FINANCIAL CONDUCT AUTHORITY

Improving outcomes in non-workplace pensions

Consultation Paper
CP21/32**

November 2021

How to respond

We are asking for comments on this Consultation Paper (CP) by **18 February 2022**.

You can send them to us using the form on our website at: www.fca.org.uk/cp21-32-response-form

Or in writing to:

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1 Summary

Why we are consulting

1.1 There are two ways consumers can save for retirement with a pension: a non-workplace pension (NWP) or a workplace pension. In this paper, we make proposals to enhance outcomes for consumers with NWPs, drawing on experience from workplace interventions and investment pathways for drawdown.

1.2 We are consulting on proposed rules for firms operating NWPs. Because we have found evidence of some NWP consumers finding it difficult to identify appropriate investments, or leaving large amounts of their pension pot in cash, we propose to require firms to:

- offer non-advised consumers buying an NWP a ready-made, standardised investment solution (a 'default option'), and to make this available alongside other investments
- send a notification ('cash warning') to consumers with potentially inappropriate levels of cash in their NWP to warn them that their pension savings are at risk of being eroded by inflation.

1.3 The NWP market is large, with around 13 million accounts and accumulated pension savings of around £470 billion. NWPs are used by self-employed consumers without access to a workplace pension, as well as by consumers wanting to supplement their workplace pension savings or consolidate existing pension pots. Consumers may save into an NWP over time, or have a lump sum they want to invest in a tax-efficient way for their retirement. NWPs are almost all regulated by the FCA.

1.4 In 2018, we published a Discussion Paper (DP18/1) to improve our understanding of how well the NWP market was working for consumers. In 2019, we published a Feedback Statement (FS19/5), in which we found similar demand-side weaknesses to workplace pensions. Limited consumer engagement, combined with complex and confusing products and charges, had led to a lack of competitive pressure to drive better value for consumers with NWP products.

1.5 This is a particular concern given the increase in NWPs sold without regulated advice. The data we collected for our Feedback Statement FS19/5 showed that non-advised sales had increased from an average of 8% between 1988 and 2012, to an average of 28% between 2012 and 2017. More recent data, from a sample of firms, revealed that 35% of new sales were non-advised in 2019. For streamlined SIPPs, which offer a very wide range of funds and are sold to the mass market, as many as 50% of new sales were non-advised. We estimate that around 125,000 non-advised consumers buy an NWP each year.

1.6 We also found that many non-advised consumers buying an NWP did not find it easy to choose appropriate investments for their pension savings. Some may select investments incompatible with their pension objectives, while others remain in cash, often for long periods. Our consumer research showed that many consumers have a 'set and forget' mentality and do not regularly review their investments.

1.7 Our proposal for a default option for non-advised consumers is designed to take away the need to engage with underlying investments, for those who do not wish to do so.

1.8 FS19/5 also set out concerns around the lack of clarity in NWP charging. We found low levels of switching between products and potentially high charges on some legacy products. We are taking forward work to address these issues jointly with the Pension Regulator (TPR), which regulates trust-based workplace pension schemes, as part of our wider work on value for money (VFM) in pensions. We want to promote consistent assessments of VFM and enable meaningful comparisons between all types of pension, both NWPs and workplace.

1.9 Our work on NWPs is part of our wider work on pensions, across all different types of pension product. Earlier this year, we and TPR published a call for input on the consumer's pension 'journey', to help us understand where consumers most need support and where further interventions may be needed. We are also closely involved in the development of pensions dashboards, which we believe have the potential to drive more informed planning and decision making. More detail on these initiatives can be found in Chapter 2.

Who this applies to

1.10 Our proposals will primarily be of interest to firms that operate NWPs, including:

- life insurers
- platform providers
- SIPP operators

1.11 Our proposals are also relevant to other stakeholders with an interest in NWPs, including:

- industry associations and trade bodies
- independent governance bodies
- asset management firms
- individuals and firms providing advice and information in this area
- consumer representative groups
- charities and other organisations with a particular interest in the ageing population

1.12 Consumers will also be affected by this consultation. We welcome views from consumers on all our proposals.

What we want to change

1.13 As the market for NWPs has developed, the range of investments available for inclusion in a NWP has become increasingly wide. Non-advised consumers buying a NWP often have little investment expertise and may not find it easy to engage with the choice and complexity of investments. Some may end up in investments that are unlikely to meet their needs and objectives for retirement or may remain in cash. Others may be put off from buying a NWP in the first place.

1.14 Our proposals for a default option are to give non-advised consumers buying a NWP the option of a standardised investment strategy, and to make this available alongside other investments. It would be designed by a firm for the typical non-advised consumer in the firm's target market. Non-advised consumers choosing this option would be able to depend on the firm for an investment strategy that meets the objective of building a pension pot for future access.

1.15 Our proposals for cash warnings are to warn consumers invested in cash that their pension savings are at risk of being eroded by inflation. While the levels of cash investment in NWPs has come down in recent years, some firms still report a concerningly high proportion of their consumers with significant and sustained investments in cash or cash-like assets. We want to prompt these consumers to consider investing in growth assets, since the cumulative effect of being invested in cash can mean a much smaller pension pot at retirement.

Outcomes we are seeking

1.16 We want default options that are fair value and designed to meet the needs of the typical non-advised consumer choosing them. They would need to have an appropriately diversified pool of investments and take proper account of climate change and other Environmental, Social and Governance (ESG) risks. We expect firms to build lifestyling into the design so that investments are de-risked automatically in the run up to a target date of retirement.

1.17 We seek, on average, a better pension outcome for consumers choosing a default option than they could otherwise achieve. While default options are for non-advised consumers who do not want to try and engage with the detail of their investments, we do not want to deter engagement with other important pension decisions. These include choosing how much they save into their pension, understanding what that might mean for income in retirement, as well as when to access their pension savings.

1.18 While this intervention is intended to protect non-advised consumers from poor pension outcomes, it may also promote competition by focusing attention on a single type of investment solution. While we do not expect all non-advised consumers to be in a position to judge whether a particular default option is well designed and offers good value, market commentary and press coverage, combined with our related workstream of clearer benchmarking of value for money, could mean that some firms become known for a good default option. If we find that default options are poorly designed and do not deliver value for money, we could consider further measures, such as the case for a charge cap, or extending the remit of IGCs to default options.

1.19 We also want to see fewer consumers holding inappropriate levels of cash in their NWPs over the longer term. We seek to correct any misconception that this is a strategy that will lead to growth in real pension income and to remind consumers who may otherwise defer investing in growth assets. We recognise that there can be good reasons for higher levels of cash investment, for example as part of a de-risking strategy before pension access, or in advance of making a specific investment that requires a certain amount of cash. While we do not want to prevent consumers from holding cash, we want sustained cash investments to be on an informed basis.

Measuring success

1.20 We intend to conduct a post-implementation review in 2-3 years' time, in which we would assess the success of the interventions. For default options, possible success metrics include the level of take up by non-advised consumers and whether default options offer value for money. For cash warnings, possible success metrics include estimated response rates and the extent to which the proportion of consumers with significant and sustained cash investments reduces over time.

Next steps

1.21 We welcome feedback on our proposals by 18 February 2022.

1.22 We will consider all feedback, and subject to responses intend to publish a final policy statement and final handbook rules in 2022.

2 Background and wider context

2.1 In this chapter, we provide the background to this consultation and an overview of other relevant work we and others have underway on pensions. We explain how our proposals link to our objectives.

Background

2.2 In 2018, we published our Discussion Paper (DP18/1) on Effective Competition in NWPs. DP18/1 marked the start of our exploration of:

- NWPs include individual personal pensions (IPPs), Self-Invested Personal Pensions (SIPPs), and other older products such as Section 32 buyout contracts (s32 buyouts) and Retirement Annuity Contracts (RACs)
- whether the NWP market has the same weaknesses the Office of Fair Trading (OFT) identified in the DC workplace pension market in 2013: demand-side weaknesses and reduced competition on charges
- the differences and similarities between these two markets

2.3 In 2019, we published our Feedback Statement (FS19/5). We found similar competition weaknesses to those identified in the workplace pensions market. We also found that non-advised consumers buying an NWP often find it difficult to decide where to invest their contributions. Even though consumers had decided to save for retirement, the process of choosing an NWP is so complex that many are disengaged even when setting one up. Many do not want, or find it difficult, to engage with investment choices and may either select unsuitable investments or remain in cash for sustained periods.

2.4 Our consumer research demonstrated a clear difference between wanting a pension and engaging in the process of getting one. Engagement at the point of sale often extends only as far as the consumer acknowledging that it is 'sensible' to have a pension. Many non-advised consumers thought they had opted for the 'average' or 'standard' investment strategy when making their investment choices.

2.5 Our work on behavioural economics highlighted how behavioural biases can lead to poor consumer decisions. Non-advised consumers buying an NWP may have the following biases in their investment decisions:

- **Risk aversion**: a reluctance to 'take risks' with their pension savings may result in the selection of inappropriately low risk investments when presented with a menu of investment choices
- **A lack of confidence in financial matters**: some consumers may not feel able to engage with investment choices when they set up or contribute to their NWP
- **Overconfidence in financial matters**: others may over-estimate their financial ability and for example select high risk investments without considering the need for appropriate diversification
- **Choice overload**: consumers can get overwhelmed when presented with a large number of options to choose from; this is the paradox of choice

- **Set-and-forget mentality**: many do not review investment choices and may stay in investments that are (or become relative to today's market) poor value for money and/or may not de-risk before accessing their pension savings

2.6 These behavioural biases are compounded by the range and complexity of investment choices available today. While some firms have developed innovative decision trees or tools to help with investment selection, some consumers may find the questions difficult to answer and respond in a way that does not reflect their true needs.

2.7 In FS19/5, we said we wanted to explore a range of possible remedies. These included:

- Requiring firms to provide ready-made investment solutions for their consumers, to align with their broad objectives. We said this could be via one or more prescribed investment pathways.
- Requiring firms to notify consumers invested in cash about the likely long-term impact, and requiring consumers to make an active decision to be invested in cash. This would be consistent with rules we had recently finalised in PS19/21 for drawdown providers following our Retirement Outcomes Review.

2.8 Other possible remedies related to improving the transparency and comparability of charges on NWPs, since we had concerns about the level and complexity of charges on some NWPs. We are taking forward further work on charges as part of our wider work on value for money in pensions.

Feedback on questions in FS19/5

2.9 In FS19/5 we asked for feedback on these possible remedies and received over 40 responses from a range of stakeholders.

2.10 In response to our question about ready-made investment solutions for NWPs:

- The majority of respondents who expressed a view supported the proposals, with most suggesting a single ready-made investment solution rather than multiple solutions with investment pathways.
- Some said that we should not require firms to offer a ready-made investment solution to existing customers who already have investments, nor to advised customers.
- Some made the point that a default investment strategy would not make sense for bespoke SIPPs.

2.11 In response to our question about notifications for consumers invested in cash and requiring an active decision to be invested in cash:

- All respondents to this question supported some form of requirement, although many suggested waiting until we could evaluate outcomes from the rules we had recently finalised for drawdown providers.
- Many made the point that holding cash can be appropriate, for example as part of a lifestyle arrangement pre-retirement.
- Some thought we should focus on how long a consumer has been significantly invested in cash rather than on an active decision to invest in cash.

2.12 We would like to thank all respondents to FS19/5. Annex 3 provides more detail on the responses that we received to the above questions.

Further work

2.13 We have since held industry roundtables to discuss our proposals in more detail. We also conducted a data request with a sample of firms to help inform our cost-benefit analysis. We have discussed our proposals with our Consumer Panel and our Practitioner Panels, and aspects of our proposals with some firms individually pre-consultation.

Wider context

2.14 The pensions and retirement income markets continue to be a priority for us. Our proposals to improve outcomes for non-workplace pension savers should be seen in the context of other regulatory initiatives that are intended to drive better outcomes for consumers, and guide them to better products. The following boxes set out some key current initiatives and their relevance to this work.

Overarching initiatives

Consumer Investments strategy and our Business Plan

Our new Consumer Investment strategy aims to give consumers the confidence to invest, including reducing the number of consumers holding investible assets in cash, while avoiding products that are too risky for their needs. As we set out in our Business Plan 2021/22, we have a range of work underway to ensure pension providers offer good value products and consumers are supported to make effective decisions.

Our proposals in this paper are part of our focus on product design in pension accumulation – saving for a pension – to help non-advised consumers make better decisions.

Consumer Duty

In May 2021, we consulted on a new Consumer Duty (CP21/13) with clearer and higher expectations for firms' standards of care towards consumers. These expectations are for the key elements of the firm-customer relationship: products and services, communications, customer service, and price and value.

Our proposals in this paper should support firms in meeting our proposed expectations. For example, the default option would be designed to meet the needs of non-advised consumers who want a standardised investment strategy rather than selecting underlying investments for themselves. The cash warning would be consistent with our communications expectations, since it would help equip consumers to make properly informed decisions about their NWP investments. Our proposals are also in line with the proposed cross-cutting rules in CP21/13, which would require firms to avoid foreseeable harm, act in good faith toward their consumers and enable them to pursue their financial objectives.

Other relevant initiatives

Driving value for money in DC pensions
Driving value for money in DC pensions is one of two priority workstreams in our Joint Regulatory Strategy with TPR, published in 2018. In September 2021, we published a Discussion Paper (DP21/3) jointly with TPR on developing a common framework for assessing value for money across all DC pensions, setting out possible metrics and benchmarks to enable consistent and meaningful comparisons. These metrics and benchmarks are focused on the 3 core elements of value for money: investment performance, service, and charges and costs.

We also recently published a Policy Statement (PS21/12) with targeted rules on how Independent Governance Committees (IGCs) and Governance Advisory Arrangements (GAAs) must assess value for money and compare the charges and costs of their provider's scheme with those of other schemes. IGCs/GAAs are required under our rules to provide independent assessment of the value for money of workplace personal pension schemes and drawdown investment solutions of investment pathways.

As we set out in DP21/3, in due course such measures will also be relevant for benchmarking non-workplace products. Our proposals in this paper for an NWP default option would provide a focus for comparisons.

Pensions consumer journey
The pensions consumer journey is the other priority workstream in our Joint Regulatory Strategy. In May 2021, we published our joint Call for Input: Pensions Consumer Journey. This explored the stages of the pensions consumer journey, the drivers of harm, and what more can be done to enhance engagement and support consumer decision making. We are currently considering the responses that we received, including in relation to non-workplace products.

Climate-related financial disclosures and supporting investment in long-term assets
We have wider work underway to introduce climate-related financial disclosure requirements, with the aim of increasing transparency so that clients and consumers can make considered choices. In June 2021, we consulted (CP21/17) on proposals aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), for asset managers, life insurers, and FCA-regulated pension providers.

We have also worked with the Bank of England, the DWP, HM Treasury and with industry to break down some barriers to investing in long-term, illiquid assets. In May 2021, we consulted (CP21/12) on a new authorised fund regime for a Long-Term Asset Fund (LTAF). Our aim is to facilitate an environment where DC pension schemes and other investors that wish to invest in productive assets can more readily do so.

Both initiatives are intended to drive holistic thinking about investment strategies, which will be highly relevant to the design of default investment strategies, including the NWP default option proposed in this paper.

Relevant initiatives led by the DWP

We are engaging with the Department for Work and Pensions (DWP) on other important initiatives to help deliver better pension outcomes for consumers. These include but are not limited to work on:

- pensions dashboards (see below)
- simpler annual pension statements (see below)
- increasing pension saving by the self-employed (see below)
- building scale in the DC pensions market
- preventing transfers of pensions into scams
- small and deferred pension pots

Pensions dashboards
Pensions dashboards will enable consumers to go online to view information about all their pension savings in one place, including non-workplace pensions. The Pensions Dashboard Programme (PDP), convened by the Money and Pensions Service (MaPS), is responsible for developing and implementing the infrastructure that will enable dashboards to operate.

Our role in the development of pensions dashboards is a regulatory one. The Pension Schemes Act 2021 placed a duty on us to make rules requiring the providers of personal and stakeholder pensions to supply information to the pensions dashboards ecosystem, upon request and consent from the customer. We will also be responsible for authorising the providers of pensions dashboards. We have long advocated the introduction of a pension dashboard and are working closely with the PDP and the DWP on this important initiative.

Simpler annual pension statements
Simpler Annual Benefit Statements (SABS) aim to support greater consumer engagement with pensions by making annual benefit statements shorter, more consistent and impactful. We worked with the DWP on the regulations and accompanying statutory guidance. Last month, the DWP recently published the government's response and laid regulations following its consultation in May 2021. The regulations will require simple 2 page statements for all DC pension schemes used for automatic enrolment, including contract-based schemes, and will come into force on 1 October 2022. We support the DWP's ambition to extend SABS to DC pensions more widely, including to non-workplace pensions, with the aim of improving the transparency and comparability of statements across different types of pension.

Increasing pension saving by the self-employed
The DWP is trialling ways to make it easier for self-employed people to save for retirement. This includes testing digital tools and behaviourally-inspired messages delivered at the right time to prompt pension saving. The DWP is also working with National Employment Savings Trust (NEST) Insight and fintech firms to test innovative savings mechanisms on digital platforms. Other work, with HMRC and MaPS, involves trialling prompts for when self-employed people complete online tax returns, to encourage them to consider how they can save for retirement and to seek guidance from MoneyHelper.

How our proposals link to our objectives

Consumer protection

2.15 Our proposals for a default option are intended to protect non-advised consumers who find it difficult to engage with investments and end up making poor choices for their NWP. The range of investments available in today's market can be very wide and complex. Some non-advised consumers may choose investments that are not properly diversified or otherwise compatible with their pension objectives. We want to ensure that there is support for consumers faced with this complexity, in the form of an easy-to-access, standardised investment solution for their NWP. We expect default options, which would be designed by firms to meet the pension objectives of the typical non-advised consumer in the firm's target market, to deliver substantially better pension outcomes for these consumers.

2.16 Our proposals for cash warnings are intended to protect consumers who have already held a potentially inappropriate level of cash in their NWP for a sustained period. The cash warning would highlight how inflation erodes the value of cash investments. It is intended to prompt consumers to consider whether they should remain in cash or switch to growth assets.

Competition

2.17 While our proposals are designed primarily to protect consumers, they may also promote competition between providers in the interests of consumers. Some NWP providers may seek to promote their default option. NWP providers known for a well-designed and good value default option could attract a greater share of new NWP business.

Equality and diversity considerations

2.18 Our proposals in this paper would affect consumers using NWPs to save for their retirement. Overall, we do not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010. The default option may help improve the accessibility of NWPs since it would be for non-advised consumers unable or unwilling to choose investments. So, it may have a positive impact on potentially vulnerable consumers.

2.19 We will continue to consider the equality and diversity implications of the proposals in light of consultation feedback, and will revisit them when publishing the final rules.

3 Default investment strategy

3.1 In this chapter, we explain our proposals to ensure that a standardised investment strategy ('default option') is offered to non-advised consumers buying an NWP and is made available alongside other investments.

Our concerns

3.2 The data we have collected suggests that an increasing proportion of new NWP business is non-advised. At the same time, the market has evolved to offer a wide range of investments for inclusion in an NWP. Consumers are being asked to make complex investment choices when they may not find it easy to engage with the options available due to behavioural biases and a lack relevant expertise.

3.3 Platform providers that offer streamlined SIPPs may target retail consumers who want to choose their own investments. But streamlined SIPPs have become mass market products. Some consumers who are attracted to a platform provider may lack the confidence or skills to choose appropriate investments for a pension product, which by its nature is generally for the long term.

3.4 We are concerned that non-advised consumers who are unwilling or unable to engage with the investments are at risk of poor pension outcomes. They may remain in cash or choose underlying investments that are not compatible with their objectives. For example, they may choose investments that are not appropriately diversified, or are inappropriately high risk, or conversely low risk but with low potential for growth. They may also not take charges properly into account. Having chosen investments, they may neglect to monitor investment performance and not revisit their choices, including as they approach retirement when their investment needs may change.

3.5 In the DC workplace market these risks are mitigated by the availability of default investment strategies. Under automatic enrolment (AE), consumers who do not choose an investment are automatically invested in the default arrangement. 92% of workplace scheme members (not just AE) are invested in a default arrangement, mostly because they made no choice although some have actively chosen it. Moreover, the choice of investments is generally limited to a pre-selected range of funds considered appropriate for inclusion in a workplace pension.

Our proposals for a default option

3.6 Having considered the responses that we received to our questions in FS19/5 and to our data request, and taking account of our discussions with industry, we are consulting in this paper on rules to require firms to offer non-advised consumers a default investment strategy ('default option') for their NWP.

3.7 This would be similar to the requirement for a default arrangement in workplace pensions used for automatic enrolment, albeit that consumers would not be automatically defaulted into the NWP default option if they make no choice. Instead, they would have to accept the offer of the default option, as part of the product purchasing process or in subsequent decisions about their investments.

3.8 Since we propose that firms make a single default option available to non-advised consumers, there would be no prescribed choice architecture. But we want non-advised consumers to be aware that the default option is available. Firms would be required to ensure that they present it in an appropriately prominent way, when non-advised consumers first set up their NWP and at other times when they are choosing investments. Non-advised consumers who have no need for the default option can simply decline or ignore the offer.

3.9 Our proposed approach differs from our approach in our existing rules for drawdown investment pathways. In decumulation, there are a range of objectives that consumers might have for the funds to be invested in drawdown. To better equip non-advised drawdown consumers to select an investment that aligns to the purpose they wish their funds to serve, we prescribed 4 high-level objectives for investment pathways and require providers to determine and offer an investment solution for each objective. We also prescribe a choice architecture.

3.10 In accumulation, on the other hand, consumers have the common objective of building their pension savings. The single default option would be compatible with the needs of the firm's typical non-advised consumer who might choose the default option. Non-advised consumers with different needs would be free to choose their own investments or make use of decision trees or tools offered by the firm.

3.11 We propose that firms accepting new non-advised business must make a default fund available. We have considered requiring firms to contact existing non-advised customers to offer them the firm's default option, but do not propose this. We think it would be disproportionate, since non-advised consumers who already have NWP investments are less likely to respond to such an offer. Firms would be required to offer their default option in menus of investments, and alongside decision trees and tools. That should benefit existing non-advised customers who are reviewing their investments or deciding where to invest a new contribution, as well as new non-advised customers investing for the first time.

3.12 We have also considered whether to require firms with only legacy NWP business to make a default fund available to their customers. Many firms have small books of legacy business, sometimes from decades in the past. We are not confident at this stage that the benefits to consumers would outweigh the costs associated with such proposals. We intend to come back to this issue once we have assessed the effectiveness of our intervention for new non-advised business and following our work to improve the clarity on NWP charging in the context of our VFM work.

Q1: Do you agree that we should require firms to offer a single default option rather than multiple default options/ investment pathways?

Q2: Do you think there is a case for requiring firms with only legacy NWP business to make a default option available to their customers?

Engaged versus disengaged consumers

3.13 In our industry roundtables, firms were broadly supportive of our proposal for a single default investment strategy for NWPs. But some firms thought that we should only require them to offer a default option to non-advised consumers demonstrably disengaged with investments, in the context of our aim of protecting consumers unwilling or unable to engage with investments. These firms argued that engaged consumers would have no need for it and so should not be offered it.

3.14 We have considered this suggestion, but are not taking it forward for the following reasons:

- The practical difficulty of defining 'disengaged' in a usable and objective way.
- Some supposedly 'engaged' non-advised consumers may engage because they have to in order to make investments, despite lacking confidence in their own ability to select appropriate investments or answer decision tree questions in a way that reflects their needs.
- The potential for 'gaming' whereby firms could claim that all their non-advised customers are engaged by requiring them to complete a decision tree or select their own investments as part of opening an NWP.

3.15 We have also been told that a proportion of consumers choosing the default option might otherwise have engaged with the investment choices on offer. Having chosen the default option, they see no need to engage further. So, offering a default option might run counter to our desire to see consumers engage more with their pensions.

3.16 We think consumers can engage with their pension without engaging with the underlying investments. Indeed, consumers need to engage with their projected income in retirement, how much they contribute, and when they plan to access their pension. This engagement is at the level above the underlying investments.

3.17 Moreover, engagement with investments by consumers who lack the skills or expertise to make appropriate investment choices can put pension outcomes at risk. Investments may be poorly diversified, involve too much or too little risk, and may not be regularly reviewed over time. For these consumers, a default option designed and governed by the firm is likely to deliver a better pension outcome than they could achieve on their own. Indeed, a well-designed and good value default option may also attract consumers who have some knowledge of investments but think they would do better in an investment strategy specifically designed for a pension.

> **Q3: Do you agree that we should require firms to offer a default option to all non-advised consumers entering into an NWP? If not, what would you propose?**

The providers covered by our proposal

3.18 Our proposed rules for a default option would apply to firms operating NWP schemes such as insurers, platform providers and smaller SIPP operators.

3.19 Some firms operate schemes that, at an HMRC registration level, encompass both workplace and non-workplace arrangements. Our proposed rules would apply in respect of the non-workplace arrangements within the overarching scheme.

Exemptions

Advised consumers

3.20 Firms would not be required to offer a default option to consumers who have received a personal recommendation for their NWP. It would be for the adviser to recommend suitable investments. Firms that do not accept any new non-advised consumers into their NWP arrangements would not be required to make a default option available.

3.21 To benefit from the exemption, we think that evidence of transactional advice is acceptable. Under our existing rules, we expect transactional advice on an NWP (which is itself an investment) to include a personal recommendation on the underlying investments. That is a responsibility of the adviser. We do not propose that NWP providers be required to confirm that transactional advice has included a personal recommendation on the underlying investments.

3.22 We provide guidance on where a firm would **not** have reasonable grounds to determine that a consumer has received a personal recommendation. This would be where the determination is based solely on information that:

- is more than 12 months old
- the consumer is transferring from an advised product
- the consumer pays for advice about other investments

Discretionary investment management services

3.23 We know that some wealth management firms offer NWPs with discretionary investment management services. Firms would not be required to offer a default option to consumers who enter into an NWP arrangement that includes discretionary investment management services.

Q4: Do you agree that we should not require firms to offer a default option to advised consumers or consumers using discretionary investment management services for their NWP?

Bespoke SIPPs

3.24 In this paper, we refer to firms offering 'empty wrapper' SIPPs as bespoke SIPP operators. These firms do not offer a menu of investments from which a consumer must choose. Rather, the consumer knows what investments they want and directs the SIPP operator to make the investments. For example, a consumer may want an investment in a particular commercial property in which they have a business interest.

3.25 Consumers using bespoke SIPPs are generally advised. Bespoke SIPP operators could avoid the requirement to offer a default option by turning away non-advised consumers unless they take advice. But we do not want non-advised consumers to be denied use of bespoke SIPPs because of our rules. Such consumers generally know what investments they want, or know that they will want investments not available on menus, otherwise they would not have sought out a bespoke SIPP operator in the first place.

3.26 We also recognise that bespoke SIPP operators generally do not offer or promote investments, either their own or those of other firms. We think it would be disproportionate to require that they make a default option available when this would be the only investment that they offer and few of their clients would make use of it.

3.27 So, we have considered how best to exempt bespoke SIPP operators from the proposed requirement. We think the key is whether the firm offers, distributes or promotes investments for inclusion in the SIPP, or promotes platform services that distribute such investments (in the remainder of this chapter, 'offer' is used to refer to one or more of these activities). We propose that firms which do **not** offer investments for inclusion in the NWP, including investments provided by other firms, would not be required to offer a default option.

3.28 In our proposed rules, we have done this in the application provision that sets out the scope of the relevant rules. We propose that the relevant rules apply to firms operating NWPs that offer investments. So, there is no separate exemption provision for bespoke SIPPs. A bespoke SIPP operator may arrange investments, for example when a customer requests particular investments, provided they are not offering them.

3.29 SIPP operators which offer investments for inclusion in NWPs, for example for inclusion in streamlined SIPPs, would be required to offer a default option.

3.30 We are aware that in a financial services group, one firm might offer investments and then arrange SIPPs with another firm in the same group. The second firm would operate SIPPs but might not offer any investments. That could put the second firm, the SIPP operator, outside of scope of our proposed rules, which is not what we intend.

3.31 In addition, we have seen cases where bespoke SIPP operators accept non-advised business from third-party firms that both arrange the SIPP and promote a specific investment for inclusion in the SIPP wrapper. The specific investment may be high risk or come with very high charges which make it clearly inappropriate as a pension investment. Some scams have followed this pattern.

3.32 To address these possibilities, the proposed application provision would have the effect of also requiring a firm to offer a default option to non-advised consumers if the firm accepts business from other persons that both arrange the NWP and offer investments for the NWP.

3.33 Before arriving at our proposed approach, we discussed alternatives with some firms. We could instead have exempted 'investment regulated pension schemes,' as defined in pensions legislation, since it relates to where members direct investments and would include 'empty wrapper' SIPPs. But this term is too broad, since it includes circumstances where consumers buying an NWP select from a menu of investments offered by the firm.

3.34 We have also considered following our existing rules for investment pathways, which allow an easement for smaller providers such as bespoke SIPP operators. Under the easement, firms with fewer than 500 non-advised consumers a year entering drawdown do not have to offer pathway solutions for any of the investment pathway objectives. But they do have to offer the investment pathways choice architecture to their non-advised consumers and must refer them to the investment pathways comparator provided by the Money and Pensions Service (MaPS), or to another provider's pathway solutions.

3.35 Many non-advised consumers enter drawdown as a consequence of taking their 25% tax-free cash. That may be their only aim at this stage. Our Retirement Outcomes Review identified that many of these consumers are engaged only with the decision to take their tax-free cash, not the important decision around how they should invest their remaining funds that move into drawdown. That is why we require firms using the easement to nevertheless offer the investment pathways choice architecture (and subsequently refer consumers to the MaPS comparator or to another provider's pathway solutions).

3.36 By contrast, in accumulation, non-advised consumers seeking out a bespoke SIPP operator to set up a pension are more likely to be engaged with decisions around the investment of their contributions. They typically choose a bespoke SIPP because they want to be able to request specific investments. So we consider that a requirement to refer is unnecessary here.

3.37 We propose a straight exemption rather than a threshold because we think all non-advised consumers entering into an NWP should be offered a default option. Firms who want to avoid the requirement can choose not to accept non-advised business, or not offer nor promote investments to non-advised consumers.

Q5: Do you think we are right to exempt bespoke SIPPs? Do you see any issues with our proposed approach? If so, what would you suggest?

Consumers with workplace pensions reclassified as non-workplace

3.38 Some insurers reclassify workplace personal pension policyholders as non-workplace when they leave their employer and become a deferred member. From the perspective of the consumer, nothing has changed other than them becoming a deferred member. They remain in the same investments and most will be in the default arrangement. Being reclassified as non-workplace does not take them outside the remit of Independent Governance Committees, which oversee the value for money of workplace personal pension schemes.

3.39 We propose that there would be no requirement to offer a default option to these reclassified consumers, as long as the provider does not offer them other investments outside of the range already available to them within the workplace arrangement. The act of reclassifying them as non-workplace would not require the offer of a default option either, since they would not be entering into a new contract.

When a default option would be offered

3.40 Our aim is for non-advised consumers to be aware that a default option is available from the time that they set up their NWP. We also want them to be presented with the default option alongside other investment choices and alongside decision trees or tools that lead to investments. This is so that consumers who find it difficult to engage with the choices or tools know that they can select the default option.

Upfront

3.41 We propose that firms be required to offer a default option to non-advised consumers at the time they enter into an NWP with the firm.

3.42 Some firms have told us that consumers may set up an NWP in advance of their first contribution, sometimes months in advance. Moreover, the setting up may be a separate process from the funding of the NWP. They suggested that rather than having to offer a default option on set up, firms should be allowed to offer it when the consumer first contributes, if this is later.

3.43 We believe it is important that non-advised consumers are aware of the existence of a default option at the time they set up their NWP, even if they fund the NWP at a later date. Knowing a default option is available may reassure some consumers that they will not later have to make complicated investment choices. Firms may present the default option at set up as an option for consumers for when they have funded their NWP.

3.44 We think that firms should also offer a default option to non-advised consumers at the time they fund their NWP, if this is later than when they set it up. Our proposed rules would require this. We propose guidance to clarify that where a consumer funds their NWP at the same time as setting it up, a default option need not be offered twice.

In menus of investment choices

3.45 When non-advised consumers are presented with a menu of investments available for inclusion in their NWP, we think that the default option should be included in the menu. We want non-advised consumers selecting investments from a menu to be reminded of the default option and to be able to select it easily. Including the default option in menus would also benefit existing customers not previously offered the default option, who are now reviewing their investments or considering where to invest a new contribution.

3.46 We think the default option should be presented at a time and place most likely to bring it to the attention of consumers before they invest their contributions. We recognise that menu structures have different levels and a default investment strategy may not fit in sub-menus. For example, if the consumer is looking at a sub-menu of corporate bonds, they would not expect to see the default option. The default option could be presented alongside other funds or groups of funds.

3.47 We do not think it would be acceptable for a consumer to be able to navigate menus and select investments without being offered the default option as part of that process. Firms would need to include the default option in menus with this in mind.

Alongside decision trees and tools

3.48 Pre-purchase questioning tools or filtering tools for investments (as described in PERG 8.30A.1G and PERG 8.30A.9G, respectively) can be very helpful. They may lead to standardised solutions for consumers with particular needs or characteristics. We do not wish to deter firms from making such tools available.

3.49 Our concern is that some non-advised consumers may not want to use such tools or may find the questions difficult to answer. For example, a consumer may not be able to say what their risk appetite is, or may answer in a way that does not reflect their true characteristics, needs and objectives. They may say they want a 'low risk' strategy for their pension investments when this may be high risk in terms of projected pot size at retirement.

3.50 Just as the default option would be offered in menus of investment choices, we think it should be presented alongside decision trees or tools, at point of entry. A consumer who has entered and finds themselves struggling should know that they can exit and go back to the default option.

Q6: Do you agree that the default option should be offered upfront, in menus of investment choices, and alongside decision trees or tools? If not, what would you suggest?

How a default option would be offered

3.51 When offered upfront, we propose that the default option should be presented prominently and on a stand-alone basis. When offered in menus of investments, it should be presented with at least equal prominence to other investments. When offered alongside a pre-purchase questioning or filtering tool, it should be presented with at least equal prominence to that.

3.52 It is also important that consumers understand the purpose of the default option and who it is for. We do not want consumers to think they will be automatically invested in the default option should they make no choice. It is an option that consumers must choose and is for consumers who are less willing or less able to make investment decisions.

3.53 We propose to require firms to label their default option as the 'standardised investment strategy' for non-advised consumers. We considered the label 'default option' but the word 'default' may have negative connotations and might imply (even with 'option') that consumers will be automatically invested in it should they make no choice.

3.54 We also want consumers to understand that the default option is designed for the firm's average non-advised consumer and is not necessarily the best option for them individually. When offering a default option, firms would be required to make clear that the default option:

- has been designed taking into account the needs, objectives and characteristics of the typical consumer within the default option's target market and to set those out
- is not tailored to the consumer's specific circumstances, and that if the consumer wishes to ensure that any investment, including the default option, is suitable for inclusion in their NWP, they should consider seeking investment advice

3.55 Some firms have asked us whether by offering a default investment strategy to consumers they risk straying into advice. We do not think that by offering a default option a firm is carrying on the regulated activity of advising on investments.

Q7: Do you agree with our proposals for how a default option would be offered?

Governance and design

3.56 We believe that good product governance improves consumer outcomes. We want firms to design default options that give non-advised consumers the best chance of meeting their pension objectives and are value for money. Consumers should have confidence that default options are designed in their interests and are regularly reviewed. Clearly, such options will be designed with target markets in mind rather than a personalised proposition.

3.57 Our proposed new Consumer Duty (CP21/13) sets out overarching expectations for firms' standards of care towards consumers. In addition, our Product Intervention and Product Governance sourcebook (PROD) aims to improve consumer outcomes by ensuring that firms have appropriate systems and controls for the design, approval, marketing and ongoing management of products throughout their lifecycle.

3.58 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.

3.59 PROD 4 requires identification of a target market, the design of a product that is compatible with the needs, characteristics and objectives of consumers in that target market, and product testing. It also requires firms distributing products which they do not manufacture to ensure that those products are distributed in line with the needs, characteristics and objectives of the firm's target market.

3.60 When we made rules for investment pathways, we wanted to ensure that all manufacturers and distributors of pathway solutions are subject to broadly equivalent rules on product governance. PROD 4 applies to manufacturers or distributors of pension arrangements that take the legal form of an insurance contract, such as an insurance-based personal pension or a contract-based pension scheme. To help ensure consistency, we extended the application of PROD 4 to capture, for the manufacturing or distributing of pathways solutions, providers of arrangements that do not take the legal form of an insurance contract.

3.61 We propose to follow the same approach for our rules on product governance for default options. We propose to extend the application of PROD 4 so that it also applies, for the manufacturing or distributing of default options, to the providers of arrangements that do not take the legal form of an insurance contract.

What this means for default option design

3.62 In designing default options, in terms of investment strategy including asset allocation, firms would be required to take account of the characteristics, needs and objectives of the typical consumer within the target market for the default option. Firms should have in mind the average non-advised consumer in their target market. While a well-designed default option that is value for money may attract advised business, it should not be designed with advised consumers in mind.

3.63 We think that our requirements in PROD are broadly aligned with the DWP's guidance for workplace pension default arrangements used for automatic enrolment. In designing default options, we would expect firms to consider, for example:

- the likely characteristics and needs of consumers using the product
- an appropriate and diversified allocation of assets, to manage risks while seeking investment growth
- an appropriate and competitive price for the product, which bears a reasonable relationship to the services being provided

3.64 We have proposed additional requirements in our product governance rules to reflect the above.

3.65 We would also expect firms to take account of the likely need for future changes to a default option, for example changing which funds are used in the construction of the default option. Firms should seek not to depend on obtaining consent from consumers in order to make these changes. Further, consumers should not be locked into the default option should they wish to switch to other investments.

3.66 Where firms replace a default option, it may be in the interests of existing customers to be transferred from the previous default option to the new one. We would want firms to consider whether it would be appropriate to transfer existing customers.

3.67 Firms with existing standardised solutions may choose to adapt one of these as their default option. A firm may continue to offer a number of standardised solutions, for example as end points for decision trees or tools but, as explained above, the default option would always be presented at the point of entry.

Q8: **Do you agree that we should extend our product governance rules in PROD 4 to all manufacturers and distributors of default options?**

Multiple NWP propositions

3.68 Some firms or groups of firms may operate different businesses with different target markets. Our proposed rules would not require the same default option to be offered across these. But a firm would not be able to offer an individual more than one default option, nor could a firm offer a default option that depends on that individual's answers to a decision tree or tool. We think some non-advised consumers may answer in a way that does not reflect their pension objectives. For instance, their stated risk appetite may not reflect their true objectives. Moreover, those choosing the default option have the common objective of building a pension pot for future access.

3.69 It would remain possible for a firm to offer different investment options depending on a consumer's answers to a decision tree or tool. But only one (if any) would be the default option and the default option must also be offered alongside a decision tree or tool, at point of entry.

ESG and climate change

3.70 In common with other pension products, default options will be long-term investments for most consumers. It is particularly important that firms take proper account of climate change and other ESG risks and opportunities in the investment design of a default option. We refer firms to our existing guidance in the section of our Handbook titled 'Senior Management Arrangements, Systems and Controls' (SYSC), at SYSC 3.2.23G and SYSC 4.1.15G.

Lifestyling and target date funds

3.71 Many workplace default arrangements include 'lifestyling' in the years before a target retirement date, to de-risk investments towards an investment portfolio appropriate for how consumers are likely to want to use their pension savings. While we expect firms to include lifestyling where this meets the needs of their target market, our existing rules and pensions legislation do not require it.

3.72 We propose to require firms to include lifestyling in the design of a default option, unless the needs, objectives and characteristics of consumers in the target market for the default option are incompatible with lifestyling. We think this unlikely. The form and timing of the lifestyling would depend on how and when consumers in the target market are likely to want to use their pension savings. A default option can also be designed as a 'to and through' solution into decumulation, with de-risking as appropriate.

3.73 Rather than lifestyling a single investment strategy, some larger firms and some master trusts offer a series of target date funds as a workplace default arrangement, where each fund is for a different age cohort. Members joining the scheme are defaulted into the target date fund for their age. This allows the scheme to adjust the investment mix of each fund over time as the cohort ages, with appropriate de-risking in the years approaching likely pension access.

3.74 Our proposed rules would enable the use of target date funds for default options. For both target date funds and lifestyling, we think that firms should assume pension access at state pension age unless an individual has stated otherwise. This information, together with an individual's age, can be used to determine where to place an individual within the default option.

> **Q9:** **We have sought to enable different models of default option while ensuring that firms take account of ESG risks and the need for lifestyling. Do you think we have provided sufficient flexibility? Alternatively, do you think we should be more prescriptive?**

Third party manufacture

3.75 We propose to allow firms to offer default options manufactured by other firms. We recognise that some firms may not manufacture their own investment products and may lack existing capabilities and governance arrangements to manufacture a default option.

3.76 Where a firm distributes a default option, we propose that the firm must consider the needs, characteristics and objectives of the non-advised consumers to whom the firm will distribute the default option, and also take into account the manufacturer's compliance with the requirements in PROD 6.4, and its financial strength.

Review of default options

3.77 We propose that the manufacturer of the default option should do a full review of the design, performance and continued suitability of the default option and its investment strategy at least every 3 years, as for workplace default arrangements used for automatic enrolment.

3.78 We propose that the distributor of the default option, if different from the manufacturer, should review their choice of default option at least every 3 years.

Keeping records

3.79 Our rules and guidance on record-keeping are set out in our Handbook at SYSC 9.1. In summary, we require firms to 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 default options so they can show that they have met all their requirements, particularly around communicating with consumers. It will also help them show that they are complying with product governance rules.

3.80 In addition to these general requirements, we propose to require providers to maintain records in specific areas where we believe it is most important that firms keep good records. This is intended to ensure consistent record keeping across firms. Examples of areas we propose to include are:

- how the firm has determined, on reasonable grounds, that particular consumers entering an NWP have received a personal recommendation (where these consumers have not been offered the firm's default option)
- the number of non-advised consumers entering into an NWP with the provider every year
- of these, the number who choose the default option
- the number of other consumers who choose the default option every year, and whether these are existing customers or new advised customers
- the contributions made to and assets invested in the default option
- the product approval process for the default option and reviews undertaken

Independent governance and the case for a charge cap

3.81 Independent Governance Committees (IGCs) and Governance Advisory Arrangements (GAAs) oversee the value for money of workplace personal pensions in accumulation and more recently investment pathways in decumulation. They act solely on behalf of scheme members in raising concerns about value for money with their firm. An IGC/GAA can escalate its concerns to employers, scheme members, and to us, if the firm does not take actions to address its concerns.

3.82 We have considered extending the remit of IGCs/GAAs to oversee the value for money of NWP default options. While this would be consistent with our approach for workplace personal pensions and investment pathways, our 2020 thematic review of the effectiveness of IGCs/GAAs found a mixed picture and we have work underway on value for money that will support their effectiveness. In addition, we recognise that IGCs/GAAs have recently taken on new duties, including disclosure obligations, and will have new duties under PS21/12 published earlier last month.

3.83 We have also considered the case for a charge cap on default options. This could mirror the charge cap on default arrangements used for automatic enrolment.

3.84 On balance, we propose to pause on extending the remit of IGCs/GAAs to default options and do not propose a charge cap at this time. We expect providers to consider their obligations under our product governance rules and under our proposed Consumer Duty.

> **Q10: Do you agree that we should not extend the remit of IGCs/GAAs or cap the charges of default options at this time?**

Implementation timeline

3.85 We propose that providers be given 12 months to implement these proposals from the date we publish our final rules and guidance. We expect to publish our final rules and guidance in 2022.

> **Q11:** **Do you agree with our proposed implementation timeline for the default option?**

Post-implementation review and supervising our proposals

3.86 Subject to other priorities, we intend to conduct a post-implementation review of default options after they have been implemented by firms. We want to allow time for firms to operate default options so that we can assess how well they work in practice. This means we would conduct the review no earlier than 2024.

3.87 In the post implementation review, we intend to take a view on the value for money of default options provided by firms. This would be in the context of our wider work on value for money in pensions. We would then revisit the case for a charge cap and whether to extend the remit of IGCs/GAAs to default options.

3.88 Our supervision of default options 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.

4 Cash warnings

4.1 In this chapter, we explain our proposals for a requirement that firms give cash warnings to consumers holding cash or cash-like assets in their NWPs for sustained periods of time.

Our concerns

4.2 For many NWP consumers, being invested in assets that aim to provide growth will be crucial to making sure they can meet their long-term objectives. The cumulative impact of being invested in growth investments rather than in cash or cash-like assets can be very significant over the long term. For example, over a 20-year period, a consumer making regular contributions into their NWP could have a pension pot at least 55% larger by investing in growth assets. In this example we assume equal annual contributions and a 5% annual return on growth assets versus a 1% annual return on cash-like assets. A consumer making a single initial contribution with no further contributions could have a pension pot that is at least 115% larger.

4.3 Our data collection exercise in 2020 found lower reported levels of cash (including cash-like assets) held in NWPs than we had found in 2017, but with wide variation between providers. While many providers in our sample reported that under 1% of their consumers under the age of 50 had significant and sustained cash holdings, around one-third of providers reported more than 3% of their consumers and around one-fifth of providers reported more than 6% of their consumers. Most of these consumers held more than 75% of their NWP assets in cash.

4.4 As we had expected, non-advised consumers were more likely to have a significant and sustained cash holdings in their NWPs. However, the proportion of advised consumers with significant and sustained cash holdings was also high for some providers. Providers with a high proportion of non-advised consumers invested in cash were also likely to have a high proportion of advised consumers invested in cash.

Figure 1: Firms with Non-Advised Consumers

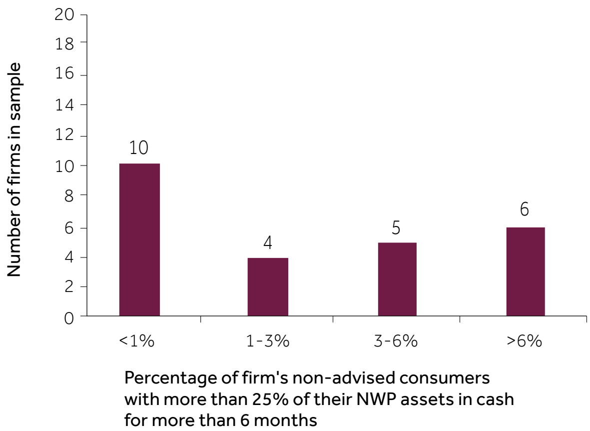
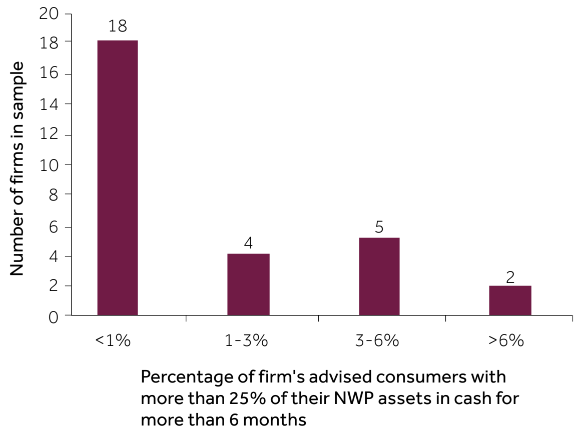


Figure 2: Firms with Advised Consumers



4.5 We remain concerned that some consumers hold a significant proportion of their NWP assets in cash for sustained periods of time. We think that consumers should be made aware of the likely long term impact on pension outcomes.

Our proposals for a cash warning

4.6 In this chapter, we are consulting on a requirement for the providers of NWPs to send a notification (a 'cash warning') to consumers with a significant and sustained proportion of their NWP assets invested in cash, with annual cash warnings thereafter. Where we say 'cash' we also mean 'cash-like' assets. We consider that our proposals should cover investing in 'cash-like' assets because the risks faced by consumers are very similar. 'Cash-like' assets include money market funds or money, deposits, or investments that are defined as 'near cash' in our Handbook.

4.7 We have sought to align our proposals where appropriate with cash warnings for non-advised consumers entering or transferring into a drawdown fund. These are required under our existing rules for investment pathways.

4.8 Under our proposals, providers would be required to send cash warnings to consumers who have more than 25% of their NWP assets invested in cash for more than 6 months. We propose a lower threshold than the 50% threshold for the cash warnings under our existing rules for drawdown. We think a lower threshold is appropriate because consumers saving for a pension generally have longer investment timeframes than those moving into a drawdown fund. Consumers building a pension pot are less likely to have good reason for being invested in cash, whereas consumers in drawdown may have objectives compatible with a higher proportion in cash.

4.9 We propose a sustained holding of more than 6 months because the impact of being invested in cash is cumulative and long term. We want to allow time for consumers to make investments in growth assets. Some consumers may not invest their cash contributions immediately, or may need time after selling investments to decide where to reinvest.

4.10 We do not see the need for a cash warning if the absolute amount of cash in the NWP is small. We propose a threshold amount of £1,000. This corresponds to a pot size of £4,000 at the 25% threshold for a cash warning.

4.11 We propose to make cash warnings mandatory for consumers more than 5 years away from normal minimum pension age (currently 55) or a protected pension age if that is lower. This is because consumers approaching pension access may de-risk their investments by investing more in cash. Some may plan to take their entire pot as cash. But we also propose guidance that providers should consider giving cash warnings beyond that age limit through to any expected date of pension access.

4.12 We expect that providers may consider it appropriate to continue to give cash warnings, since many consumers retire at or around state pension age. Our proposed approach would enable providers to tailor triggers for non-mandatory cash warnings to the characteristics and likely needs of their consumers. For example, a provider might choose to set a higher cash threshold for consumers closer to retirement. The provider could also take into account how their consumers are likely to access their pension savings.

4.13 We propose that providers may exclude cash held as part of a lifestyle investment solution from the calculation of the percentage of NWP assets held as cash. We do not think this is likely to be relevant to most calculations for a required cash warning because of our proposed age limit.

4.14 In summary, providers would be required to send cash warnings to consumers who meet the following conditions:

- more than 25% of their NWP is invested in cash, excluding cash held for lifestyling purposes
- the amount of cash is more than £1,000
- the above 2 conditions have been met in all other assessments carried out during the preceding 6 months
- the consumer is more than 5 years away from normal minimum pension age (currently 55) or a protected pension age if that is lower

4.15 Under our proposals, a consumer who has been given a cash warning and continues to meet the conditions would be sent ongoing cash warnings. We propose that providers have up to a year before they must resend a cash warning. Our intention is to enable ongoing annual cash warnings. We think it important that consumers who receive a cash warning and do not act on it continue to receive cash warnings.

Q12: **Do you agree with our proposals for cash warnings to be given to consumers with significant and sustained cash holdings in their NWPs?**

Q13: **Do you agree that we should make cash warnings mandatory up to the proposed age limit, with guidance that providers should consider giving cash warnings beyond that age limit?**

For advised as well as non-advised consumers

4.16 Our proposals would require providers to give initial and ongoing annual cash warnings to all their NWP consumers who meet the conditions, including existing and advised consumers.

4.17 Our data collection exercise found that while the proportion of advised consumers under the age of 50 with significant and sustained cash holdings was lower than non-advised consumers, for about one quarter of providers in our sample it was above 3%. Some providers reported a substantially higher proportion of their advised consumers. While there can be good reason for holding a high level of cash in the short term, over longer time periods it is less likely to deliver good pension outcomes.

4.18 Some of these consumers may have received transactional advice to set up an NWP, but no further advice on their NWP investments. Transactional advice on an NWP will include investment advice, but only at the point of setting it up. Other consumers may be considered advised by a provider, but have not received advice for a long period of time. Cash may build up as a result of regular contributions, dividends, or sales of investments where the consumer does not reinvest in growth assets. We think all these consumers may benefit from a cash warning if they have significant and sustained cash holdings.

4.19 We have considered whether to exclude from the requirement those consumers who the provider can determine, on reasonable grounds, are receiving ongoing advice for their NWP investments. For example, we could allow providers not to give cash warnings to consumers who have received a recent personal recommendation, although a provider may not always know.

4.20 On balance, we think it simpler and of relatively small marginal cost to require cash warnings for all consumers who meet the conditions. Few consumers receiving ongoing advice should be significantly invested in cash, up to the proposed age limit for mandatory cash warnings. For those who are not clear why they are significantly invested in cash, a cash warning may prompt a conversation with their advisor. If they already know why, we do not think a cash warning will result in harm to the consumer.

4.21 Our proposed approach differs from our approach under our existing rules for non-advised drawdown, under which the provider must assume a consumer is non-advised unless they can determine, on reasonable grounds, that the consumer has received a personal recommendation about the investment of their drawdown fund. For subsequent annual cash warnings in the drawdown context, we allow providers to assess whether an initially non-advised consumer has since received a personal recommendation, and if so not to give them annual warnings.

4.22 Our proposed difference in approach is because there is less likely to be a good reason for significant and sustained cash holdings in pension accumulation, when a consumer is building a pension pot for future access.

> **Q14:** **Do you agree that we should require cash warnings for all consumers who meet the conditions, including advised consumers?**

We do not propose to require an active decision

4.23 In FS19/5 we asked for views on whether we should require providers to ensure that non-advised consumers with cash holdings have actively chosen to be invested in cash. This would be consistent with our requirements for non-advised drawdown, where providers must ensure that non-advised consumers moving into drawdown make an active decision if their drawdown fund is to be wholly or predominantly invested in cash.

4.24 In the context of consumers entering drawdown without advice, where consumers are often most focused on accessing their 25% tax-free cash, the requirement for an active decision is intended to ensure that consumers cannot inadvertently or unknowingly invest their drawdown fund wholly or predominantly in cash.

4.25 While most responses supported an active decision for cash holdings in NWPs, we have discussed this further with stakeholders. We are not persuaded that consumers would benefit from being asked for confirmation of an active decision each time they contribute to their NWP or sell an investment for cash.

4.26 We have considered whether to propose requiring an active decision at some point after a cash contribution, or at some point after a consumer builds up a significant cash holding. For example, we could require providers to ensure an active decision at the same time as a cash warning. But providers would have to ask for an active decision outside of a natural decision point in time and consumers might not respond. It would also require providers to develop a process for asking the question and a process for consumers who do not respond. There would be a cost to industry that ultimately consumers may end up paying.

4.27 We are also mindful that we found lower reported levels of cash in our 2020 data collection exercise than we had found in 2017 and also lower than the levels of cash we had found for drawdown funds.

4.28 For the above reasons, we do not propose at this time to require providers to ensure an active decision to hold cash. Consumers would receive a cash warning, once cash has built up to a significant level and has not been invested in growth assets for a sustained period.

Q15: Do you agree that we should not at this time require providers to ensure an active decision to hold cash in an NWP?

The providers covered by our proposals

4.29 Our proposed rules for cash warnings would apply to providers operating NWP schemes such as insurers, platform providers and SIPP operators.

4.30 Some providers operate schemes that, at an HMRC registration level, encompass both workplace and non-workplace arrangements. Our proposed rules would apply for the non-workplace arrangements within the overarching scheme.

Proposed exemption for discretionary investment management services

4.31 We do not see the need for a cash warning in relation to NWP assets where a consumer has contracted with a third party to manage and invest the assets on their behalf. For example, some bespoke SIPP accounts may include assets where a discretionary investment manager has been given permission to manage and invest the assets.

4.32 We propose that cash warnings would not be required if discretionary investment managers have permission to execute trades, or request that the SIPP operator place dealing instructions, for all the NWP assets. Where they have permission for part but not all of the NWP assets, we propose that part may be excluded from the calculation of the proportion of NWP assets held in cash.

We do not propose to exempt bespoke SIPPs from giving cash warnings

4.33 We have considered carefully whether to exempt bespoke SIPP operators from the proposed requirement to give cash warnings to all their consumers meeting the conditions. We note that investment pathway cash warnings, while for non-advised consumers only, apply to bespoke SIPP operators as well as other NWP providers.

4.34 Most consumers with bespoke SIPPs are advised and may receive ongoing advice about their investments. Our data collection exercise found that bespoke SIPP operators in our sample typically reported relatively high proportions of their consumers under the age of 50 with significant and sustained cash holdings. This was the case for their advised as well as their non-advised consumers. Many of these consumers were more than 75% invested in cash.

4.35 In our industry roundtables, we were told that some consumers with a bespoke SIPP may build up cash over time to invest in a specific non-mainstream investment, for example commercial property, that may require a certain amount. If this takes them some time to do, and takes them above the 25% threshold for more than 6 months, they would receive a cash warning. But we do not see the harm of providing a cash warning when the consumer knows why they are holding a significant level of cash.

4.36 We were also told that consumers may allocate a proportion of their NWP assets to cash as part of their investment strategy. An allocation could be significant in an active strategy that takes account of market conditions in the short term. But, as earlier, we think there is unlikely to be good reason for remaining invested in cash to a significant extent over the longer term. Advised consumers who receive a cash warning and are not clear why they are significantly invested in cash may benefit from discussing this with their advisor.

4.37 Our proposals for default options would exempt bespoke SIPP operators from the requirement to offer a default option. We do not think it inconsistent to exempt bespoke SIPP operators from default options but not from cash warnings. A cash warning serves a different purpose.

4.38 On balance, we do not propose to exempt bespoke SIPP operators from being required to give cash warnings to all their consumers, including advised consumers, who meet the conditions. As above, if a discretionary investment manager has permission to execute trades or request that the SIPP operator place dealing instructions, for some part of the assets held within a SIPP, that part may be excluded under our proposals from the calculation of the proportion of NWP assets held in cash.

Q16: Do you agree that we should not exempt bespoke SIPP operators from the proposed requirement to give cash warnings?

What a cash warning would say

4.39 To be effective, a cash warning should have a clear and simple message presented in a way that is likely to engage consumers. While we do not propose to mandate the precise wording, we propose to prescribe what the content must include. We have sought to align the proposed content with the investment pathways cash warning, where appropriate.

4.40 Our aim is to prompt consumers to consider whether holding a significant proportion of their NWP assets in cash is consistent with their objectives. We do not want to push consumers into growth assets, which are likely to be more volatile in the short term, but we do want consumers to think about whether investments other than cash may deliver a better pension outcome for them.

4.41 We propose that the cash warning must:

- inform the consumer that more than a quarter of their NWP assets is invested in cash or investments that are similar to cash
- say that their NWP is at risk of being eroded by inflation
- include a generic illustration that clearly shows how erosion by inflation would affect a £10,000 pot over 10 years, assuming 0% interest and using the Consumer Prices Index (we propose 10 years rather than the 5 years for investment pathways cash warnings because consumers have longer to be invested when building a pension)
- inform the consumer that they should consider whether their current investments are likely to grow sufficiently to meet their objectives

4.42 We think a visual illustration of the impact of inflation is more likely to engage consumers than text, but recognise that some providers may face system constraints on what can be included in a communication. We propose to permit a text explanation, as we do for the investment pathways cash warning.

4.43 Our proposals include guidance that the provider should also:

- explain in plain language or illustrate that different types of investment have a different balance of risk relative to potential gain
- inform the consumer that the provider offers other investments including the default option, where the provider offers one, and the consumer is not advised (a firm may also wish to inform advised consumers about its default option)
- make clear the warning is not advice and that the value of investments can fall as well as rise

4.44 In our view, providing a cash warning as envisaged in our rules and guidance does not constitute advice. We have previously indicated that the investment pathways cash warning does not constitute advice, and formalised that view in PERG 8 Annex 1 'Examples of what is and is not a personal recommendation and advice.' We propose to formalise our view that the NWP cash warning does not constitute advice by adding it as an example.

Q17: Do you agree with our proposals for the content of a cash warning?

When the need for a cash warning would be assessed

4.45 Providers would not be required to continuously monitor a consumer's NWP assets to determine whether a cash warning is required. Instead, we propose that providers must, for each of their consumers, determine the proportion invested in cash at least once every 3 months.

4.46 To determine whether the holding has been sustained, a provider must consider all assessments conducted over the preceding 6 months, for example the 2 previous assessments. If, in addition to the current assessment, more than 25% was invested in cash in each of the previous assessments, the requirement to notify the consumer would be triggered.

4.47 Under our proposed approach, a small proportion of consumers may be sent cash warnings when their cash holdings were not continuously sustained for over 6 months. For example, cash holdings might dip below 25% at times between assessments, or might be continuously over 25% but for somewhat less than 6 months. Providers who want to minimise the number of consumers who are sent cash warnings under our proposed rules may conduct more frequent assessments.

4.48 Providers would also not be required to assess the cash investments of <u>all</u> their NWP consumers in each assessment, although they may choose to do so. Our proposed requirement for an assessment at least once every 3 months would apply at the level of each consumer. This allows providers to spread assessments and the issuance of cash warnings throughout the year.

Q18: Do you agree with our proposals for when the need for a cash warning would be assessed?

When a cash warning would be sent

4.49 We propose that if the conditions are met in an assessment, the cash warning must be sent within an appropriate timeframe after the date of the assessment.

4.50 We consider that an appropriate timeframe is likely to be within 3 months. As with assessments, we want to give providers some flexibility but avoid undue delay. But at times of high market volatility, when markets may fall substantially, a cash warning may not be appropriate. We do not want to prompt consumers to consider growth investments at just the wrong time. In such circumstances a longer timeframe may be appropriate, but that is unlikely to be longer than 6 months.

4.51 We recognise that providers may want to send cash warnings alongside other client communications. We think this is acceptable, provided that the warning is in a separate document that does not include unrelated information. We propose guidance to that effect.

4.52 If a cash warning has previously been given to a consumer who continues to meet the conditions, we do not think it proportionate to require further cash warnings every 3 months. We propose that the requirement to resend a cash warning following an assessment would not apply for 1 year from the date of the last cash warning.

4.53 Our proposed approach would allow providers to send ongoing cash warnings on the same date of each year for a consumer who continues to meet the conditions. Providers would be able to adjust the timing of ongoing cash warnings to annual benefit statements, for example by sending a second cash warning within a year.

Q19: Do you agree with our proposed timeframe for sending cash warnings? If not, what would you suggest?

Record keeping

4.54 Our rules and guidance on record keeping are set out in our Handbook at SYSC 9.1. These rules and guidance apply generally to record keeping by firms.

4.55 We propose to set out in a rule a list of other areas where we think it is important that NWP providers keep good records for cash warnings. Examples of areas we are proposing to include are set out below:

- dates of assessments, with the number of consumers assessed and the number of consumers who meet the conditions
- a breakdown of the above numbers between advised and non-advised consumers, and a further breakdown between consumers who were customers before and after these requirements come into force
- of those consumers who meet the conditions, the number who continue to meet the conditions in subsequent assessments, to track how consumers move out of significant cash holdings over time

4.56 We may request data as part of a post-implementation review of default options and cash warnings for NWPs. Providers will find it easier to meet these requests if they ensure they can easily extract relevant data from their systems.

Q20: Do you agree that we should provide guidance on the data we would expect providers to retain? Are there other data you think important?

Implementation timeline

4.57 We propose that providers be given 12 months to implement these proposals from the date we publish our final rules and guidance. We expect to publish our final rules and guidance in 2022.

Q21: Do you agree with our proposed implementation timeline for cash warnings?

Post-implementation review & supervising our proposals

4.58 Subject to other priorities, we intend to conduct a post-implementation review no earlier than 2024.

4.59 Our supervisory approach may include meetings with management, on-site assessments, desk-based reviews and reviews covering clusters of providers. We will coordinate our future supervision in this area with the planned post-implementation review.

Annex 1
Questions in this paper

Q1: **Do you agree that we should require firms to offer a single default option rather than multiple default options / investment pathways?**

Q2: **Do you think there is a case for requiring firms with only legacy NWP business to make a default option available to their customers?**

Q3: **Do you agree that we should require firms to offer a default option to <u>all</u> non-advised consumers entering into an NWP? If not, what would you propose?**

Q4: **Do you agree that we should not require firms to offer a default option to advised consumers or consumers using discretionary investment management services for their NWP?**

Q5: **Do you think we are right to exempt bespoke SIPPs? Do you see any issues with our proposed approach? If so, what would you suggest?**

Q6: **Do you agree that the default option should be offered upfront, in menus of investment choices, and alongside decision trees or tools? If not, what would you suggest?**

Q7: **Do you agree with our proposals for how a default option would be offered?**

Q8: **Do you agree that we should extend our product governance rules in PROD 4 to all manufacturers and distributors of default options?**

Q9: **We have sought to enable different models of default option while ensuring that firms take account of ESG risks and the need for lifestyling. Do you think we have provided sufficient flexibility? Alternatively, do you think we should be more prescriptive?**

Q10: **Do you agree that we should not extend the remit of IGCs/GAAs or cap the charges of default options at this time?**

Q11: **Do you agree with our proposed implementation timeline for the default option?**

Q12: Do you agree with our proposals for cash warnings to be given to consumers with significant and sustained cash holdings in their NWPs?

Q13: Do you agree that we should make cash warnings mandatory up to the proposed age limit, with guidance that providers should consider giving cash warnings beyond that age limit?

Q14: Do you agree that we should require cash warnings for all consumers who meet the conditions, including advised consumers?

Q15: Do you agree that we should not at this time require providers to ensure an active decision to hold cash in an NWP?

Q16: Do you agree that we should not exempt bespoke SIPP operators from the proposed requirement to give cash warnings?

Q17: Do you agree with our proposals for the content of a cash warning?

Q18: Do you agree with our proposals for when the need for a cash warning would be assessed?

Q19: Do you agree with our proposed timeframe for sending cash warnings? If not, what would you suggest?

Q20: Do you agree that we should provide guidance on the data we would expect providers to retain? Are there other data you think important?

Q21: Do you agree with our proposed implementation timeline for cash warnings?

Q22: Do you have any comments on our cost benefit analysis?

Annex 2
Cost benefit analysis

1. Financial Services and Markets Act 2000 (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 proposal. We provide monetary values for the impacts where we believe it is reasonably practicable to do so. For others, we provide estimates of outcomes in other dimensions. Our proposals are based on carefully weighing up these multiple dimensions and reaching a judgement.

Problem and rationale for interventions

3. When consumers purchase an NWP, they may be asked to make complex choices about the underlying investments in their wrapper. These decisions are likely to affect the returns they receive over the long term as well as the level of charges levied on their investments.

4. In FS19/5, we found that the proportion of NWPs sold without advice had increased substantially, to around 30%. This risks more consumers not engaging with investment decisions.

5. We are concerned that non-advised consumers buying an NWP may be unwilling or unable to engage with the choice of underlying investments available. Consequently, they can become invested in products which do not meet their objectives, resulting in an investment portfolio with excessive risk or inappropriately low risk, inappropriate time horizons or without sufficient diversification.

6. We are also concerned that a proportion of all NWP consumers may hold inappropriate levels of cash or cash-like investments in their NWP for sustained periods of time. The value of their pension savings is at risk of being eroded by inflation and they risk missing out on investment returns from growth assets.

7. In FS19/5, we highlighted how cash featured among the top five most popular investments for several schemes. The responses to our data request issued in August 2020 indicated a small but significant proportion of consumers in accumulation under the age of 50 holding more than 25% of their NWP assets in cash for over 6 months. For the 6-month period ending in December 2019, this was approximately 2% of consumers per firm, as a weighted average across our sample of 30 firms. The proportion was higher for non-advised consumers at 9% per firm, as a weighted average, with significant variation between firms in our sample.

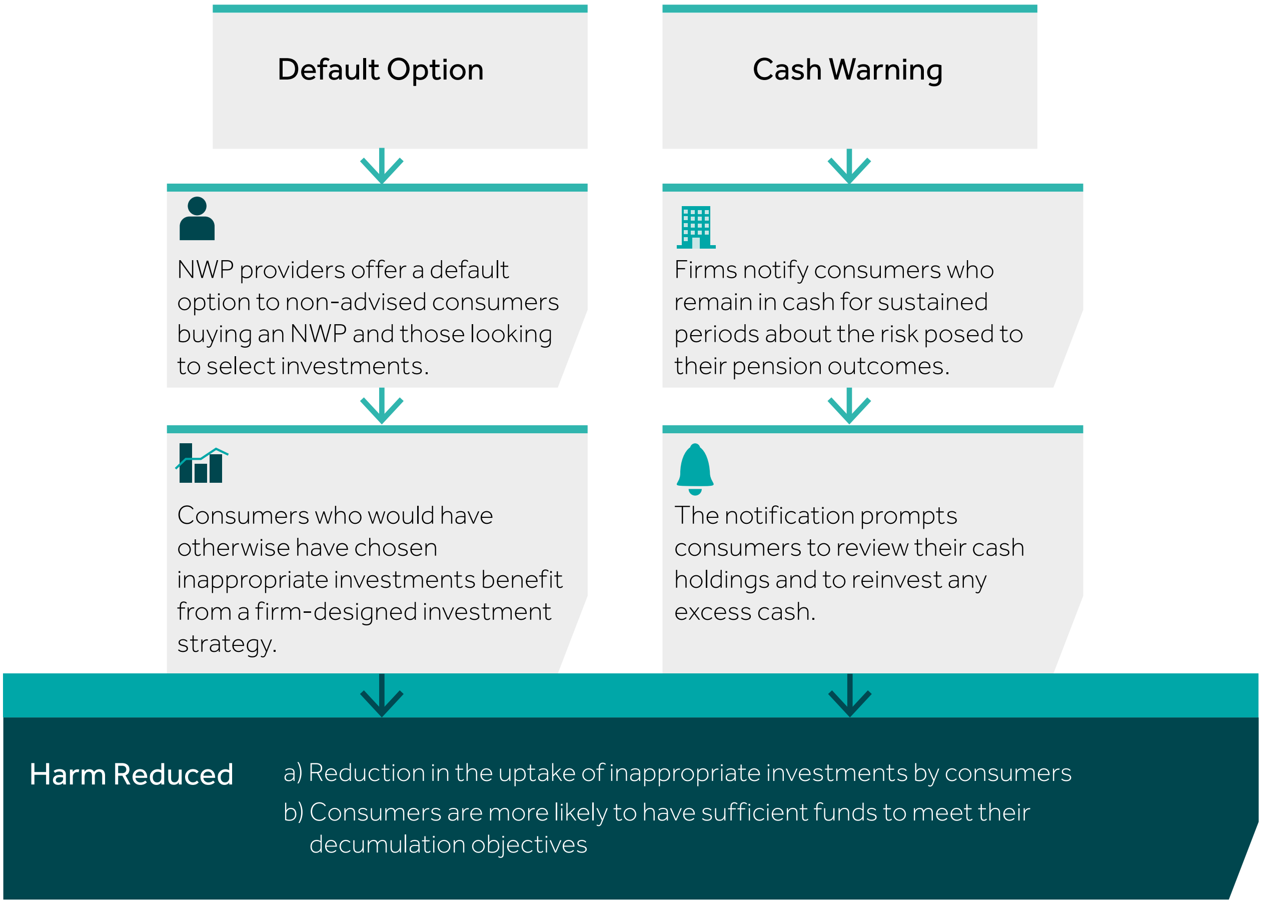
Our interventions

8. To address the harms set out above we propose 2 interventions:

- A standardised investment strategy ('default option') available to non-advised NWP consumers to reduce the risk that they either select investments incompatible with their pension objectives or remain in cash for long periods. Providers would be required to offer their default option to non-advised consumers buying an NWP, in menus of investment choices, and alongside decision trees and tools. The default option would be designed to meet the needs of the firm's typical non-advised consumer and would include lifestyling.
- A notification ('cash warning') to consumers who have held over 25% of their NWP assets in cash or cash-like investments for over 6 months. This would be sent to both advised and non-advised consumers and would alert them to the likely long-term financial consequences of holding large amounts of cash as opposed to investing in growth assets. The requirement for a cash warning would apply to consumers more than 5 years away from normal minimum pension age, which is currently 55, or a protected pension age if that is lower. It would exclude cash held for lifestyling purposes. We also propose guidance that providers should consider giving cash warnings beyond that age limit through to the expected date of pension access.

9. The following diagram sets out the causal chain of how we expect our proposed interventions to reduce the harms described above.

Causal chain depicting how our proposals aim to reduce harm to consumers.



10. In the text below, we set out our baseline and key assumptions followed by a summary of costs and benefits. Section 1 sets out the CBA for the default option intervention. Section 2 sets out the CBA for the cash warning intervention.

Baseline and key assumptions

11. Without our interventions, we expect consumer behaviour regarding investment decisions and cash holdings to remain unchanged.

12. We have estimated the number of providers and consumers impacted by the 2 interventions using a combination of FCA data and firm responses to our data request from 2017. We have assessed these numbers for both "larger" and "smaller" providers, where for the purposes of this CBA providers are "larger" if they have more than 50,000 NWP accounts and are "smaller" otherwise. For the purpose of this CBA, we will treat "smaller" providers as medium size firms in the Standardised costs model.

13. The requirement to make a default option available would only apply to firms open to new non-advised business. We estimate that around 20-30% of the firms in the NWP market would be required to make a default option available. This corresponds to firms currently accepting new non-advised consumers, less a small number of firms currently accepting very few new non-advised consumers annually. We have assumed that firms accepting fewer than 5 new non-advised consumers annually would stop accepting new non-advised business so that they are not required to make a default option available.

14. The requirement to send cash warnings would apply to all firms operating NWPs.

Summary of costs and benefits

15. The following table summarises the costs and benefits of the proposals detailed in this CP.

Default option

Table 1: Default option – total costs and potential benefits over 10 years

Costs:	
One-off costs	£11.8m
Present value of ongoing costs (over 10 years)	£39.5m
Estimated total present value of costs	£51.3m
Potential benefits:	
More appropriate investment strategy	Not quantified We estimate an additional 4-9bp on default option AUM would cover total costs
Less time in cash before investing	£68.9m net of costs
More non-advised consumers buying a NWP	Not quantified

16. While it was not reasonably practicable for us to quantify the overall benefits of requiring a default option, we have considered by how much investment performance would need to improve, for those consumers selecting the default option, for the benefits to exceed the total costs to industry.

17. We have done this by projecting the growth in assets under management (AUM) in default options over 10 years. We have assumed a 5% annual return on the default option. We have also assumed the amounts contributed and that 25-50% of new non-advised consumers choose their firm's default option.

18. Across the 10 years, default options would have to deliver better returns (before considering other potential benefits) of 4-9 basis points on projected AUM relative to the counterfactual – what those non-advised consumers choosing the default option would have achieved on their own. Such consumers would have held widely different investments which may not be compatible with their pension objectives.

19. We think it is reasonable to expect that, on average, default options will deliver much more than 4-9 basis points additional return relative to what these consumers would have achieved without it.

20. We have separately sought to quantify one part of the overall benefit. Using data from our August 2020 data request, we estimate that 24% of new non-advised consumers choosing the default option when they buy an NWP would otherwise have remained in cash for one year on average before switching to growth assets. A benefit to these consumers is the difference between the investment return of the default option (we assume 5% p.a.) relative to being invested in cash, over one year. Our estimate for that benefit alone at £68.9m is greater than the total cost to industry.

Cash warning

Table 2: Cash warning – total costs and potential benefits over 10 years

Costs:	
One-off costs	£13.7m
Present value of on-going costs (over 10 years)	£20.6m
Estimated total present value of costs	£34.3m
Potential benefits:	
Excess cash investments switched to growth assets	Not quantified We estimate that 1.2% of consumers receiving a cash warning would need to switch out of cash to cover total costs

21. It was also not reasonably practicable for us to quantify the overall benefits of requiring a cash warning. Using a similar approach to the default option analysis, we have considered what proportion of consumers receiving a cash warning would need to switch to growth assets for the benefits to exceed the total cost to industry.

22. As for the default option analysis, we have considered benefits and costs over 10 years, since NWPs are generally long-term investments. We have not assumed that consumers switching would have otherwise remained in cash for the rest of the 10 years. Rather, we estimate that they would otherwise have remained in cash for a further 3 years. We assume that long-time savers who receive a cash warning would have remained in cash longer than new consumers who recently purchased an NWP because they represent the relatively small proportion of consumers who have already held at least 25% of their NWP assets in cash for more than 6 months. So, they are more likely to remain in cash for a longer period unless they are prompted by a cash warning to switch.

23. Overall, we estimate that 1.2% of consumers receiving a cash warning would have to switch to growth assets (such as the default option) for the benefits to exceed the total cost to industry. We think it is reasonable to expect more than 1.2% of consumers to switch.

Section 1: Default Option

24. The default investment strategy would be designed for a typical non-advised consumer based on the provider's target market.

25. Providers which do not offer investments for inclusion in their NWP would not be required to offer a default option. This means that bespoke SIPP operators and firms offering discretionary fund management services would be exempt from our proposed rules.

Larger firm population estimate

26. Our 2017 data collection identified 26 larger firms with open and/or closed books of NWP business. We subtracted 15 larger firms with only closed books of NWP business, since the requirement to offer a default would apply to firms accepting new non-advised consumers. This reduced the initial figure of 26 larger firms to 11.

Smaller firm population estimate

27. Our 2017 data collection identified 91 smaller firms with open and/or closed books of NWP business. These firms included bespoke SIPP operators and a small number of firms which were exclusively wealth managers, together 59 firms. We subtracted these from the 91 smaller firms, reducing the initial figure of 91 smaller firms to 32.

28. From the 32 smaller firms we excluded those with closed books only and those which accepted fewer than 5 new non-advised consumers annually. This threshold of 5 consumers was applied because firms accepting a very small number of new non-advised consumers annually are likely to decide to only accept advised consumers so that they are not required to offer a default option. We also removed firms which were known to be in administration and those belonging to the same group as the affected larger firms. This left us with 17 smaller firms who would provide a default option.

Estimated number of consumers choosing the default option

29. Based on our 2017 data and updated using our 2020 data collection from a sample of firms, we estimate that the 11 larger firms together accepted approximately 111,000 new non-advised consumers annually. Similarly, we estimate that the 17 smaller firms together accepted approximately 13,600 new non-advised consumers annually. These sum to approximately 124,600 new non-advised consumers annually for the industry.

30. We are aware that some insurers may reclassify workplace pension policyholders as non-workplace when they leave an employer, for example when changing jobs. These deferred members remain in the same investments and most will be in the default arrangement. Being reclassified as non-workplace does not take them outside the remit of Independent Governance Committees, which oversee the value for money of workplace personal pension schemes. But some insurers may have included these individuals in their data for new non-advised consumers, and so they would be included in our estimate of new non-advised consumers annually for the industry.

31. Under our proposals, providers would not be required to offer these individuals a default option. We have taken this into account in estimating a wide range for the number of non-advised consumers choosing the default option each year.

32. We assume that 25–50% of new non-advised consumers take up the default option each year, for an estimated range of 31,000–62,000 consumers who would benefit from our intervention.

33. This is before considering existing non-advised consumers who may choose the default option, for example when reviewing their investments or considering where to invest new contributions or cash holdings, and before considering advised consumers for whom the default option may be recommended as a suitable investment. We are unable to estimate these numbers.

One-off costs

Familiarisation and gap analysis

34. We expect providers to incur familiarisation costs by reading the new rules and undertaking gap analysis. We use standard assumptions to estimate these costs based on the Standardised Costs Model, which is further detailed in Annex 1 of "How we analyse the costs and benefits of our policies". For consistency with other cost benefit analyses, these costs for firms labelled as smaller in this consultation paper were obtained for firms classified as medium-sized in the Standardised Costs Model. This is because relatively smaller pensions providers in the financial services sector are likely to be classified as medium-sized under the Standardised Costs Model.

35. We assume that there will be approximately 22 pages of policy documentation which relate to the default investment strategy (either directly or as a general introduction to the new rules) that providers will need to familiarise themselves with. We assume that it would take around 1.1 hours to read the document. It is further assumed that 20 compliance staff at larger providers, and 5 compliance staff at smaller providers will read the document. Finally, we assume an hourly compliance staff salary, including overheads of £59 at the larger providers and £63 at the smaller providers.

36. We also estimate the cost for providers of conducting a legal review of these proposals given how they constitute a new requirement. There are around 12 pages of legal instrument which relate to the default investment option either directly or as a general introduction to the new rules. It is assumed that 4 legal staff at larger providers and 2 legal staff at smaller providers, will review the legal instruments associated with the default investment strategy. Finally, we assume an hourly legal staff salary, including overheads, of £69 at both larger and smaller firms.

37. Since smaller firms will need to ensure that they are compliant with our rules irrespective of whether they already offer a standardised investment product, we assumed that the familiarisation and gap analysis costs per firm are the same regardless of their product offering.

38. Using these assumptions, we expect a total industry wide cost of £53,000 for familiarisation and gap analysis.

Costs of designing and implementing the default option

39. The tables presented in the following sections provide our estimates for the average costs per firm associated with the implementation and continued provision of a default option. The one-off and ongoing costs data were provided by firms in our August 2020 data request and corresponded to the following categories: project management costs, design costs, staffing costs, governance costs, IT costs, training costs, additional costs and familiarisation and gap analysis. We asked firms to estimate these costs for a firm that has to design and implement a new standardised investment strategy rather than adapting an existing strategy.

40. We have not shown the average cost per affected firm separately for each cost category because some firms grouped certain costs together, and for some categories the number of firms responding was small.

Larger firm costs

41. The larger firms in our sample already had one or more standardised investment strategies, one of which could be adapted as the firm's default option at reduced cost. We assumed that all affected larger firms could do the same. So, we applied a reduction to the cost estimates provided by larger firms to develop a default option, which we assumed to be a reduction of 40-60%. By taking an average of the responses from larger firms and applying this reduction, we estimate the average one-off costs for a larger firm to be £750,000-£1,130,000. Across the 11 larger firms together, we estimate total one-off costs of £8.3m-£12.4m.

Smaller firm costs

42. We estimated one-off costs for smaller firms in a similar way. However, only about 20% of the smaller firms in our sample had an existing standardised investment strategy that they could adapt as a default option. So, we only applied the cost reduction to 20% of our population of affected smaller firms. This equates to 4 out of the 17 smaller firms.

43. For the 13 smaller firms without an existing standardised investment strategy that they could adapt, and based on the responses, we estimate average one-off costs per firm of £100,000 and a total across those 13 firms of £1.3m. For the 4 smaller firms with an existing standardised investment strategy that they could adapt, we applied a 40-60% reduction and estimate average one off-costs per firm of £40,000-£60,000, which across those 4 firms total to £160,000-£240,000.

Table 3: The average one-off cost estimate for the affected firm population to develop a default solution.

One-Off Costs (£K)	Larger Firms	Smaller Firms		Total
	Firms with a suitable existing solution	Firms with a suitable existing solution	Firms with no suitable existing solution	Total
Total per firm	941	53	104	
Number of affected firms	11	4	13	28
Cost to Industry	10,350	210	1,350	11,910

Ongoing Costs

Maintaining the default investment strategy

44. Our estimates of ongoing costs for larger and smaller firms are based on the average costs estimated by firms in response to our August 2020 data request. We have not applied a reduction where firms have one or more existing standardised investment strategies. This is because while an existing standardised investment strategy may be used as the basis for the design of the default option, the default option will not necessarily replace the existing strategy but may be in addition to it. We estimate total ongoing costs annually of £3.6m for larger firms and £1.0m for smaller firms, together £4.6m annually across all affected firms.

45. The table below sets out our estimates of annual ongoing costs.

Table 4: The ongoing cost estimate for the affected firm population to maintain a default solution.

Ongoing Costs p.a. (£K)	Larger Firms	Smaller Firms	Total
Total per firm	328	58	
Number of affected firms	11	17	28
Cost to Industry	3,610	990	4,600 p.a.

Benefits

Better aligned selection of investments to the saving objectives of disengaged non-advised consumers.

46. We believe that the primary benefits of our intervention, such as better fund diversification and investment selection, lifestyling, stronger product governance and consideration of ESG issues, cannot be practically quantified. Section 138I (8) of FSMA requires the FCA to include an explanation and a statement of its opinion when it is not reasonably practicable to estimate the costs or benefits under the CBA.

47. Our intervention aims to protect non-advised consumers against the risk of selecting investments which fail to meet their pension objectives. Non-advised consumers who

choose the default option are more likely to be consumers who would otherwise find it difficult to select appropriate investments. A firm-designed default option should, on average, deliver better investment performance over the longer term than these consumers could achieve on their own. For example, consumers may have otherwise been heavily invested a particular stock or asset class, instead of appropriately diversified funds.

48. We were unable to identify practical means of identifying consumers who might choose the default option and determine the investment returns that they currently achieve over the longer term. Such consumers are likely to be invested in a wide range of different investments.

49. Instead, we have considered how much the benefits would have to be, to exceed the present value of the total cost to industry. We have calculated by how much investment returns would have to improve, on average, for non-advised consumers choosing the default option. We have expressed this as basis points on projected assets under management (AUM) in default options, considered over 10 years.

50. In other words, we have considered by how much the investment performance of default options would have to exceed the very mixed investment strategies of those consumers who would choose the default option were it available, and have asked what that difference would have to be, expressed as basis points on projected AUM, to exceed the present value of the total cost to industry.

51. As stated in paragraph 32, we estimated that 31,000-62,000 new non-advised consumers annually will choose default options. Using data provided by the ABI and FCA product sales data, we estimated that 40% of NWP savers contribute single premiums of £52,000, on average, and 60% contribute regular annual premiums of £5,500, on average.

52. We projected AUM in default options across the industry over 10 years by using the above estimates and by assuming an average investment return on the default option of 5% annually. We calculated the additional basis points return on projected AUM that would equate to the present value range of total costs to industry. We estimate this additional return to be 4bp-9bp, across the industry.

Table 5: Projected numbers of consumers and AUM in default options

Year	Consumers invested in default options	Cumulative assets under management (£B)
1	31,000–62,000	0.8–1.5
2	62,000–124,000	1.6–3.2
3	93,000–186,000	2.6–5.2
4	124,000–248,000	3.7–7.4
5	155,000–310,000	4.9–9.8
6	186,000–372,000	6.2–12.5
7	217,000–434,000	7.7–15.3
8	248,000–496,000	9.2–18.4
9	279,000–558,000	10.9–21.7
10	310,000–620,000	12.7–25.3

53. The impact of proper fund diversification on investment returns is important over longer time frames, including beyond the first 10 years of our proposed intervention. However, even without accounting for the additional protection to consumers beyond 10 years, these results suggest that the benefits are likely to outweigh the one-off and ongoing costs incurred by firms. We think it is reasonable to expect that default options will, on average, improve investment returns by much more than 4bp-9bp annually, relative to what consumers who choose the default option could otherwise achieve on their own.

54. Automatic lifestyling within the default option may also provide additional protection to less engaged consumers through the appropriate de-risking of investments during the final years before they plan to access their retirement savings. Our findings from FS19/5 suggest that only 13% of NWP providers currently offer lifestyling to consumers, and we hope to increase this proportion through the intervention.

55. We expect the default strategy to have stronger environmental, social, and corporate governance credentials when viewed holistically, relative to individual offerings which a typical less engaged consumer might otherwise have selected.

56. Furthermore, we believe some consumers currently refrain from purchasing an NWP due to the perceived complexity of selecting suitable investments. We are not able to estimate how many new consumers may enter the NWP market following our intervention, but expect some increase in the uptake of NWPs due to having simplified the decision-making process for some consumers.

57. Overall, we think it is reasonable to expect that consumers selecting the default option will, on average, benefit from investment returns that are much more than 4bp-9bp compared to what they would have achieved on their own.

58. We have considered whether the default option intervention is proportionate for the population of affected smaller firms only. The total costs to these firms would be higher relative to the estimated number of consumers using their default options. For smaller firms, we estimated that 3,400-6,800 consumers choose the default option annually. Using the same methodology, we estimate that the additional return needed to be 8bp-16bp annually, relative to the counterfactual, for affected smaller firms only. We think it is reasonable to expect that consumers of smaller firms selecting the default option will, on average, benefit from additional investment returns that are more than 8bp-16bp.

Less time in cash before investing

59. Although we were unable to quantitatively evaluate the primary benefits of the proposed intervention, we were able to analyse a secondary benefit arising from a proportion of new non-advised NWP consumers choosing the default option when they set up an NWP, instead of remaining in cash unnecessarily due to indecision.

60. We estimate that the proportion of all new non-advised consumers who remained in cash for at least 2 months after opening an NWP to be 24% of the estimated total of 124,600. This proportion was derived from the responses to our August 2020 data request. By extrapolating the data, we also estimate that consumers who hold more than 25% of their NWP assets as cash tend to remain in cash for roughly 1 year on average.

61. New non-advised consumers choosing the default option are likely to do so at the time of setting up their NWP or soon after. So, we can estimate an early benefit of investment returns from the default option for those who would otherwise have remained in cash for a period. We assume that of our estimated number of 31,000-62,000 non-advised consumers accepting the default option annually, 24% (the same proportion as for all non-advised consumers) remain in cash for at least 2 months and on average for approximately 1 year. These consumers would benefit, on average, from 1 year's investment returns from the default option relative to the low returns of holding cash.

62. Using the responses of 28 firms from our August 2020 data, we found the average net returns on cash or cash-like holdings received by consumers to be 0.19% in 2019.

63. We assumed a 5% rate of investment return for default options. For simplicity, we also assume that NWP contributions are made at the start of each year, while costs incurred by firms and the interest gained from investments are paid at the end of the year. A discount rate of 3.5% was applied from the 2nd year onwards, following HMT's guidance for impact assessments and other appraisals.

64. Over 10 years, we calculate that consumers receive a total net present value benefit of £26.7m–£111.0m, compared to the present value cost to industry of £49.2m–£53.3m.

Section 2: Cash warning

65. The second proposed intervention is a cash warning for NWP consumers who have held more than 25% of their NWP assets in cash or cash-like holdings for a sustained period of more than 6 months. Cash held as part of a lifestyle investment solution may be excluded from the calculation of the percentage of NWP assets held as cash.

66. We propose to make cash warnings mandatory for consumers more than 5 years away from normal minimum pension age (which is currently 55, so consumers under the age of 50) or from a protected pension age if that is lower. Few consumers currently have a protected pension age. We propose guidance that firms should consider sending cash warnings to consumers above the age limit, but this is not a requirement, and we want firms to have the flexibility to adjust the triggers for a cash warning as appropriate.

67. The proposed requirement will apply to both non-advised and advised consumers. We considered excluding consumers whose providers are able to evidence ongoing advice, but concluded that it would be simpler and of relatively low marginal cost to require firms to send cash warnings to all consumers meeting the conditions. We think that consumers receiving ongoing advice are less likely to have significant and sustained cash holdings, up to the proposed age limit for mandatory cash warnings. Those advised consumers that do, and do not know why, may benefit from a conversation with their adviser that a cash warning might prompt.

68. Responses from the August 2020 data request indicate that there may roughly be 82,000 NWP consumers in accumulation who are under the age of 50, and have sustained cash holdings over 25% of their NWP assets for more than 6 months. The average cash holding for this cohort is approximately 70%.

Population overview

69. Given that all NWP firms are captured by this requirement, we expect our intervention to affect approximately 26 larger firms and 91 smaller firms.

70. From the August 2020 data collection, we found the average number of consumers per firm with cash holdings greater than 25% for more than 6 months to be 2,900 and 100, based on the sample of 10 larger and 20 smaller firms respectively. We extrapolated these average figures to the 26 larger and 91 smaller firms to derive an estimated number of affected consumers of 82,000.

One-off costs

Familiarisation and gap analysis

71. Using the same procedure as the default option section, we assume that there will be approximately 18 pages of policy documentation which relate to the cash warning (either directly or as a general introduction to the new rules) that providers will need to familiarise themselves with. We assume that it would take around 1 hour to read the document.

72. We also estimate the cost for providers of conducting a legal review of these proposals given they constitute a new requirement. There are around 6 pages of legal instrument which relate to the cash warning either directly or as a general introduction to the new rules.

73. Using these assumptions, we expect a total industry wide cost of £110,000 for familiarisation and gap analysis.

Designing and implementing the cash warning

74. We acknowledge that some providers may already operate a system for notifying consumers of larger cash balances, but we expect this to apply only to a minority of providers and don't believe it would meaningfully impact the overall cost to industry.

75. We received cost data from 7 larger and 15 smaller firms to the August 2020 data request relating to the cash warning requirement. The one-off and ongoing cost data provided by these firms were averaged and extrapolated to provide the total industry costs of £13.7m for our estimated NWP population.

Table 6: The one-off cost estimate for all affected firms to implement cash warnings for consumers.

One-off costs (£K)	Larger Firms	Smaller Firms	Total
Total per firm	399	36	
Number of Firms	26	91	117
Cost to Industry	10,370	3,280	13,650

Ongoing costs

Maintaining the cash warning

76. We estimated ongoing costs in Table 7 below based on the average of estimates provided to us by firms in response to our August 2020 data requests, extrapolated to the industry. We think our estimated ongoing costs may be overestimates, given that they equate to approximately £25 per cash warning issued, based on the present value of the ongoing cost to industry over 10 years divided by the projected total number of cash warnings issued over 10 years.

Table 7: The ongoing cost estimate for all affected firms to provide cash warnings.

Ongoing costs (£K)	Larger Firms	Smaller Firms	Total
Total per firm	34	18	
Number of Firms	26	91	117
Cost to Industry	880	1,640	2,520 p.a.

Benefits

Consumers make more suitable investment decisions

77. Our aim is to prompt consumers to consider whether holding a significant proportion of their NWP assets in cash is consistent with their objectives. We are concerned that some consumers may wrongly believe that holding cash is a prudent and appropriate strategy for pension saving over the long-term, failing to account for the effects of inflation and the significant missed opportunity costs from not investing in growth assets. Other consumers may need to be reminded before they take action.

78. While we do not want to push consumers into growth assets, which are likely to be more volatile in the short term, we want consumers to think about whether investments other than cash may deliver a better pension outcome for them. Those consumers who take action as a result of a cash warning are likely to reduce their cash holdings by investing in growth assets.

79. It is not reasonably practicable to estimate the number of consumers who would take action as a result of a cash warning. Instead, we have performed a break-even analysis to calculate the percentage of consumers transferring from cash into a 5% return fund which would allow the derived benefits to approximately equal the incurred costs.

80. The one-off and ongoing cost data provided by these firms were averaged and extrapolated to provide the total industry costs with a present value of £35.3m over 10 years for our estimated NWP population.

81. As a baseline for our model, we assume that the consumers who take action as a result of the cash warning would have retained high levels of cash holdings for 3 years in the absence of any cash warning. Thus, the benefit from our proposal is effectively 3 years of higher returns. Over 10 years, we estimate that approximately 1.2% of consumers who receive the notification would need to transfer into a fund with a 5% rate of return each year for the benefits gained to equal the present value total cost to industry at £35.3m. We also assume that the population of new consumers affected by the notification is static and that the average pot within this customer cohort comprises

70% cash and has a value of £45,000 (therefore the value affected is £32,175). The return on cash was assumed to be 0.19%.

Q22: Do you have any comments on our cost benefit analysis?

Annex 3
Summary of responses to questions in FS19/5

1. In Feedback Statement (FS19/5), we sought views from stakeholders on possible remedies to protect consumers and promote competition in the NWP market. The feedback period ran from 30th July to 8th October 2019. We received 25 responses from professional bodies, authorised firms, trade associations, consumer groups, individual consumers and the FCA's statutory panels.

2. In this Annex, we summarise and respond to feedback on the 2 questions in FS19/5 that relate to our proposals in this consultation paper for default options and cash warnings. The other questions sought views on how to improve the clarity and comparability of charges, on publishing charges information, on measures to address the level of charges, and on what a value for money (VFM) framework for pensions might look like. The feedback to these other questions is being considered in our wider work on VFM in pensions.

NWP investment pathways

3. In FS19/5, we suggested one or more investment pathways for non-advised NWP consumers who do not or cannot engage with their investment decisions. We said these could be ready-made investment solutions with lifestyling.

4. We noted that the design, governance and communication of NWP investment pathway(s) would play an important role in ensuring good outcomes for customers. In that context, we said that there were several options we could pursue:

- setting conditions, including for example a charge cap, and
- extending the remit of Independent Governance Committees (IGCs) to ensure pathways are appropriate and provide VFM.

Q1: ***Do you have any views on introducing investment pathways? How many pathways would benefit consumers: one or multiple? If introduced, what criteria should we consider in defining investment pathway(s) for NWPs? Can you suggest a proportionate alternative?***

5. Most respondents supported the introduction of investment pathway(s) in some form, for new non-advised consumers. But some considered that pathways as a requirement would be disproportionate, since the NWP market was mostly advised.

6. Roughly half of respondents argued that the proposals should not apply to bespoke or complex SIPPs, but otherwise broadly supported the introduction of pathway(s) for non-advised consumers. A few respondents strongly supported the introduction of investment pathway(s) for new non-advised consumers and also thought they should be required for existing non-advised consumers.

7. A few respondents argued that investment pathways would go against the concept of self-investment and might result in some consumers not taking advice. They pointed out a risk that consumers might misconstrue the default pathway(s) as being suitably tailored to their objectives, if they got to it via decision trees or risk profiling tools.

8. There was no clear consensus on the number of investment pathways that should be offered. Some respondents suggested a single default option akin to workplace arrangements, to simplify the decision-making process while still meeting consumers' broader objectives. Others supported multiple pathways, to account for different ages, objectives or risk profiles. Several respondents suggested that the number of pathways should be determined by providers themselves.

9. On setting conditions and the possibility of a charge cap, some respondents argued that this should only be introduced as a last resort. They suggested that a charge cap could lead to unintended consequences, such as limiting innovation or resulting in an excessive focus on low-cost, passive investments rather than VFM.

10. While a few respondents thought that the remit of IGCs should be extended to NWPs, most suggested that this would complicate existing governance or accountability structures. Some industry respondents said that it would increase costs for consumers without achieving better outcomes. Some thought that existing senior management oversight and product governance would be sufficient to ensure that investment pathway(s) would be appropriately designed and offer VFM.

11. A few respondents sought clarity around the lifestyling proposition of the default pathway(s) and queried how this should relate to the drawdown investment pathways from the Retirement Outcomes Review (RoR).

Our Response

We agree that some form of investment pathway(s) is needed for non-advised NWP consumers. The proportion of non-advised consumers buying an NWP has increased. These consumers include the self-employed and those seeking to consolidate multiple pensions. Such consumers may not always have clear investment objectives and may be negatively influenced by behavioural biases such as short-termism or excessive risk aversion.

On whether requiring investment pathway(s) would go against the concept of self-invesment, we agree that it would take away the need to engage further with underlying investments, for those consumers choosing one. But it would be for consumers who would otherwise find it difficult to select appropriate investments, putting them at risk of a poor pension outcome. Many non-advised consumers are unable or unwilling to engage properly with investments and are likely to remain less engaged throughout their pension journey. Even if they engage more, we think most of these consumers are unlikely to develop sufficient expertise to make optimal decisions about the mix of investments to include within their NWP.

On the number of investment pathway(s), we note that certain NWP providers already offer a range of 'standard' solutions which account for different consumer needs. We do not want to prevent firms from offering such a range. But, as a requirement, we think that a firm should offer only one default option to the non-advised consumers within its target market. Consumers choosing the default option will have the common objective of building their pension savings for future access.

We note the concerns around introducing a charge cap. We do not propose a charge cap on default options at this time.

We think that IGCs as independent bodies have an important role in ensuring VFM of workplace personal pensions and investment pathway solutions. IGCs have a duty to raise any concerns about VFM with the board of their firm. Firms have a duty to respond to those concerns. Nonetheless, we do not propose to extend the remit of IGCs to NWP default options at this time. We have work underway on VFM that will support the effectiveness of IGCs. We also recognise that they have recently taken on other new duties. We may revist the case for a charge cap and whether to extend the remit of IGCs following a post-implementation review of default options.

In FS19/5, we found that only 13% of all NWP accounts had a lifestyling option in 2017. We propose to require firms to include lifestyling in the design of a default option, unless the needs, objectives and characteristics of consumers in their target market for the default option are incompatible with lifestyling. The design of lifestyling may take into account how consumers in the default option are likely to access their pension savings, including via drawdown investment pathways.

Cash investments

12. In FS19/5, we said that we had recently finalised rules requiring drawdown providers to:

- ensure non-advised decisions to invest wholly or predominantly in cash in drawdown are active, and
- give all consumers initial and ongoing warnings about the likely long-term impact of being invested in cash.

13. We thought consistent proposals could be appropriate for NWPs.

Q2: ***Do you have any views on applying an 'active decision' requirement to non-advised investments in cash, and additional warnings to all consumers about the impact of such a decision? Can you suggest a proportionate alternative?***

14. All 25 respondents supported broad alignment with our our rules for drawdown providers. But some respondents thought that the focus should not be an active decision to hold cash as such, but rather the elapsed time a consumer holds cash.

Others thought that we should require an 'active decision' from non-advised consumers who choose to remain in cash.

15. A few respondents suggested that we wait to evaluate the outcomes and possible unintended consequences from implementing an 'active decision' in drawdown. One respondent said that requirements must not add complexity to the process of adding cash before making an investment decision, for example via a platform at the end of a tax year.

16. Respondents generally thought that cash warnings should be issued to relevant consumers. Many respondents asked that we recognise that holding cash or cash-like assets can be appropriate, for example as part of a lifestyling arrangement pre-retirement, or where a consumer has a low capacity for loss or is saving cash with the intention of making a large investment.

17. A few respondents asked us to define a threshold amount of cash, and said that this might be different to the threshold (50%) in our finalised rules for drawdown providers. Some also proposed that the requirement for cash warnings should only apply to non-advised consumers.

18. A few respondents suggested highlighting the availability of advice and guidance through the Money and Pensions Service (MaPS) to promote greater engagement from consumers, rather than solely focusing on the requirement for an 'active decision' to hold cash.

19. Several respondents asked for further guidance around measures providers can take, without providing advice, to help consumers who are invested in cash when this may not be the best option for them.

Our Response

We recognise the practical difficulties of implementing an 'active decision' to invest in cash for pensions in accumulation. We have had further discussions with stakeholders to better understand the issues.

Consumers may be invested in cash as a result of contributions or the sale of an investment and might not respond to a request for an 'active decision.' This added complexity may increase the cost to industry and could ultimately result in higher charges to consumers. We also found lower reported levels of cash in our 2020 data collection exercise than we had found in 2017 and also lower than the levels of cash we had found in drawdown funds. This makes the cost to industry harder to justify.

Given that both the cash warning and 'active decision' serve a similar purpose, in prompting consumers to consider whether they should move out of cash, we propose not to proceed with a requirement for an 'active decision' at this time.

We agree that cash warnings should be issued to relevant consumers. We also note the appropriateness of holding cash in certain circumstances. We think that by setting conditions for a mandatory cash warning, which include a sustained holding and an age limit, fewer consumers will be issued a cash warning that they do not need. Those consumers who receive a cash warning and know why they are invested in cash do not have to take action.

We propose a lower threshold (25%) relative to our drawdown requirements (50%), since there is less likely to be good reason for higher levels of cash when building a pension pot for the longer term. We also propose that cash be above the threshold for more than 6 months for a mandatory cash warning.

We considered requiring cash warnings for non-advised consumers only. But given the difficulties of demonstrating ongoing advice, and the fact that relatively few consumers who are actually receiving ongoing advice should be significantly invested in cash, we propose mandatory cash warnings for all consumers who meet the conditions.

Firms may choose to highlight in their cash warnings the availability of guidance from MaPS. However, firms should also be mindful not to include too much additional information. Consumers receiving cash warnings are likely to be less engaged with their NWP and the key message of the cash warning might be missed.

In our view, providing a cash warning under our proposals does not constitute advice. We propose to formalise our view by adding the proposed NWP cash warning as an example in PERG 8 Annex 1 'Examples of what is and is not a personal recommendation and advice.'

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. This Annex also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s. 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

4. 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.

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

6. 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

7. 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 are also relevant to the FCA's operational objective to promote competition in the interests of consumers.

8. In formulating our proposals for securing an appropriate degree of protection for consumers, we have considered how the existing market operates. As set out in the consultation paper, we have found that many non-advised consumers lack investment expertise and may not find it easy to select appropriate investments for an NWP. Our proposals for a standardised investment strategy ('default option') for non-advised consumers are designed to protect these consumers from selecting investments which may be incompatible with their pension objectives. Our proposals for a requirement for providers to send a notification ('cash warning') to consumers with potentially inappropriate levels of cash in their NWP is to warn these consumers that their pension savings are at risk of being eroded by inflation and encourage them to consider investing in growth assets. These measures aim to protect consumers from sub-optimal pension outcomes.

9. Although our proposals are primarily designed to protect consumers, they are also relevant to the FCA's competition objective of promoting competition between firms in the interests of consumers. NWP providers may compete by developing better designed and more accessible default options to attract a greater share of new NWP business.

10. We consider these proposals compatible with the FCA's strategic objective of ensuring that the relevant markets function well because our proposals for a default option and cash warnings have the effect of better aligning investments in NWPs with the pension objectives of consumers. The default option also removes a potential barrier of entry for consumers who may be deterred from purchasing an NWP because of the need to engage with investments for inclusion in the NWP, when the choice and complexity of investments available can be very wide. For the purposes of the FCA's strategic objective, "relevant markets" are defined by s. 1F FSMA.

11. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s. 3B FSMA. We cover the most relevant of these below.

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

12. We do not believe that our proposals will have a significant impact on our resources and the way we use them. The future work that we conduct in relation to these proposals, such as post-implementation review, will form part of our future business planning.

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

13. We believe that the measures we are proposing are proportionate. We have set out a cost benefit analysis in Annex 2 for consultation.

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

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

The general principle that consumers should take responsibility for their decisions

15. The measures proposed in this consultation paper are designed to support non-advised consumers by ensuring that a default option is offered for inclusion in their NWP. Consumers would remain responsible for accepting the offer. They would also be responsible for their decision to enter into an NWP arrangement in the first place. Cash warnings are intended to prompt consumers to consider whether they should remain invested in cash in their NWP. A consumer receiving a cash warning would remain responsible for deciding whether to invest in growth assets rather than cash.

The responsibilities of senior management

16. 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

17. We have had regard to this principle and do not believe our proposals undermine it. We believe this CP has taken account of the different types of businesses who operate in the NWP market. We have excluded bespoke SIPP operators from the requirement to offer a default option to non-advised consumers because we consider that the requirements would be disproportionate for this kind of business.

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

18. 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

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

20. 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 relevant in relation to our proposals.

Expected effect on mutual societies

21. 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.

Compatibility with the duty to promote effective competition in the interests of consumers

22. When advancing our consumer protection objective, we have a duty, so far as compatible with advancing that objective, to discharge our general functions (such as making rules and giving general guidance) in a way which promotes effective competition in the interests of consumers. Our 2018 NWP Consumer Engagement Research found that many non-advised respondents sought to shorten and simplify the decision-making process when opening an NWP by relying on provider brand recognition or recommendations from family and friends, rather than comparing the market and selecting a provider which offers a product that best suits their perceived needs. This behaviour favours large and established NWP providers over newer market entrants. We consider that our proposals for a default option would focus attention on a single investment solution and enable market commentators to compare the default options offered by different providers. This may encourage non-advised consumers to select a provider offering a well-regarded default option for NWPs. It may also help newer market entrants to better compete with incumbent firms at attracting new NWP consumers

Equality and diversity

23. We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.

24. As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. The outcome of our consideration in relation to these matters in this case is stated in paragraph 2.18 of the Consultation Paper.

Legislative and Regulatory Reform Act 2006 (LRRA)

25. We have had regard to the principles in the LRRA for the parts of the proposals that consist of general policies, principles or guidance. We consider that the rules we are proposing are proportionate and balance the practicality of implementation by firms with the need for appropriate consumer protection. As part of our proposed interventions, we suggest several exclusions which include discretionary investment management firms and bespoke SIPP operators.

26. We are consulting on our proposals in this CP, and will continue to engage with stakeholders throughout this consultation process before making any rules.

27. We have had regard to the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance.

Annex 5
Abbreviations used in this paper

Abbreviation	Description
AE	Automatic Enrolment
AUM	Assets Under Management
CBA	Cost Benefit Analysis
COBS	Conduct of Business Sourcebook
CP	Consultation Paper
DC	Defined Contribution
DP	Discussion Paper
DWP	Department for Work and Pensions
ESG	Environmental, Social and Governance
EU	European Union
FCA	Financial Conduct Authority
FS	Feedback Statement
FSMA	Financial Services and Markets Act
GAA	Governance Advisory Arrangement
HMRC	Her Majesty's Revenue and Customs
HMT	Her Majesty's Treasury
IDD	Insurance Distribution Directive
IGC	Independent Governance Committee
IPP	Individual Personal Pension
LRRA	Legislative and Regulatory Reform Act 2006
LTAF	Long-Term Asset Fund

Abbreviation	Description
MAPS	Money and Pensions Service
NEST	National Employment Savings Trust
NWP	Non-workplace pension
OFT	Office of Fair Trading
PDP	Pensions Dashboard Programme
PERG	Perimeter Guidance Manual
PROD	Product Governance Sourcebook
PS	Policy Statement
RAC	Retirement Annuity Contract
RDR	Retail Distribution Directive
ROR	Retirement Outcomes Review
SABS	Simpler Annual Benefit Statements
SIPP	Self-Invested Personal Pension
S32 buyouts	Section 32 Buyout Contract
SYSC	Senior Management Arrangements, Systems and Controls
TCFD	Taskforce on Climate-Related Financial Disclosures
TPR	The Pensions Regulator
VFM	Value for Money

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.

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Appendix 1
Draft Handbook text

NON-WORKPLACE PENSIONS INSTRUMENT 2022

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the following powers and related provisions in or under the following sections of 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 provisions listed above are specified for the purposes of section 138G(2) (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) below.

(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 Non-Workplace Pensions Instrument 2022.

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.

cash-like investments	*cash* or *near cash*, units in a *regulated money market fund*, or units in a fund authorised as a money market fund for the purposes of the *UK* version of Regulation (EU) No 2017/1131 of the European Parliament and the Council of 14 June 2017 on money market funds, which is part of *UK* law by virtue of the *EUWA*.
default option	an *investment* or group of *investments* offered for inclusion in a *non-workplace pension* and designed to meet the needs, objectives and characteristics of a typical *non-advised client* in the target market.
lifestyling	an investment strategy that aims, as the member of a *pension scheme* approaches retirement, progressively to reduce the potential for significant variation caused by market conditions in the value of the member's accrued rights.
non-advised client	(in *COBS* 19 and *PROD* 6) a *retail client* in relation to whom a *firm* has not been able to determine, on reasonable grounds, that the client has received, or will receive, a *personal recommendation* or investment management services for the purposes of *COBS* 19.11.5R.
non-workplace pension	the individual arrangements, of a member of a *non-workplace pension scheme* who is a *retail client,* with the scheme's *operator*.
non-workplace pension scheme	a *personal pension scheme* or *stakeholder pension scheme*, in situations where the scheme will be used to provide members with benefits other than employment benefits.
target date fund	a *fund* whose investment strategy is adjusted over time based on when *investors* in the *fund* are expected to access their investment.

Amend the following definition as shown.

manufacture …

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

distribute	…	
	(3)	(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* or a *default option*.

Annex B

Amendments to the Conduct of Business sourcebook (COBS)

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

19 Pensions supplementary provisions

…

19.10 Drawdown, investment pathways and cash warnings

Definitions

19.10.1 R In *COBS* 19.10:

(1) ~~"cash-like investments" includes *cash* or *near cash*, 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 (2017/1131/EU), which is part of UK law by virtue of the *EUWA*;~~ [deleted]

…

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) …

…

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

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

…

…

19.10.30 R Before carrying out the *retail client's* request referred to in *COBS* 19.10.8R, the *firm* must:

(1) …

(2) subject to *COBS* 19.10.32R, if carrying out the *retail client's* request referred to in *COBS* 19.10.8R would result in more than 50% of the

retail client's drawdown fund being invested in ~~cash-like investments~~ *cash-like investments*:

(a) ensure that the *retail client* has made an active decision to invest in ~~cash-like investments~~ *cash-like investments*; and

…

…

…

19.10.38 R The cash warning must:

(1) …

(2) using plain language, warn the *retail client* that:

(a) more than half of their eligible drawdown fund is invested in ~~cash-like investments~~ *cash-like investments*; and

…

…

…

19.10.47 G A *firm* to which the record-keeping rules in *SYSC* 3 (Systems and controls) or *SYSC* 9 (Record-keeping) apply should maintain a record of its compliance with the requirements in this section including:

(1) …

…

(16) evidence of how each *retail client* who received an initial cash warning made an active choice, in accordance with *COBS* 19.10.30R(2)(a), to invest more than 50% of their drawdown fund in ~~cash-like investments~~ *cash-like investments*;

…

…

After *COBS* 19.10 (Drawdown, investment pathways and cash warnings) insert the following new section. The text is not underlined.

19.11 Non-workplace pensions: default options and cash warnings

Definitions

19.11.1 R In *COBS* 19.11:

(1) "cash warning" is the warning in *COBS* 19.11.31R;

(2) "filtering tool" means a tool whereby a *firm* makes the list of the *investments* it sells easier to search by allowing the *customer* to filter products based on factors presented by the *firm* and selected by the customer, and showing to the customer the *investments* that meet the factors selected by the customer;

(3) "pre-purchase questioning tool" means a tool, including a decision tree, that puts a sequence of questions in order to extract information from a *person* to help them best select an *investment* that meets their needs.

Application of default option rules

19.11.2 R *COBS* 19.11.10R to *COBS* 19.11.22G apply to an *operator* of a *non-workplace pension scheme* that:

(1) offers, distributes or promotes *investments*, or promotes *platform services* that distribute *investments*, in relation to their inclusion in a *non-workplace pension* of the *operator*; or

(2) accepts, for inclusion in a *non-workplace pension*, *investments* which are offered, distributed or promoted by another *person* where that other *person*, or another *person* connected to it, also arranges for the *retail client* to enter into the *non-workplace pension* with the *operator*.

19.11.3 G The effect of *COBS* 19.11.2R is that *COBS* 19.11.10R to *COBS* 19.11.22G:

(1) do not apply where an *operator arranges*, at the request of a *retail client*, an *investment* for inclusion in, or the provision of *platform services* in respect of, the *retail client's non-workplace pension,* provided that the *operator* has not also offered, distributed or promoted those *investments* or *platform services* to the *retail client*;

(2) apply where an *operator* accepts, for inclusion in a *retail client's non-workplace pension,* an *investment* offered, distributed or promoted by a third-party, including a *platform services provider* or an introducer, where that third party or someone connected to that third party, also arranges for the *retail client* to enter into the *non-workplace pension* with the *operator*.

19.11.4 R *COBS* 19.11.10R to *COBS* 19.11.22G do not apply where an *operator* starts treating a *retail client's* workplace pension arrangements as a *non-workplace pension* after the *retail client* has become a deferred member of the relevant *qualifying scheme,* so long as the *firm* does not offer, distribute or promote to the *retail client* any *investments* or *platform services* other than those available in connection with the former workplace pension arrangements, including the *default arrangement* and any *investments* available on a self-select basis.

Exclusion from default option rules in relation to advised clients

19.11.5 R *COBS* 19.11.10R to *COBS* 19.11.22G do not apply in relation to a *non-workplace pension* where the *firm* has determined, on reasonable grounds, that the *retail client*:

(1) has received or will receive, either as part of transactional or ongoing advice, a *personal recommendation* on the decision to enter into the *non-workplace pension* or in relation to the investment of their contributions to, or assets in, the *non-workplace pension*; or

(2) has appointed an *investment manager* in relation to the investment of the *retail client's* contributions to, or assets in, the *non-workplace pension*.

19.11.6 G A *firm* will not have reasonable grounds to determine that a *retail client* has received, or will receive, a *personal recommendation* for the purpose of *COBS* 19.11.5R(1) if the determination is based solely on information that:

(1) is over 12 *months* old;

(2) the *retail client* is in, or transferring from, an advised product; or

(3) the *retail client* provides *remuneration* to an *adviser* in relation to other *investments*.

Application of cash warning rules

19.11.7 R *COBS* 19.11.23R to *COBS* 19.11.33G apply to an *operator* of a *non-workplace pension scheme*.

19.11.8 R *COBS* 19.11.23R to *COBS* 19.11.33G do not apply in relation to a *non-workplace pension* where the *firm* has determined, on reasonable grounds, that the *retail client* has appointed an *investment manager* in relation to the investment of their contributions to, or assets in, the *non-workplace pension*.

Purpose

19.11.9 G The purpose of this section is to specify the circumstances where a *firm* must:

(1) offer a *default option* to a *non-advised client* in connection with their *non-workplace pension*; and

(2) provide warnings to a *retail client* who has invested, for a sustained period of time, over a certain percentage of their *non-workplace pension* in *cash-like investments*.

Requirement to offer a default option

19.11.10 R *A firm* must offer its *retail clients* a *default option* for inclusion in the *non-workplace pensions* it operates for those clients.

19.11.11 R A *firm* must not:

(1) offer more than one *default option* to a *retail client*; or

(2) make the decision as to which *default option* to offer to a *retail client* depend on the *retail client's* answers in a pre-purchase questioning tool or a filtering tool.

19.11.12 G A *firm* may, as a single *default option*, offer a series of different *target date funds* that depend on *retail clients'* target retirement dates.

When and where to offer a default option

19.11.13 R A *firm* must offer the *default option* at the time the *retail client*:

(1) enters into the *non-workplace pension* operated by the *firm*; and

(2) makes their initial cash contribution into the *non-workplace pension*,

unless the *retail client* is, at the point of entry into the *non-workplace pension* with the *firm*, only transferring in *investments* they already hold elsewhere.

19.11.14 G Where a *retail client*:

(1) does not make their initial cash contribution at the point of entry into the *non-workplace pension* with the *firm*, the *firm* must still comply with *COBS* 19.11.13R(1), so as to bring the existence of the *default option* to the attention of the *retail client* from the moment they enter into the *non-workplace pension* with the *firm*; and

(2) makes their initial cash contribution at the point of entry into the *non-workplace pension* with the *firm*, the *firm* can comply with *COBS* 19.11.13R by offering the *default option* only once.

19.11.15 R Additionally, where a *firm*, or any other *person* involved in the offer, distribution or promotion of *investments* for inclusion in a *non-workplace pension* of the *firm*:

(1) sets out, in menus or otherwise, the other *investments* available to the *retail client* for inclusion in their *non-workplace pension*, the *firm* must set out the *default option* in a location most likely to bring it to the attention of that *retail client*;

(2) makes available pre-purchase questioning tools or filtering tools that enable a *retail client* to select *investments* for inclusion in their *non-*

workplace pension, the *firm* must set out the *default option* alongside those tools.

19.11.16 G It is unlikely that complying with *COBS* 19.11.15R(1) would require a *firm* to set out the *default option* in every menu, or in every level of a menu, where other *investments* are set out.

How to present the default option

19.11.17 R A *firm* must present a *default option*:

(1) when complying with *COBS* 19.11.13R, prominently and on a standalone basis; and

(2) when complying with *COBS* 19.11.15R, with at least equal prominence to any other *investment*, pre-purchase questioning tool or filtering tool made available to *retail clients* alongside the *default option*.

19.11.18 R A *firm* must ensure that, when complying with *COBS* 19.11.13R and *COBS* 19.11.15R, it:

(1) clearly labels a *default option* as a “standardised investment strategy”;

(2) sets out, in a clear and prominent way, the aims of the *default option*, explains that the *default option* has been designed to meet the needs, objectives and characteristics of a typical *non-advised client* in the target market for the *default option*, and sets out what the *manufacturer* considers those needs, objectives and characteristics to be; and

(3) makes it clear that the *default option* is not tailored to the specific needs, objectives or characteristics of any particular *retail client*, and that if the *retail client*:

(a) considers that their needs, objectives and characteristics may fall outside those of the typical *non-advised client* in the target market as described by the *firm*, they may wish to consider other investment options;

(b) wishes to ensure that the *non-workplace pension* and any *investments* included in it (including the *default option*) are suitable for them, the *retail client* should consider seeking *investment advice*.

Preparing to offer a default option

19.11.19 R A *firm* must be in a position to offer a *default option* in good time before it has to offer the *default option* pursuant to *COBS* 19.11.10R, in order to allow for sufficient internal product governance.

19.11.20 G The *default option* may be *manufactured* and *distributed* by either the *operator*, by another *firm*, or by both.

19.11.21 G *Manufacturers* and *distributors* of *default options* must comply with the product governance requirements in PROD.

19.11.22 G (1) Where *firms* decide to replace a *default option*, they may need to consider whether it would be appropriate to transfer existing clients to the new *default option*.

(2) This may be the case, for example, if the transfer is required to prevent consumer harm and avoid risking non-compliance with our *rules*, for example *Principle* 6. This could be the case where *firms* determine that the *default option* no longer meets the product governance requirements in PROD and existing clients are likely to suffer harm as a result.

(3) If *firms* decide to transfer existing clients to a new *default option*, they will need to consider the information needs of their clients, and communicate to them appropriately and in good time, in a manner that is clear, fair and not misleading.

(4) *Firms* are required to have appropriate arrangements in place (including contractual powers that are fair and transparent and comply with the *CRA*) to enable them to comply with their obligations under the *regulatory system*.

Cash warnings: conditions

19.11.23 R At least once during every 3-*month* period, for each of the *non-workplace pensions* that *retail clients* have entered into with the *firm*, the *firm* must assess whether, at the time of the assessment:

(1) more than 25% of the *non-workplace pension* is invested in *cash-like investments*, excluding any *cash-like investments* held in connection with *lifestyling* or within a *target date fund*;

(2) the amount of the cash holding in (1) is greater than £1,000;

(3) the conditions in (1) and (2) were also met in all the other assessments carried out during the 6-*month* period preceding the day of the assessment; and

(4) the *retail client* is more than five years away from (i) normal minimum pension age, as defined in primary legislation from time to time, or (ii) if lower, a protected pension age;

(the “conditions”).

19.11.24 R For the purposes of *COBS* 19.11.23R, the start of the 3-*month* period is:

(1) initially determined by reference to the date members enter into their *non-workplace pensions* with the *firm*, and

(2) after the initial 3-*month* period, by reference to the date when, for each *retail client*, the *firm* last carried out the assessment under the *rule*.

Cash warnings: timing

19.11.25 R If all the conditions in *COBS* 19.11.23R are met, the *firm* must provide the *retail client* with a cash warning within an appropriate timeframe after the date when the assessment in that *rule* was carried out.

19.11.26 G For the purposes of *COBS* 19.11.25R, an "appropriate timeframe" is likely to be within 3 *months* of carrying out the assessment in *COBS* 19.11.23R, unless the current market conditions would make it inappropriate to warn the *retail client* about their cash holdings within that timeframe, although providing the cash warning later than 6 *months* after the date of the assessment is unlikely to be appropriate.

19.11.27 R If a *firm* has provided a cash warning pursuant to *COBS* 19.11.25R, the requirement in *COBS* 19.11.25R does not apply again until after one year of the *firm* providing the previous cash warning.

19.11.28 G Notwithstanding *COBS* 19.11.27R, a *firm* can choose to provide a new cash warning during the year following the previous cash warning, in which case *COBS* 19.11.27R would apply from the date when the new cash warning is provided.

19.11.29 G Where the condition in *COBS* 19.11.23R(4) is no longer met, a *firm* should consider whether it would be appropriate to keep providing the cash warning up until the time a *retail client* accesses their pension.

19.11.30 G A *firm* may send the cash warning with other client communications, provided that the cash warning is included in a document separate to those other client communications.

Cash warning: form and content

19.11.31 R The cash warning at *COBS* 19.11.25R must:

(1) be provided in a *durable medium*;

(2) using plain language, warn the *retail client* that:

(a) more than 25% of their *non-workplace pension* is invested in *cash-like investments*; and

(b) the value of their *non-workplace pension* is at risk of being eroded by inflation; and

(3) include a generic example (provided as an explanation, an illustration or both) of how inflation erosion would affect a £10,000 cash pot over 10 years, assuming 0% interest and using a measure of inflation generally accepted in the *United Kingdom*; and

(4) inform the *retail client* that they should consider whether their current investments are likely to grow sufficiently to meet their objectives.

19.11.32 G The *firm* should also:

(1) inform the *retail client* that:

(a) the cash warning is not advice or a substitute for it;

(b) the value of any investment can fall as well as rise;

(2) explain to and/or illustrate for the *retail client* that different types of investment have a different balance of risk to potential gain; and

(3) include in the cash warning a statement to the effect that, where applicable, the *firm* makes available *investments* for inclusion in *non-workplace pensions*, including the *default option*.

19.11.33 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* 19.11.31R(3).

Record keeping

19.11.34 G A *firm* to which the record-keeping rules in *SYSC* 3 (Systems and controls) or *SYSC* 9 (Record-keeping) apply will need to maintain a record of its compliance with the requirements in this section including, where relevant, how it has determined on reasonable grounds (including records of the evidence it has relied upon) that, in accordance with *COBS* 19.11.5R, a *retail client* is not a *non-advised client*.

19.11.35 R A *firm* must also maintain a record of:

(1) the number of *non-advised clients* entering into a *non-workplace pension* with the *firm* each year;

(2) the number of those *retail clients* in (1) who chose the *default option*;

(3) the number of *retail clients* not included in (1) that choose the *default option* each year, distinguishing between *retail clients* who were *clients* of the *firm* before *COBS* 19.11.10R to *COBS* 19.11.22G came into force and those who became *clients* later;

(4) the volume of contributions made by *retail clients* to the *default option* each year;

(5) the volume of assets under management attributable to the *default option;*

(6) a description of the product approval process for the *default option* and of any reviews undertaken in compliance with *PROD* 6;

(7) in relation to cash warnings, differentiating between advised clients and *non-advised clients*, as well as between those *retail clients* who were *clients* of the *firm* before *COBS* 19.11.23R to *COBS* 19.11.33G came into force and those who became *clients* later:

(a) the dates when assessments were carried out, alongside the number of *retail clients* assessed on those dates;

(b) of the *retail clients* in 7(a), the number who met the conditions at *COBS* 19.11.23R; and

(c) of the *retail clients* in 7(b), the number who continue to meet the conditions at *COBS* 19.11.23R in subsequent assessments.

…

TP 2 Other Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
…					
2.37	*COBS* 19.11.10, *COBS* 19.11.15	R	*COBS* 19.11.10R and *COBS* 19.11.15R do not apply in relation to a *firm's* existing *non-advised clients* as of [insert date of the entry into force of the instrument], provided the *firm* does not enter into new *non-workplace pensions* with *non-advised clients* after [insert date of the entry into force of that rule].	From [insert date of the entry into force of the instrument] indefinitely	[insert date of the entry into force of the instrument]

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
2.38	*COBS* 19.11.23, *COBS* 19.11.24(1)	R	For the purposes of *COBS* 19.11.23R the start of the 3-*month* period is initially determined, in respect of existing members on [insert the date of entry into force of the instrument], by reference to that date, and not by reference to the date they entered into their *non-workplace pensions* with the *firm*.	From [insert date of the entry into force of the instrument] to [[insert date of the entry into force of the instrument] plus 3 months]	[insert date of the entry into force of the instrument]

Annex C

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

In this Annex underlining indicates new text, unless otherwise stated.

1 Product intervention and Product Governance Sourcebook (PROD)

…

1.3 Application of PROD 3

…

Manufacturing pathway investments <u>and default options</u>

1.3.16 G A *firm* that is within the scope of *PROD* 3 (Product governance: MiFID) when it *manufactures pathway investments* <u>or *default options*</u> 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 (Product governance: additional provisions for pathway investments <u>and default options</u>) 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 <u>and default options</u>

1.4.3A G A *firm* that is within the scope of *PROD* 4 (Product governance: IDD) when <u>it</u> *manufactures pathway investments* <u>or *default options*</u> 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 (Product governance: additional provisions for pathway investments <u>and default options</u>) 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* <u>or *default options*</u> 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 the *rules* or *onshored regulations* in *PROD* in relation to that *manufacturing* or *distribution* activity, then *PROD* 4, *PROD* 1.4.4UK and *PROD*

1.4.10G, apply 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* <u>or *default options*</u> 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 *onshored regulations* in *PROD*.

…

Effect and interpretation of PROD 1.4 and PROD 4 for certain manufacturers and distributors of pathway investments <u>and default options</u>

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

(1) comply with provisions marked "UK" 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* <u>or *default options*</u>; 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)
…	…
"insurance-based investment products"	*pathway investment* <u>or *default option*</u>
…	…
"insurance product"	*pathway investment* <u>or *default option*</u>

…	...

…

1.6 Application of PROD 6

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

(1) that *manufactures* or *distributes pathway investments* or *default options* 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* or *default options*, 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* or *default options*, 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.

…

6 Product governance: additional provisions for pathway investments and default options

…

After PROD 6.3 (Manufacture of pathway investments) insert the following new sections. The text is not underlined.

6.4 Manufacture of default options

6.4.1 R When designing a *default option*, a *manufacturer* should take into account, among other considerations, the fact that *COBS* 19.11 requires *operators* to offer the *default option* to *non-advised clients* for inclusion in their *non-workplace pensions.* As a result, the *default option* must be designed to be compatible with the needs, characteristics and objectives of a typical *non-advised client* in the *default option's* target market.

6.4.2 R A *manufacturer* must also ensure that:

(1) when specifying the investment strategy of the *default option*, and its costs and charging structure, it takes into account what the *manufacturer* considers, on reasonable grounds, to be the likely needs, objectives and characteristics of a typical *non-advised client* in the target market;

(2) the investment strategy of the *default option*:

(a) takes into account the target retirement age of a typical *non-advised client* in the target market, and their likely strategy for accessing their pension;

(b) includes *lifestyling*, unless the needs, objectives and characteristics of the typical *non-advised client* in the target market are incompatible with *lifestyling* or the *default option* is based on *target date funds*; and

(c) seeks growth, while managing risks, through an appropriate and diversified asset allocation; and

(3) the *default option* has appropriate and competitive price and charges, which bear a reasonable relationship with the services being provided.

6.4.3 G *Manufacturers* are expected to take reasonable steps to understand the likely needs, objectives and characteristics of a typical *non-advised client* in the *default option's* target market. This could include carrying out sufficient research and consumer testing in support of its conclusions. What amounts to a typical *non-advised client* may be based on the needs, objectives or characteristics that are most commonly seen among *non-advised clients* within the target market.

6.4.4 R *Manufacturers* must review their *default options* at least once every 3 years to ensure that they:

(1) remain consistent with the needs, characteristics and objectives of their target markets; and

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

6.5 Distribution of default options

6.5.1 R A *firm* must not *distribute* a *default option* unless it is compatible with the needs, characteristics and objectives of the *retail clients* to whom the *firm* distributes the *default option*.

6.5.2 R When carrying out the compatibility assessment in *PROD* 6.5.1R, a *firm* must also take into account:

(1) the *manufacturer's* compliance with the requirements in *PROD* 6.4; and

(2) the financial strength of the *manufacturer*.

6.5.3 R A *firm* must review the distribution arrangements for the *default options* it distributes at least every 3 years.

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?**
…		
(36) A *firm* gives a cash warning to a *retail client* in accordance with the requirements in *COBS* 19.10.38R and the *guidance* in *COBS* 19.10.39G<u>, or in accordance with the requirements in *COBS* 19.11.31R and the *guidance* in *COBS* 19.11.32G</u>.	No. This is not a recommendation to *buy*, *sell*, subscribe for, exchange, redeem, hold or underwrite a particular *investment*; or exercise or not exercise any right conferred by such an investment to *buy*, *sell*, subscribe for, exchange or redeem such an *investment*.	No. This is not advice on the merits of *buying*, holding or *selling* a particular *investment*.

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