to ensure that consumers are provided with clear information about the charges they pay in drawdown, which ultimately facilitates a competitive drawdown market. For the purposes of the FCA's strategic objective, "relevant markets" are defined by s. 1F FSMA.

8. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s. 3B FSMA, as set out in the following sections.

The need to use our resources in the most efficient and economic way

9. We have considered this principle and do not believe that our proposals will have a significant impact on our resources and the way we use them. Any work undertaken after implementation of our proposals – such as the planned post-implementation review – will form part of our future business planning.

The principle that a burden or restriction should be proportionate to the benefits

10. In Annex 3 we have set out our analysis of the costs and benefits of our proposals for consultation. Overall, we believe that our proposals are a proportionate response to the harm that we have found.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

11. We have considered this principle and do not believe our proposals undermine it.

The general principle that consumers should take responsibility for their decisions

12. The pension freedoms mean that consumers have more choice when accessing their pension savings. With this increase in choice, consumers need to make more decisions; ultimately, though, it is for them to decide what's best for them. Broadly, our proposals for consultation aim to help non-advised consumers to make investment choices that better reflect their needs and objectives for their drawdown pot. Our evidence from the Final Report suggests that, at present, many providers do not have simple, well-structured investment choices for consumers entering non-advised drawdown – so our proposals aim to ensure these are provided. Furthermore, our proposals for consultation also aim to ensure that consumers are provided with clear information about the charges they pay in drawdown, which helps the consumer consider whether they could get a better deal elsewhere.

The responsibilities of senior management

13. We have had regard to this principle and do not believe our proposals undermine it.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

14. We have had regard to this principle and do not believe our proposals undermine it. The analysis we have undertaken since publication of CP18/17 demonstrates our commitment to understanding how our proposals will impact different business models and arrangements across the drawdown market – specifically SIPPs.

The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information

15. We have had regard to this principle and do not believe our proposals undermine it.

The principle that we should exercise of our functions as transparently as possible

16. We have had regard to this principle and do not believe our proposals undermine it.

17. In formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s. 1B(5)(b) FSMA). We do not consider this is relevant in relation to our proposals.

Expected effect on mutual societies

18. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies than other authorised persons, or present them with any more or less of a burden than other authorised persons.

Equality and diversity

19. We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we conduct an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered.

20. The outcome of the assessment in this case is stated in paragraphs 2.14 and 2.15 of the CP.

Legislative and Regulatory Reform Act 2006 (LRRA)

21. We have had regard to the principles in the LRRA for the parts of the proposals that consist of general policies, principles or guidance and consider that our proposals are proportionate and will result in an appropriate level of consumer protection when balanced with the impact of affected providers.

22. We have had regard to the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance, but this duty does not apply to regulatory functions exercisable through our rules.

Treasury recommendations about economic policy

23. We have had regard to the Treasury's recommendations under section 1JA FSMA. Our proposals are consistent with these recommendations, as they aim to improve outcomes for consumers entering - and in - drawdown, while supporting competition between providers operating in this market.

Annex 5
Abbreviations used in this paper

CBA	Cost Benefit Analysis
CP	Consultation Paper
COBS	Conduct of Business Sourcebook
DB	Defined Benefit
DC	Defined Contribution
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
GAA	Governance Advisory Arrangement
IDD	Insurance Distribution Directive
IGC	Independent Governance Committee
LRRA	Legislative and Regulatory Reform Act 2006
MiFID (& MiFID II)	Markets in Financial Instruments Directive
PERG	Perimeter Guidance Manual
PROD	Product Intervention and Product Governance Sourcebook
ROR	Retirement Outcomes Review
SFGB	Single Financial Guidance Body
SIPP	Self-Invested Personal Pension
SYSC	Senior Management Arrangements, Systems and Controls
TPR	The Pensions Regulator
UFPLS	Uncrystallised Fund Pension Lump Sum

We have developed the policy in this Consultation Paper in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 7948 or email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 12 Endeavour Square, London E20 1JN

Appendix 1
Draft Handbook text

CONDUCT OF BUSINESS SOURCEBOOK (INVESTMENT PATHWAYS) INSTRUMENT 2019

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137A (The FCA's general rules);
(2) section 137T (General supplementary powers); and
(3) section 139A (Power of the FCA to give guidance).

B. The rule-making powers listed above are specified for the purpose of section 138G (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on [*date*].

Amendments to the Handbook

D. 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).

(1)	(2)
Glossary of definitions	Annex A
Conduct of Business sourcebook (COBS)	Annex B
Product Intervention and Product Governance sourcebook (PROD)	Annex C

Amendments to material outside the Handbook

E. The Perimeter Guidance manual (PERG) is amended in accordance with Annex D to this instrument.

Citation

F. This instrument may be cited as the Conduct of Business Sourcebook (Investment Pathways) Instrument 2019.

By order of the Board
[*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. The text is not underlined.

capped drawdown pension fund	in accordance with paragraph 8 of schedule 28 to the Finance Act 2004, sums or assets held in a *personal pension scheme* or *stakeholder pension scheme* and designated as available for the payment of capped *income withdrawals.*
flexi-access drawdown pension fund	in accordance with paragraph 8A of schedule 28 to the Finance Act 2004, sums or assets held in a *personal pension scheme* or *stakeholder pension scheme* and designated as available for the payment of unlimited *income withdrawals.*
investment pathway	the process as set out in *COBS* 19.10.11R to 19.10.19R that a *retail client* can use to select a *pathway investment* for investing the sums and assets in their *capped drawdown pension fund* or *flexi-access drawdown pension fund*;
pathway investment	an investment that corresponds to the pathway options in *COBS* 19.10.15R(1).

Amend the following definitions as shown.

distribute	…	
	<u>(3)</u>	<u>(in relation to *PROD* 1.4.3AG, 1.4.3BR and 1.4.3CG, *PROD* 1.6.1R and *PROD* 6) *arranging* a *pathway investment*.</u>
	…	
income withdrawals	(a)	(as defined in paragraph 7 of ~~Schedule~~ <u>schedule</u> 28 to the Finance Act 2004) in relation to a member of a pension scheme, amounts (other than an annuity) which the member is entitled to be paid from the member's:

(i) ~~drawdown pension fund (as defined in paragraph 8 of that Schedule)~~ *capped drawdown pension fund* in respect of an arrangement; or

(ii) ~~flexi-access drawdown pension fund (as defined in paragraph 8A of that Schedule)~~ *flexi-access drawdown pension fund* in respect of an arrangement; or

…

manufacture …

(3) (in relation to *COBS* 19, *PROD* 1.6 and *PROD* 6) creating, developing, designing, issuing, operating and/or underwriting a *pathway investment*.

Annex B

Amendments to the Conduct of Business sourcebook (COBS)

Part 1: Comes into force [*date*]

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

9	**Suitability (including basic advice) (other than MiFID and insurance-based investment products)**	
…		
9.3	**Guidance on assessing suitability**	
…		
9.3.3A	G	When a *firm* is making a *personal recommendation* to a *retail client* about *income withdrawals* it should consider whether a *pathway investment* is suitable for its *retail client*.

…			
16	**Reporting information to clients (non-MiFID provisions)**		
…			
16.6	**Communications to clients – life insurance, long term care insurance and ~~income withdrawals~~ drawdown pensions**		
…			
	Drawdown pensions: annual statements		
16.6.7A	R	In the rest of this section:	
		(1)	“annual statement” is the information required to be provided to a *retail client* on an annual basis at *COBS* 16.6.8R;
		(2)	“cash terms” means pounds and pence;
		(3)	“cash-like investments” includes *cash* or *near cash*, or units in a *regulated money market fund*, or units in a fund authorised as a money market fund for the purposes of the European Parliament and Council Regulation on money market funds (2007/1131/EU); and
		(4)	“drawdown fund” means either a *capped drawdown pension fund or flexi-access drawdown pension fund*;

		(5)	"non-advised *retail client*" is a *retail client* who has not received a *personal recommendation* from the *firm* or another *firm* in respect of how to invest the sums or assets in their drawdown pension fund.	
	Annual statements			
16.6.8	R	At intervals of no longer than 12 *months*, ~~from~~ beginning on the date a *retail client* first takes a *pension commencement lump sum* or an *uncrystallised funds pension lump sum payment*, or first makes an ~~*income withdrawals*~~ *income withdrawal* ~~or one-off, ad-hoc or regular *uncrystallised funds pension lump sum payments*~~, the relevant *operator* of a *personal pension scheme* or *stakeholder pension scheme* must:		
		(1)	provide the *retail client* with such information as is necessary for the *retail client* to review the election and decide what to do with their pension fund going forward, including where relevant the information required by *COBS* 13 Annex 2 2.9R, *COBS* 16.6.8AR and *COBS* 16.6.9R; and	
		…		
16.6.8A	R	If a *retail client* is invested in a *pathway investment* the annual statement must include the following:		
		(1)	a short description of each *pathway investment* they are invested in including the corresponding option under *COBS* 19.10.15R(1) and the current value of each *pathway investment* in cash terms;	
		(2)	(for those *retail clients* invested in two or more *pathway investments*) how their drawdown fund is split, in cash terms, across the different *pathway investments*;	
		(3)	all the *pathway investments* options (*COBS* 19.10.15R(1));	
		(4)	a statement reminding the *retail client* that they can, at any time:	
			(a)	select a different *investment pathway* option and change their *pathway investment*;
			(b)	select an investment that is not a *pathway investment*;
			(c)	(where this option is available) split their drawdown fund across two or more *pathway investments*;
			(d)	choose a different product to access their pension savings;
			(e)	shop around, with an explanation of how they may do so.

16.6.8B	G	If a *retail client* has been invested in the same *pathway investment* for 5 years (or a multiple of 5 years) a *firm* should consider including in the *retail client's* next annual statement:			
		(1)	a reminder of the number of years the *retail client* has been invested in the same *pathway investment*; and		
		(2)	a statement that the *retail client* should review their investment selection.		
…					
	Personal or stakeholder pension schemes in decumulation: actual costs and charges disclosure				
16.6.10	R	(1)	An *operator* of a *personal pension scheme* or *stakeholder pension scheme* must provide costs and charges information to a *retail client* which must be:		
			(a)	based on actual costs and charges (including transaction costs and the cost of advice) charged by the *operator* or other parties, which have been paid out of the *retail client's*:	
				(i)	drawdown pension fund; or
				(ii)	*personal pension scheme* or *stakeholder pension scheme* from which an *uncrystallised funds pension lump sum payment* was paid;
			(b)	aggregated and totalled; and	
			(c)	expressed in pounds and pence.	
		(2)	If exact figures for transaction costs are unknown or difficult to identify, *operators*:		
			(a)	may provide a reasonable estimate of such costs when providing the costs and charges information; or	
			(b)	if that is not possible, must include a written statement, with the costs and charges information, to explain which transaction costs are not included.	
		(3)	The *operator* must include a written statement with the costs and charges information, stating whether or not any adviser remuneration, including *adviser charges*, *consultancy charges*, *commission* or *commission equivalent*, is included in the aggregated costs and charges figure.		
	Drawdown pensions: annual cash warnings				

16.6.11	R	If a non-advised *retail client* has given instructions to invest more than 50% of their drawdown fund in cash-like investments, the *operator* of the *personal pension scheme* or *stakeholder pension scheme* must provide a cash warning annually on each anniversary of that instruction for so long as the drawdown fund remains so invested.		
16.6.12	R	The "cash warning" must be provided in a *durable medium* and, using plain language:		
		(1)	warn the *retail client* that:	
			(a)	more than half of their drawdown fund is invested in cash-like investments; and
			(b)	their drawdown fund is at risk of being eroded by inflation; and
		(2)	inform the *retail client* that if they plan to invest for the longer-term, they should consider whether their current investments are likely to grow sufficiently to meet their objectives.	
16.6.13	G	The "cash warning" should also:		
		(1)	explain how inflation risk works, alongside a comparison of:	
			(a)	the interest rate currently being paid on the *retail client's* cash-like investments; and
			(b)	the current inflation rate (using a measure generally accepted in the *United Kingdom*);
		(2)	(if appropriate) inform the *retail client* that:	
			(a)	this warning is not advice or a substitute for it, and if the *client* is unsure of how to proceed they should consider seeking advice from a *FCA*-regulated financial adviser;
			(b)	the value of any investment can fall as well as rise;
			(c)	different investments entail different risks, so the *retail client* should consider their attitude to, and capacity for, risk when choosing investments;
		(3)	provide the *retail client* with a statement to the effect that (to the extent applicable) the *firm* offers *pathway investments* and other investments; and	
		(4)	remind the *retail client* that they can:	
			(a)	shop around (with an explanation of how to do that); and

			(b)	seek regulated advice or review information on the *SFGB*'s website.
16.6.14	G	In the *FCA*'s view the Consumer Prices Index is a national index of retail prices and so may be used as a measure of the current inflation rate for the purposes of *COBS* 16.6.12G(1)(b).		
16.6.15	G	A *firm* to which the record-keeping rules in *SYSC* 3 or *SYSC* 9 apply should maintain a record of its compliance with the requirement to provide a cash warning including:		
		(1)	the number of non-advised *retail clients* who received a cash warning on the anniversary of their instruction to invest more than 50% of their drawdown fund in cash-like investments; and	
		(2)	the number of *retail clients* who contacted the provider after receiving a cash warning and a record of what action the *firm* and *retail client* took in each case.	

After COBS 19.9 (Pension annuity comparison information) insert the following new section. The text is not underlined.

19.10 Drawdown and investment pathways

Definitions

19.10.1 R In this section:

(1) "cash-like investments" includes *cash* or *near cash*, or units in a *regulated money market fund*, or units in a fund authorised as a money market fund for the purposes of the European Parliament and Council Regulation on money market funds (2007/1131/EU);

(2) "cash warning" is the warning in *COBS* 16.6.12R;

(3) "drawdown fund" means either a *capped drawdown pension fund or flexi-access drawdown pension fund*;

(4) "non-advised *retail client*" is a *retail client* who has not received a *personal recommendation* from the *firm* or another *firm* in respect of how to invest the sums or assets in their drawdown fund;

(5) "pathway investments exempt firm" is a *firm* which:

(a) has elected not to offer *pathway investments*; and

(b) is satisfied on reasonable grounds that it is more likely than not to have fewer than 500 of its non-advised *retail clients* designate funds to a drawdown fund in the 12 *months* following the date of the election in (a), taking into account:

(i) the number of non-advised *retail clients* who designated funds to a drawdown fund in the preceding 12 *months*;

(ii) the potential impact of any change in the *firm's* business plans over the next 12 *months*; and

(iii) any other relevant factors;

(6) references to a *firm* "offering" the *retail client* a *pathway investment* mean that the investments are either:

(a) *manufactured* by the *firm* (F1); or

(b) *manufactured* by another *firm* (F2) and available for investment in the drawdown fund operated by F1; and

(7) references to a *firm* "referring" the *retail client* to a *firm* offering a *pathway investment* mean that the *firm* (F1) arranges for the *retail client* to invest in a *pathway investment* available through transfer to the drawdown fund operated by another *firm* (F2), where F2 offers *pathway investments* in accordance with (6)(a) above.

Who?

19.10.2 R This section applies to a *firm* which operates a *retail client's personal pension scheme* or *stakeholder pension scheme.*

19.10.3 G The application of this section is modified for a pathway investments exempt firm.

19.10.4 R A pathway investments exempt firm must review its status at least once every 12 *months*. Any change to a *firm's* status as a pathway investments exempt firm takes effect 12 *months* after the review date.

Purpose

19.10.5 G The purpose of this section is to help non-advised *retail clients* designating some or all of the funds in their *pension schemes* into a drawdown fund make an active decision about how to invest those drawdown funds to achieve their retirement objectives.

19.10.6 G This section specifies the circumstances where a *firm* dealing with a non-advised *retail client* in relation to the investment of the sums or assets in their drawdown fund must:

(1) give the *retail client* the opportunity to use the *investment pathways*;

(2) offer the *retail client* a *pathway investment* or refer the *retail client* to a *firm* which offers *pathway investments*;

(2) ensure that *retail clients* investing wholly or predominantly in cash-like investments, make an active decision to do so; and

(3) provide warnings to *retail clients* investing wholly or predominantly in cash-like investments;

(4) remind *clients* about their option to shop around and use *pensions guidance*.

When?

19.10.7 R A *firm* must take the steps in this section when either:

(1) a *retail client* requests to designate some or all of the funds in their *pension scheme* to a drawdown fund; or

(2) a *retail client* transfers sums or assets from an existing drawdown fund to a drawdown fund operated by the *firm.*

19.10.8 R A *firm* need not take the steps in this section where the *firm* carries out the *retail client's* previous instructions to designate their funds on a regular basis into a drawdown fund.

Step 1: determine whether the retail client is transferring in

19.10.9 R The first step is to ask the *retail client* whether they have used the *investment pathways* at another *firm* and have been referred to the *firm's* drawdown fund to invest in one of the *pathway investments* that the *firm* offers. If the answer to this question is "yes", the *firm* does not have to take any further steps. If the answer is "no" the *firm* must proceed to step 2.

Step 2: determine whether the retail client has received a personal recommendation

19.10.10 R The second step is to ask the *retail client* whether they have received a *personal recommendation* in the last 12 *months* in respect of how to invest the sums or assets in their drawdown fund:

(1) if the answer is "no" the *firm* must proceed to step 3.

(2) if the answer is "yes" the *firm* must ask the *retail client* if their personal or financial circumstances have changed since they received the *personal recommendation*:

(a) if the answer is "yes", or the *retail client* or the *firm* is unsure, the *firm* must proceed to step 3.

(b) if the answer is "no" the *firm* does not have to take any further steps.

Step 3: offer use of investment pathways

19.10.11 R The third step is to ask the *retail client* how they want to select the *investment* for their drawdown fund from the following options:

(1) use the *investment pathways*;

(2) select investments without using the *investment pathways*; or

(3) (where applicable) remain invested in their current investments.

19.10.12 R The option to use *investment pathways* must be presented with equal prominence to options (2) and (3).

19.10.13 R If a *retail client* selects option (2) or (3) the *firm* must provide the *client* with the information in *COBS* 19.10.24R.

19.10.14 R If a *retail client* selects option (1), or the *retail client* is unsure about the option to select, or the *firm* is unsure about which option the *retail client* has selected, the *firm* must proceed to step 4.

Step 4: present investment pathway options

19.10.15 R The fourth step is to:

(1) present the *retail client* with the following *investment pathway* options:

(a) Option 1: I have no plans to touch my money in the next 5 years;

(b) Option 2: I plan to use my money to set up a guaranteed income (annuity) within the next 5 years;

(c) Option 3: I plan to start taking my money as a long-term income within the next 5 years;

(d) Option 4: I plan to take out all my money within the next 5 years; and

(2) ask the *retail client* to select an *investment pathway* option that corresponds most closely to their current intentions.

19.10.16 R A *firm* must not present to the *retail client* any other investment options at the same time as it presents the *investment pathway* options.

19.10.17 R If a *retail client* selects an *investment pathway* option, the *firm* must proceed to step 5.

19.10.18 G If, after the *firm* completes step 4, the *retail client* does not select an *investment pathway* option the *firm* should:

(1) consider providing the *retail client* with the opportunity to view the *investment pathways* options again or ask if the *retail client* requires further information to make their decision; and

(2) remind the *retail client* that they can shop around and provide a clear and prominent statement about the availability of advice and *pensions guidance*.

Step 5: offer pathway investments

19.10.19 R (1) The fifth step is for the *firm* to:

(a) either:

(i) offer the *retail client* a *pathway investment* that corresponds to the pathway option selected in step 4; or

(ii) refer the *retail client* to a *firm* that offers a *pathway investment* that corresponds to the pathway option selected in step 4; or

(iii) (for pathway investments exempt firms only) refer the *retail client* to the *SFGB* drawdown comparator; and

(b) provide the *retail client* with a clear and prominent statement:

(i) that other *firms* offer *pathway investments* for the *investment pathway* option selected by the *retail client* and that the *retail client* may benefit from shopping around, with an explanation of how they may do so; and

(ii) that the *SFGB* is available to assist the *retail client* with shopping around for *pathway investments* with an explanation of how they may access the *SFGB* and the *SFGB* drawdown comparator.

(2) A pathway investment exempt firm need only do (1)(a)(ii) or (iii) and (1)(b).

19.10.20 G If after the *firm* completes step 5 the *retail client* does not select a *pathway investment* the *firm* should:

(1) consider providing the *retail client* with the opportunity to view the *investment pathways* options again or ask if the *retail client* requires further information to make their decision;

(2) remind the *retail client* that they can shop around and explain how they can do that; and

(3) provide a clear and prominent statement about the availability of advice and *pensions guidance*.

Preparing for step 5

19.10.21 R To prepare for step 5:

(1) a *firm* (excluding pathway investments exempt firms) must be in a position to:

(a) offer, or refer to other *firms* offering, a *pathway investment* for each of the pathway options; and

(b) offer at least two *pathway investments*; and

(2) *firms* may offer, or refer to other *firms* offering, the same *pathway investment* for more than one *investment pathway* option, but must not offer, or refer the *retail client* to other *firms* that offer, the same *pathway investment* for all *investment pathway* options;

(3) pathway investments exempt firms must be in a position to either:

(a) refer clients to *pathway investments* offered at other *firms*; or

(b) refer clients to the *SFGB* drawdown comparator.

19.10.22 R *Firm*s must not offer more than one *pathway investment*, nor refer *retail clients* to more than one *firm* offering a *pathway investment*, for any *investment pathway* option.

19.10.23 R (1) *Firms* must label *pathway investments* clearly using the corresponding option listed in *COBS* 19.10.15(1)R.

(2) *Firms* must not label any other investments as *pathway investments* or mislead a *retail client* into thinking that another investment is a *pathway investment*.

Information for clients who choose not to use pathways

19.10.24 R If the *retail client* has decided at any point in the process before the *firm* completes step 5 (other than as a result of an up to date *personal recommendation* – see *COBS* 19.10.10R) not to use the *investment pathways* the *firm* must:

(1) give the *retail client* a further opportunity to use the *investment pathways*;

(2) remind the *retail client*, if the *retail client* has chosen to remain in their current investments, of their current investment strategy and that the *retail client* should check that it meets their current investment objectives;

(3) provide the *retail client* with a cash warning (if applicable); and

(4) remind the *retail client* that they can shop around and how to do that, including the option of using the *SFGB* drawdown comparator; and

(5) provide a clear and prominent statement about the availability of advice.

19.10.25 G *Firms* communicating with *retail clients* about their *drawdown pension* options should also consider their obligation to provide such information as is necessary for the *retail client* to make an informed decision, including (where relevant) the information listed in *COBS* 19.4.14R.

Product governance

19.10.26 G *Firms* should ensure that *pathway investments* comply with the product governance requirements specified in *PROD*.

Active decision to invest in cash

19.10.27 R If a non-advised *retail client* makes a decision that results in more than 50% of their drawdown fund being invested in cash-like investments:

(1) the *firm* must ensure that the *retail client* has made an active decision to invest in that way; and

(2) the *firm* must give the *retail client* a cash warning.

19.10.28 G A *retail client's* signature on a pre-populated form, whether in paper or electronic format, is not sufficient evidence of an active decision.

Record keeping

19.10.29 R A pathway investments exempt firm must maintain a record of:

(1) the dates its exemption applies; and

(2) how the *firm* assessed that it meets the requirements for the exemption with reference to the criteria in *COBS* 19.10.1R(5)(b).

19.10.30 G A *firm* to which the record-keeping rules in *SYSC* 3 or *SYSC* 9 apply should maintain a record of its compliance with the requirements in this section including:

(1) the number of advised and non-advised *retail clients* entering into drawdown arrangements with the *firm*;

(2) a record of how the *firm* determined whether a *retail client* was non-advised;

(3) the number of non-advised *retail clients* who choose to:

(a) use the *investment pathways*; or

(b) remain invested in their current investments; or

(c) select from the *firm's* own range of investments (where available) without using the *investment pathways*;

(4) the number of non-advised *retail clients* who selected a *pathway investment* option, broken down by option number;

(5) the number of non-advised *retail clients* who failed to select a *pathway investment* option, and a record of any follow-up action taken by the *retail client* or the *firm*;

(6) the number of non-advised *retail clients*:

(a) offered a *pathway investment*; and

(b) who selected the *pathway investment* offered;

(7) a record of the action taken by the *retail client* and the *firm* where a *retail client* did not select the *pathway investment* offered;

(8) where a *firm* directs a *retail client* to another *firm's pathway investment*:

(a) the number of non-advised retail clients directed to another *firm's pathway investment*;

(b) the number who transferred to that *firm*;

(c) a record of the action taken in each case by the *firm* and the *retail client* where the *retail client* did not transfer; and

(d) a record of how the ceding *firm* selected that *pathway investment* and, where relevant, how they reviewed that selection;

(9) where a *firm* manufactures *pathway investments*, a record of the product approval process undertaken by the *firm* for each *pathway investment*, and the annual review conducted for each *pathway investment* to comply with the requirements specified in *PROD* 6.2.1R;

(10) for pathway investment exempt firms:

(a) the number of non-advised *retail clients* directed to the *SFGB* drawdown comparator;

(b) the numbers of those *retail clients* who then transferred to another *firm*;

(c) a record of the action taken in each case by the *firm* and the *retail client* where the *retail client* did not transfer;

(11) the number of *retail clients* who received a cash warning in accordance with *COBS* 19.10.27R; and

(12) evidence of how each *retail client* who has received a "cash warning" made an active choice, in accordance with *COBS* 19.10.27(1)R, to invest more than 50% of their drawdown fund in cash-like investments.

…

TP 2 Other Transitional Provisions

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provisions: coming into force
…					
2.8-A	*COBS* 16.6.10 and 11	R	(1) An *operator* of a *personal pension scheme* or *stakeholder pension scheme* must, within 6 *months* of [date]: (a) identify which of its non-advised *retail clients* have more than 50% of their drawdown fund invested in cash-like investments; and (b) provide those *retail clients* with the cash warnings in *COBS* 16.6.11R and 16.6.12G at that point and annually afterwards on the anniversary of the date it first provided the cash	[Handbook commencement plus 6 months]	[date]

			warning for so long as the fund remains so invested.		
2.8-B	*COBS* 16.6.14G	G	A *firm* to which TP 2.8-A applies should maintain a record of the number of non-advised *retail clients* identified in accordance with *COBS* TP 2.8-AR(1)(a) and the number of non-advised *retail clients* sent warnings in accordance with *COBS* TP 2.8-AR(1)(b).		
…					

Annex C

Amendments to the Product Intervention and Product Governance Sourcebook (PROD)

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

1 Product intervention and Product Governance Sourcebook (PROD)

…

1.3 Application of PROD 3

…

Manufacturing pathway investments

1.3.16 G A *firm* within the scope of application of *PROD* 3 when *manufacturing pathway investments* other than in connection with its operating of a *retail client's personal pension scheme* or *stakeholder pension scheme*, is also subject to *PROD* 6 as *guidance* with respect to that *manufacturing* activity (see *PROD* 1.6.1R(3)).

…

1.4 Application of PROD 4

…

Manufacturing and distributing pathway investments

1.4.3A G A *firm* within the scope of application of *PROD* 4 when *manufacturing pathway investments* other than in connection with its operating of a *retail client's personal pension scheme* or *stakeholder pension scheme*, is also subject to *PROD* 6 as *guidance* with respect to that *manufacturing* activity (see *PROD* 1.6.1R(2)).

1.4.3B R Where a *firm*:

(1) *manufactures* or *distributes pathway investments* in connection with its operating of a *retail client's personal pension scheme* or *stakeholder pension scheme*; and

(2) is not otherwise within the scope of application of the *rules* or *EU regulations* in *PROD* with respect to that *manufacturing* or *distribution* activity, then:

(a) *PROD* 4 and *PROD* 1.4.10G apply; and

(b) *PROD* 1.4.4EU applies as a *rule*,

with respect to that *manufacturing* or *distribution* activity.

1.4.3C G The effect of *PROD* 1.4.3BR is to apply *PROD* 4 to any *firm*, such as a *SIPP* operator, which:

(1) *manufactures* or *distributes pathway investments* in connection with its operating of a *retail client's personal pension scheme* or *stakeholder pension scheme*; and

(2) before the entry into force of *PROD* 1.4.3BR was not subject to the *rules* or *EU regulations* in *PROD*.

…

Effect of provisions marked "EU" for certain manufacturers and distributors of insurance products

1.4.6 R …

…

Effect and interpretation of PROD 1.4 and PROD 4 for certain manufacturers and distributors of pathway investments

1.4.6A R A *firm* to which *PROD* 1.4.3BR applies must:

(1) comply with provisions marked "EU" in *PROD* 1.4 and *PROD* 4 as if they were *rules*; and

(2) read terms or phrases found in *PROD* 1.4 or *PROD* 4 as follows:

(a) terms referred to in column (1) of the table below have the meaning indicated in the same row of column (2) of the table;

(b) terms relating to insurance or insurance products have the meaning of the corresponding term relevant in the context of *pathway investments*; and

(c) terms or phrases which are only relevant to *firms manufacturing* or *distributing* insurance products may be disregarded.

This table belongs to PROD 1.4.6AR(2)(a).

(1)	(2)
"Article 17(1) of Directive (EU) 2016/97"	*COBS* 2.1.1R

“Article 25(1) of Directive (EU) 2016/97”	*PROD* 4.2.1R, 4.2.2R, 4.2.15R, 4.2.29R, 4.2.33R and 4.2.34R
“competent authorities”	*FCA*
“*ICOBS*”	relevant conduct of business obligations
“*IDD manufacturer* product governance requirements (*PROD* 4.2, equivalent requirements of another *EEA State* or directly applicable requirements of the IDD POG Regulation)”	*PROD* 4.2 or equivalent requirements of another *EEA State*
“insurance-based investment products”	*pathway investment*
“insurance distributor”	*distributor*
“insurance distribution activities”	*distribution* activities
“insurance intermediary and an insurance undertaking”	*firms*
“insurance product”	*pathway investment*
“‘manufacturer’ and ‘manufacturers’ within the meaning of Article 2 of this Delegated Regulation”	*manufacturer*
“manufacturing”	*manufacturing*
“*premiums*”	costs and charges
“shall”	must

…

After PROD 1.5 (Application of PROD 5) insert the following new section, PROD 1.6. The text is not underlined.

1.6 Application of PROD 6

1.6.1 R *PROD* 6 applies to a *firm*:

(1) that *manufactures* or *distributes pathway investments* in connection with its operating of a *retail client’s personal pension scheme* or *stakeholder pension scheme*;

(2) within the scope of *PROD* 4 when *manufacturing pathway investments* other than in connection with its operating of a *retail*

client's personal pension scheme or *stakeholder pension scheme*, as *guidance* with respect to that *manufacturing* activity;

(3) within the scope of *PROD* 3 when *manufacturing pathway investments* other than in connection with its operating of a *retail client's personal pension scheme* or *stakeholder pension scheme*, as *guidance* with respect to that *manufacturing* activity.

Amend the following as shown.

4 Product governance: IDD <u>and pathway investments</u>

…

After PROD 5 (Extended warranties sold with rent-to-own agreements: customer information and deferred opt-in) insert the following new chapter, PROD 6. The text is not underlined.

6 Product governance: additional provisions for pathway investments

6.1 General

6.1.1 R This chapter does not affect the application of other requirements in the *FCA Handbook* or *EU regulations* applying to *firms* within the scope of this chapter. *Firms* within the scope of *PROD* 1.3, *PROD* 1.4, *PROD* 3 and *PROD* 4 will need to continue to comply with those provisions.

6.2 Manufacture of pathway investments

6.2.1 R A *manufacturer* must review its *pathway investments* at least on an annual basis to ensure that they:

(1) remain consistent with the needs, characteristics and objectives of their identified target market, taking into account the *investment pathway* options in *COBS* 19.10; and

(2) are being *distributed* to their target market.

6.3 Distribution of pathway investments

6.3.1 R A *firm* must not *distribute* a *pathway investment* unless it is compatible with the needs, characteristics and objectives of those *retail clients* that fall within the *pathway investment's* target market, taking into account the *investment pathway* options in *COBS* 19.10.

6.3.2 R When carrying out the compatibility assessment referred to in *PROD* 6.3.1R, *firms* must take into account:

(1) the price and complexity of the *pathway investment*; and

(2) where the *firm* is referring *retail clients* to be transferred to the *personal pension scheme* or *stakeholder pension scheme* operated by another *firm*, the financial strength of that other *firm*, and the reliability and efficiency of that other *firm* in relation to its dealings with *retail clients*.

6.3.3 R A *firm* must review the distribution arrangements for the *pathway investments* it distributes at least on a two-yearly basis to ensure:

(1) the distribution arrangements are still valid and up to date; and

(2) the *pathway investments* remain compatible with, and are being *distributed* to, their target market in accordance with *PROD* 6.3.1R.

Obligations on firms where retail clients are not acting in their interests

6.3.4 R Where a *firm* (A) refers *retail clients* to another *firm* (B), where B can offer a *pathway investment* to the *retail client* if they transfer to the *personal pension scheme* or *stakeholder pension scheme* operated by B, both A and B must comply with *PROD* 6.3.5R.

6.3.5 R Where:

(1) A becomes aware of a pattern of *retail clients* choosing not to transfer to B; and

(2) A considers that this choice is likely not to be in the interests of those *retail clients*, having regard to their objectives and characteristics;

then

(3) A must promptly inform B of its concerns in (1) and (2); and

(4) A and B must each take reasonable steps to minimise the potential harm to *retail clients*.

6.3.6 G Reasonable steps for the purposes of *PROD* 6.3.5R may include A and B making it easier for *retail clients* to transfer to *the personal pension scheme* or *stakeholder pension scheme* operated by B.

Annex D

Amendments to the Perimeter Guidance manual (PERG)

In this Annex, underlining indicates new text.

8 Financial promotion and related activities

…

8 Annex 1 Examples of what is and is not a personal recommendation and advice

…

(F) Miscellaneous		
(1) Example	**(2) Is there a personal recommendation?**	**(3) Is this regulated advice for someone other than a firm with an appropriate authorisation?**
…		
(31) A *firm* offers *pathway investments* in accordance with the requirements in *COBS* 19.10.11R to 19.10.19R. The *firm* interacts with the customer online or in writing. At step 5 the *firm* offers the customer a *pathway investment* that it manufactures.	No	Essentially this process involves the *firm* filtering its investment products based on the investment objectives of the fund. This will generally not be regulated advice for the reasons in *PERG* 8.30A.12G.
(32) Same as (31) except the *firm* offers the customer a *pathway investment* manufactured by another *firm* and available for investment in the *retail client's* drawdown fund.	No	This process amounts to filtering as described in example F(31). Therefore the *firm* will generally not be giving regulated advice, for the reasons in *PERG* 8.30A.13G.

(33) A *firm* offers *pathway investments* in accordance with the requirements in *COBS* 19.10.11R to 19.10.19R. The *firm* interacts with the customer on the telephone or face to face. At step 5 the *firm* offers the customer a *pathway investment* that it manufactures.	See the answer to example F(24)	See the answer to example F(24)
(34) Same as (33) except that a *firm* offers the customer a *pathway investment* manufactured by another *firm* and available for investment in the *retail client's* drawdown fund.	See the answer to example F(24)	See the answer to example F(24)

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