FINANCIAL CONDUCT AUTHORITY

Effective competition in non-workplace pensions

Discussion Paper
DP18/1

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How to respond

We are asking for comments on this Discussion Paper by 27 April 2018.

You can send them to us using the form on our website at: www.fca.org.uk/dp18-01-response-form.

Or in writing to:
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1 Executive Summary

Pensions have an impact on the lives of very many people. For this reason, the FCA is very active in the area of long-term savings and pensions, both implementing Government initiatives and undertaking our own work - this paper is just one example. As part of our efforts to ensure the sector works well for pension savers, we are working together with The Pensions Regulator on a strategy which will look at how we will work together to tackle the key risks facing the pensions sector in the coming years.

Private pensions are a tax-efficient means of saving for later life. There are broadly two ways consumers can save for later life through a private pension: via the workplace or via individual (ie non-workplace) arrangements.

The market for workplace pensions changed significantly with the introduction of auto-enrolment. In recent years we have taken steps to address identified weaknesses in that market. Non-workplace pensions were not within the scope of that work.

This paper starts a discussion with industry and consumer representatives in order to better understand the market for non-workplace pensions: the providers and consumers, and the relationship between them, with a view to assessing the potential presence, nature and extent of harm.

We estimate that non-workplace pensions collectively represent around £400bn assets under management (AUM), more than double the amount invested in contract-based Defined Contribution (DC) workplace pension schemes. It is also a growing market. It serves a broad group of consumers seeking to save for later life: the employed, the self-employed, the unemployed and those with a wide range of other modern employment statuses. It encompasses those who have never had access to workplace pensions saving and those who want to enhance their workplace pension savings with further tax efficient savings. The membership is diverse in terms of age, income, financial experience and financial sophistication.

We have outlined the areas of potential concerns about how the market is working and the reasons for our concerns: demand-side (buyer-side) weaknesses and reduced competition on charges. In some aspects we can see parallels with the findings of the OFT study of the DC workplace pensions market in 2013 which concluded[1] that competition alone could not be relied on to drive value for money and good outcomes for consumers of DC workplace pensions. We note also the important differences between the markets.

1 http://webarchive.nationalarchives.gov.uk/20131101172428/http://oft.gov.uk/shared_oft/market-studies/oft1505

	Similarities between workplace and non-workplace pensions	Differences between workplace and non-workplace pensions
Market features	• Similar product design • Dominated by many of the same product providers • Complex products making it difficult for consumers to engage • Low level of on-going engagement with the product	• Employer makes key decisions in workplace schemes while decisions about non-workplace pensions are made by the individual (often with advice) • The loss of employer contributions may discourage members of workplace pension schemes from switching providers • Level of financial experience and awareness potentially higher for customers of some non-workplace pensions such as SIPPS
Charges	• Similar charging history, including differential charging practices (ie where a higher charge applies to customers who are no longer contributing to their pension) • Complex charges and charging structures that are difficult to compare	• The costs of non-workplace pensions are exclusively borne by the customer whereas in workplace schemes the sponsoring employer may bear some of the costs

We aim to understand whether competition is working well in the market for non-workplace pensions and whether or not there is a need to go further to protect consumers. We think it possible that the weaknesses previously identified in the market for workplace pensions may exist, in whole or in part, in the market for non-workplace pensions.

We are asking for views and evidence about the factors that influence the behaviours of consumers and providers and whether the current market dynamics ensure fair outcomes for consumers. We will, in parallel, carry out empirical work to help us understand the issues.

We do not assume that the same FCA rules and remedies should apply to both workplace and non-workplace pensions. Rather, if harm is identified through our diagnostic work, we will consult on proportionate interventions in a subsequent publication.

Background – workplace pensions

1.1 We have regulated the providers and distributors of contract-based defined contribution (DC) pensions since 2007. These pensions are a tax-efficient means of saving for later life.

1.2 There are broadly two ways consumers can save for later life through a private pension: via the workplace or via individual (ie non-workplace) arrangements. Historically, our regulatory approach has not differentiated between the two routes to market (i.e. workplace or non-workplace arrangements).

1.3 Auto-enrolment (AE) was introduced in 2012 as a way of harnessing consumers' tendency towards inertia to drive up participation in workplace pensions. AE radically changed the dynamics of the workplace pensions market by simultaneously increasing the number of enrolled individuals, employers offering schemes and the value of assets in workplace schemes.[2]

1.4 These changes sharpened focus on competition in workplace pensions and prompted the Office of Fair Trading (OFT) to conduct a study into the market for DC workplace pensions, with the aim of examining whether, in the light of AE, competition was likely to drive value for money and good outcomes for scheme members.

1.5 The OFT found that the demand side of the market was 'one of the weakest' it had analysed owing to:

- product complexity and information asymmetries
- a lack of alignment of incentives between employer and employee
- barriers to switching pension provider

1.6 The OFT also found that the demand-side weakness and charging complexity combined to reduce competition on charges, resulting in consumers over-paying for pensions, owing to:

- poor comparability of charges
- lack of switching and the persistence of legacy schemes, and
- two-tier charging structures (members pay lower charges while they continue to contribute through their employer but employees who are no longer receiving employer contributions are subject to higher charges).

1.7 The FCA, the Department for Work and Pensions (DWP) and the Pensions Regulator (TPR) worked closely to design a package of measures to address the risks of consumer harm that were present at the time and prevent risks of consumer harm in the future[3]

- a cap on the charges within default funds equivalent to 0.75% per annum of funds under management
- banning firms from paying or receiving consultancy charges
- banning firms from paying commission or other charges for advice which are not initiated by scheme members
- banning differential (two-tier) charging practices.

2 At the time, it was anticipated that AE could increase the number of individuals enrolled in DC workplace pension schemes by as many as 9 million, leading to considerable growth in the value of assets invested in workplace schemes.

3 The Department for Work and Pensions (DWP) and the Pensions Regulator (TPR) made corresponding changes in respect of trust based workplace pension schemes.

1.8 In addition, the ABI agreed to set up an Independent Project Board (IPB) to oversee an audit of schemes identified by the OFT as at risk of being poor value for money: all workplace pensions sold pre-2001 and all post-2001 workplace pension products with charges over an equivalent of 1% annual management charge (AMC).

1.9 The OFT also found that competition alone could not be relied upon to drive value for money for all savers in the DC workplace pension market. The OFT concluded that good quality, independent scheme governance could help to mitigate the impact of the weak demand side of the market by ensuring continuing scrutiny of value for money on behalf of scheme members.

1.10 Consequently, with effect from 2015, our rules:

- require firms operating workplace personal pension schemes to establish and maintain Independent Governance Committees (IGCs)
- give IGCs clear duties and strong powers to act in the interests of workplace scheme members and to provide credible and effective challenge on the value for money of workplace personal pension schemes.

Introduction – non-workplace pensions

1.11 Individual, non-workplace pensions were not included in the scope of the OFT's study or the remedies that were subsequently introduced. Non-workplace pensions include individual personal pensions (IPPs), stakeholder personal pensions (SHPs) and Self Invested Personal Pensions (SIPPs) as well as Free Standing Additional Voluntary Contributions (FSAVCs), s32 buyouts, and retirement annuities. These products are described in Annex 2.

1.12 The market for non-workplace pensions is large and continues to grow. It serves a broad group of consumers seeking to save for later life: the employed, the self-employed, the unemployed and those with a wide range of other modern employment statuses. It encompasses those who have never had access to workplace pension saving and those who want to enhance their workplace pension savings with further tax efficient savings. The membership is diverse in terms of age, income, financial experience and financial sophistication.

1.13 This Discussion Paper (DP) marks the beginning of our work to diagnose whether there is harm in this market by seeking to better understand the potential presence, nature, extent and cause of any harm. Our diagnostic work will also include a focused data request to providers (concerning their products, charges and means for ensuring fair outcomes for customers) and qualitative consumer research (to examine the factors that influence consumer decisions and behaviour, before and while invested in a non-workplace pension). We want to start a discussion with industry and consumer representatives in order to better understand the market for non-workplace pensions: the providers and consumers, and the relationship between them. The responses to this paper will help focus subsequent data requests.

1.14 As a starting point, this paper poses the question of whether the harms that the OFT identified in the workplace market are present in the market for non-workplace pensions.

1.15 We recognise that there are a number of distinguishing features between the market for workplace pensions and the market for non-workplace pensions. These differences need to be taken into account when assessing the potential for consumer harm in the non-workplace pension market. However, this DP sets out why we think it possible that the weaknesses previously identified in the market for workplace pensions may exist, in whole or in part, in the market for non-workplace pensions.

1.16 We don't assume that the same FCA rules and remedies should necessarily apply to both workplace and non-workplace pensions. Rather, if harm is identified through our diagnostic work, we will develop appropriate proportionate interventions for consultation in a subsequent publication.

1.17 Please give us your insight and evidence about the factors that influence the behaviours of consumer and providers and whether the current market dynamics ensure fair outcomes for consumers. We are keen to identify the most relevant issues. Please tell us if there are any we have missed or incorrectly emphasised.

Who does this document affect?

1.18 This DP raises questions for firms who operate, and consumers who participate in, contract based personal pensions, stakeholder personal pensions and self-invested personal pensions. It may also be of interest to other participants in the pensions value chain including providers of advice and guidance, investment platforms, asset managers and discretionary fund managers.

Is this of interest to consumers?

1.19 This DP will be of interest to all consumers who have contributed to a non-workplace pension or plan to do so in the future. It is likely to be of particular interest to consumers who are or once were:

- self-employed
- not in formal employment
- employed but ineligible for workplace pension saving
- members of workplace pensions whose benefits were transferred into a non-workplace pension

Context

1.20 This paper touches on all three of our operational statutory objectives:

- consumer protection - we focus on whether consumers of non-workplace pensions enjoy an appropriate degree of protection in terms of value for money and fair outcomes

- market integrity - our aims for market integrity include working to ensure firms put their customers' best interests at the heart of their businesses[4]
- competition - whether competition in the market for non-workplace pensions is working in the interests of consumers

1.21 We want to explore whether competition is working effectively in the interests of non-workplace pension customers. We set out our initial concerns to start an open discussion with stakeholders around the distinguishing features of the market and the potential harms that may exist within it.

1.22 We will then gather further intelligence and data to better understand whether competition is working effectively and to diagnose the extent and cause of consumer harms, where harm is identified. In this case, given our existing understanding of potential weaknesses that could impact competition, we believe this a more proportionate approach than launching a full Market Study.

1.23 In particular, we:

- explain why we believe non-workplace pensions may share some of the features that were considered by the OFT to be preventing effective competition in workplace pensions
- invite evidence and discussion of whether these or other issues prevent fair outcomes and good value specifically for non-workplace pensions customers and, if so, the nature, extent and cause of any resultant consumer harm

Summary of the discussion

1.24 In this DP we:

- explain the issues identified in the workplace pension market by OFT
- acknowledge the ways in which actors and factors in the market for non-workplace pensions are different from those in workplace pensions
- explain the ways in which we consider comparable issues are more likely than not to exist, in whole or in part, in respect of non-workplace pensions

1.25 In the following chapters, we consider potential barriers to competition specific to the demand-side of the market and charges. We also explore whether or not independent governance could enhance existing governance and oversight arrangements to drive effective competition in the interest of non-workplace pension customers.

1.26 If other issues are preventing effective competition in the interests of non-workplace pension consumers, we are keen to hear from you.

4 www.fca.org.uk/about/enhancing-market-integrity

Equality and diversity considerations

1.27 Non-workplace pensions in the accumulation phase are readily available to a very wide range of consumers under the age of 75 without prejudice to those with protected characteristics under the Equality Act 2010. The age limit is a long-standing position which recognises that pensions are long-term savings products for later life.

1.28 Overall, we don't consider that the content of this DP adversely impacts any of the groups with protected characteristics ie age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.

1.29 Before 2006, eligibility for non-workplace pensions was restricted to consumers who didn't have access to workplace pension arrangements. As a consequence, consumers eligible to contribute to non-workplace pensions may have included particular concentrations of those with certain protected characteristics. We invite respondents to highlight equality and diversity issues we should consider when analysing the evidence collected and if we look to develop potential remedies.

Next steps

What do you need to do next?

1.30 We are keen to engage all interested parties and representatives from across the industry and consumer groups. We want to hear your views on the topics set out in this document. We will host a stakeholder event to launch the discussion and invite interested parties to respond to the questions in this paper by 27 April 2018.

How?

1.31 Use the response form on our website or write to us at the address on page 2.

What will we do?

1.32 After considering your feedback, we will construct and send a focused data request to providers of non-workplace pensions, to establish an evidence base from which to test the existence and scale of any problems identified.

1.33 In parallel we will undertake qualitative consumer research examining the extent to which consumers of the various different non-workplace pensions are sufficiently engaged, informed and empowered to make effective decisions about their pensions throughout the retirement savings journey. Later in 2018, we plan to publish a paper which will provide feedback on the themes arising from the responses to the DP and the data collection. If the evidence demonstrates the existence of consumer harm, we will subsequently consult on proposals to remedy this.

2 Overview of non-workplace market

This chapter provides an overview of the market for non-workplace pensions:

- size and value of the market

The non-workplace pensions market is large and growing. At least 1 in 4 adults have accumulated benefits in non-workplace pensions. We estimate £400bn assets under management are invested in these products, which is double the amount invested in DC workplace pension schemes.

- consumers in the market

The employed, the self-employed, the unemployed and those with a wide range of other modern employment statuses. The market encompasses those who have never had access to workplace pension saving and those who want to enhance their workplace pension savings with further tax efficient savings. The membership is diverse in terms of age, income, financial experience and financial sophistication.

- products available and the providers offering them

The range of non-workplace pension products has grown over time but broadly comprises three main categories: individual personal pensions, stakeholder personal pensions and self-invested personal pensions provided by life companies, investment managers, platforms and specialist operators.

- the relevant regulatory landscape:

The FCA's principles for business and handbook rules place a number of common requirements on the conduct of pension providers, workplace and non-workplace. We also regulate many of the other participants in the pensions value chain.

Non-workplace pensions

2.1 'Non-workplace pensions' is the umbrella term we are using to represent individually arranged contract-based DC pensions. It comprises three main products:

- individual personal pensions (IPPs)
- stakeholder personal pensions (SHPs)
- self-invested personal pensions (SIPPs)

2.2 For the purposes of this review, we will also include certain substitutable products such as Retirement Annuity Contracts (RACs)[5], Freestanding Additional Voluntary Contributions (FSAVCs) and s.32 buyout contracts.

5 New contracts have not been available since July 1988, but contributions may still be made to existing contracts.

2.3 The range of non-workplace pension products has grown over time in response to legislative frameworks and changes introduced by Her Majesty's Revenue and Customs (HMRC), the Department for Work and Pensions (DWP) and Her Majesty's Treasury (HM Treasury).

2.4 An explanation of the products and their evolution is included in Annex 2.

The market

New sales – an upward trend in sales

2.5 Figure 1 shows, for each of the main product types, the number of new policies that commenced in 2016. It also shows how this has changed across the previous four years.

*Figure 1: **Non-workplace pension sales 2012 to 2016***

Source: FCA Product Sales Data, October 2017

2.6 The increase in SIPPs sales follows a visible upward trend since the introduction of the Retail Distribution Review (RDR) in 2012: sales more than doubled in 2013 and continued to rise to 794,000 by 2016. The considerable increase in personal pension sales in 2015 is likely to be attributable, at least in part, to consumers switching between products and providers specifically to access the new pension freedoms introduced in 2015. The pension freedoms enable members of DC pension schemes (typically from the age of 55) to:

- take their pension savings as cash (in one lump sum or in smaller amounts over time)
- buy an annuity (or other income generating guaranteed products that may emerge)

- use drawdown without any limits applied

- use a combination of above.

Transfers and switching[6] – recent increases triggered by the pension freedoms

2.7 The introduction of the pensions freedoms appears to have triggered increased switching and transfer activity by consumers who want flexible access to their pension savings.

- Our product sales data show that 23% of all new pension premiums in 2016 were single premiums. Single premiums are likely to reflect transfers in or switches from another pension scheme.

- Research conducted by Citizens Advice[7] found that in the first year of the freedoms, 44% of those switching did so to access a product that met their needs.

- Prior to the pension freedoms, the greatest number of transfers via Origo's Options Transfer Service was from personal and stakeholder pensions (including group contracts) into annuities.[8]

- Since then there has been a marked increase in the level of switching into SIPPs. Origo's Options Transfer Service notes that between April 2015 and February 2017, 23% of transfers on its service were from IPPs to SIPPs. For the period December 2008 to April 2015, by contrast, the transfer rate was 13%.[9]

- We have seen increased demand for transfers from defined benefit (DB) to DC schemes.[10] However, we also found that the proportion of suitable cases was lower than in the wider advisory market for pensions' advice.[11] DB pensions, and other safeguarded benefits involving guaranteed pension income, provide valuable benefits so most consumers will be best advised to keep them. For these reasons, and recognising that consumers often find pension transfers complex, we consulted, last year, on revisions to our rules for firms giving advice to consumers who are considering transferring out of their DB scheme. The British Steel Pension Scheme (BSPS) is being restructured and this has prompted many members to consider if they should transfer out of a DB scheme to a personal pension scheme. We are aware of concerns about the financial advice received by members of the BSPS. Many of the actions we have taken in response to these concerns are explained on our website.[12] We continue to keep the BSPS situation under review. We plan to publish our final rules on advice to consumers in Q1 2018.

2.8 Our consumer research will explore what considerations influence consumers' decisions to switch or transfer into non-workplace pensions.

6 The FCA definition of pension transfer includes transfers from occupational schemes to personal pension or stakeholder pension schemes. Moving pension benefits from one scheme to another scheme of the same type is what we refer to as pension switching. For example, an individual moving pension benefits from one personal pension scheme to another is switching personal pension schemes.

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

8 www.origo.com/news/Two_Years_Since_Pensions_Freedoms.aspx

9 www.origo.com/news/Two_Years_Since_Pensions_Freedoms.aspx

10 Pension freedoms; record high levels of transfer values being offered; and under-funded pension schemes looking to de-risk have all contributed to an increased appetite for DB to DC transfers.

11 www.fca.org.uk/news/news-stories/our-work-defined-benefit-pension-transfers

12 www.fca.org.uk/news/statements/fca-updates-work-financial-advice-given-members-british-steel-pension-scheme

Current value of non-workplace pensions – more than double the amount invested in contract-based DC workplace pension schemes

2.9 We estimate that non-workplace pensions collectively represent around £400bn assets under management (AUM).[13] This compares with £168bn AUM in contract-based DC workplace pension schemes.[14]

2.10 Research conducted by Mintel suggests that at least 1 in 4 adults have accumulated benefits in non-workplace pensions.[15] In 2016, more than 14 million individual and stakeholder personal pensions were in force, with an average policy value of £22,000.[16] Approximately 1.7 million SIPPs were in force.[17] According to Mintel the SIPP market is diverging into two separate areas: lower-cost and lower-value platform SIPPs and full-range bespoke SIPPs. The streamlined SIPP offers investors access to a range of standard investments. The full-range (bespoke) SIPP allows the widest choice of investments - including commercial property and more esoteric investment types such as derivatives. The average streamlined SIPP is worth nearly £90,000 and the average full-range (bespoke) SIPP around £240,000.[18]

Non-workplace pensions customers – customer diversity has grown

2.11 Non-workplace pensions were originally open only to consumers who didn't have access to an occupational or workplace scheme. It is anticipated, that the majority of non-workplace pensions are held by customers who, when they first started making contributions, were:

- self-employed
- not in formal employment or without relevant earnings (for example, consumers in ill-health and / or their carers or non-working mothers)
- employed but ineligible for workplace pension schemes

2.12 The employment status of these customers may have since changed. Such changes of employment status may have prompted members to discontinue contributions, start another NWP or join a workplace pension.

2.13 Additionally, some customers only entered into a non-workplace pension because their workplace pension savings were transferred into it on ending employment with the sponsoring employer. As such, the members of these schemes may be subject to the same demand-side weaknesses the OFT identified in the workplace pension market.

2.14 Similarly, the growth in DC saving in auto-enrolment may translate to non-workplace pensions in future if, upon change of employer/employment status, consumers choose to transfer or consolidate previously accrued benefits into new non-workplace pensions.

13 This is an estimate based on Broadridge UK Defined Contribution Market Intelligence 2016 report and FCA datasets with different firm samples and reporting periods and should be treated as a guide to the size of the DC non-workplace market, not an exact measure.

14 These figures exclude trust-based DC workplace schemes (single-employer trusts, mastertrusts, & Small Self-Administered Schemes)

15 Mintel, Personal Pensions, UK, April 2017

16 Based on the FCA and PRA insurance returns submitted by top 12 providers (by mathematical reserves).

17 Rock Consultancy, as quoted in Mintel SIPPs UK December 2016 (NB: these figures do not distinguish between individual and group arrangements).

18 Mintel, SIPPs, UK, December 2016.

2.15 Tax reforms in 2001 opened non-workplace pensions to everyone regardless of their employment status, by removing the requirement for members to possess net relevant earnings: until then, anyone in pensionable employment could not contribute to a personal pension at the same time, unless in possession of additional, independent net relevant earnings.

2.16 Additionally, the Pensions A-day tax reforms in 2006 extended eligibility to contribute to consumers up to age 75. One further consequence of the combined tax reforms was to make non-workplace pensions attractive to high net worth customers for tax planning purposes.

2.17 The non-workplace pensions market takes on a particular significance given the growth in recent years of more flexible ways of working through which workplace pension saving may not be available eg self-employment (notwithstanding the testing of targeted interventions to support pension saving among the self-employed announced by the Government in December 2017), agency work, temporary work, zero hour contracts, multi-jobs and gig-economy work.[19]

2.18 Customers of non-workplace pensions span a wide range of income and wealth profiles and diverse levels of financial experience and sophistication. For example, the Taylor Review of Modern Working Practices noted "It would be wrong to treat all self-employed people the same. Like those who are employed, the experiences and vulnerabilities of this group range from billionaire entrepreneurs to taxi drivers working 90 hours a week simply to pay their bills and includes many people who are gaining income from self-employed activity alongside their main job".[20]

2.19 Non-workplace pension products accommodate the diverse backgrounds of these customers. SHPs were designed to appeal to consumers who previously considered pensions difficult to understand, expensive and inconvenient to buy. SHPs also allowed inexperienced consumers to invest without making an active investment choice. SIPPs, by contrast, were designed for wealthier entrepreneurial investors, comfortable with taking investment risk.[21]

Providers – a small number of providers dominate the market

2.20 Almost 250 firms currently hold the relevant permissions to provide pensions (workplace, non-workplace, or both) but not all of these firms will be actively using this permission at present.

2.21 IPPs and SHPs are primarily provided by life insurers. The market for these 2 products is dominated by a relatively small number of large insurance firms[22]: the top 10 providers control approximately 85% of the total market share of policies. SIPP operators comprise a mix of: life companies, investment managers, platforms and specialist operators. It is estimated that the 5 largest SIPP operators (by assets under administration) control almost 60% of the market share.[23] It is reported that around half of all SIPP operators are thought to have portfolios comprising less than 2,000

19 Categories discussed in the Taylor Review of Modern Working Practices.

20 www.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf

21 The boundaries between IPPs and SIPPs are, however, starting to blur. For example, many new IPPs (developed specifically to accommodate the pension freedoms) are now difficult to distinguish from the streamlined, platform-based mass-market SIPPs and some life insurers' personal pension offerings are now exclusively SIPPs.

22 It is not unreasonable to expect that these firms have increased buying power compared to a small provider (economies of scale are more likely to be present).

23 Mintel report, SIPPs, December 2016 (NB: these figures do not distinguish between individual and group arrangements)

SIPP accounts[24] but many of these operators offer bespoke SIPPs, which attract higher-value clients, who are fewer in number.

Regulation of providers – most FCA requirements apply to both providers of workplace pensions and providers of non-workplace pensions

2.22 The FCA (and previously the FSA) is the conduct regulator of firms operating non-workplace pensions. Together with The Pensions Regulator (TPR), we also regulate the conduct of those operating workplace pension schemes. While the FCA and TPR operate under different statutory objectives, as far as the regulation of DC workplace schemes is concerned, both the FCA and TPR are primarily concerned with ensuring good outcomes for individuals who participate in workplace DC pension schemes. In both cases it is clear who is responsible for considering the interests of scheme members.[25]

2.23 The FCA's principles for business and handbook rules already place a number of common requirements on the conduct of pension providers, workplace and non-workplace.

Systems and Controls

2.24 SYSC (Senior Management Arrangements, Systems and Controls) outlines our management requirements for firms, with the application to insurers being set out in SYSC 1.1A. SYSC focuses on the responsibilities of directors and senior management to ensure the firm has appropriate control, supervision and accountability systems in place, including appropriate operational risk systems and controls.

2.25 In addition, we recently consulted to extend the Senior Managers and Certification Regime to most FSMA firms. Under this Regime, the most senior people who perform key roles (Senior Manager Functions) will need FCA approval and new high level standards of conduct will apply to employees who do financial services activities in a firm, thereby driving up the standards of conduct we expect from those working in the industry.

Treating customers fairly

2.26 Principle 6 specifies that a firm must pay due regard to the interests of its customers and treat them fairly. Treating customers fairly (TCF) does not necessarily mean that all customers are treated in the same manner: even so, we would expect all customers to receive fair outcomes. TCF is a dynamic principle and what is considered 'fair' may evolve over time: firms should keep fairness assessments under continuous review to ensure that actions remain appropriate when tested against a current understanding of what might be fair under all the circumstances. TCF is likely to include a consideration of value for money, product performance and product charges among other things. We expect firms to set out what they consider to be fair outcomes for their customers or different groups of customers and create a clear approach for their delivery.

2.27 Additionally, where pensions are invested in With-Profits funds, the With Profits Committee (WPC) or the With-Profits advisory arrangement for smaller firms has responsibility for ensuring fairness to policyholders, managing conflicts of interest and

24 Mintel report, SIPPs, December 2016 (NB: these figures do not distinguish between individual and group arrangements).

25 www.fca.org.uk/publication/finalised-guidance/workplace-defined-contribution-pensions-guide.pdf

ensuring fair allocation of returns.[26] As part of their remit, WPCs should assess the charges incurred by the With-Profits fund.[27]

2.28 The rules and guidance in COBS 21 represent a form of product regulation for pensions invested in unit-linked funds offered by life-insurance companies. Many providers of unit-linked pension funds additionally adhere on a voluntary basis to the ABI Guide to Good Practice for Unit-linked Funds[28], which explains that TCF incorporates a number of elements including 'Policyholders' Reasonable Expectations', but is a much broader concept.

FCA expectations

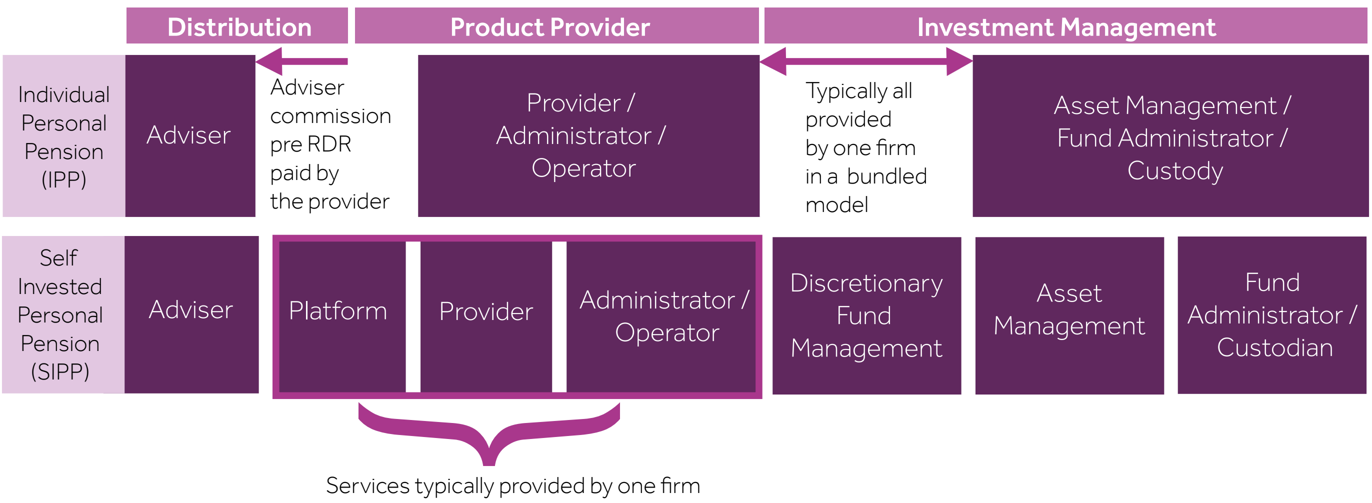
2.29 We expect providers to demonstrate that our principles and rules are embedded in their businesses and taken into account when considering new products, processes or business models. We expect boards of firms to regularly review their practices to ensure compliance with our requirements. Detailed rules within the FCA Handbook further specify what firms' responsibilities are in certain defined circumstances. For example, our handbook contains specific requirements for firms' communications with customers and requirements introduced in response to the Government's freedom and choice reforms eg the requirement to provide risk warnings and rules limiting early exit pension charges.

2.30 Industry compliance with our requirements is assumed for the purpose of this DP. Where we have specific concerns, we continue to investigate these separately.

Regulatory activity across related markets

2.31 The pension savings value chain comprises a number of industry participants beyond the pension provider. Each of these participants has an impact on how the funds that a consumer pays into their contract-based pension product translate into a pension pot, which the consumer can access in later life. We regulate financial advisers, platform providers, asset managers and other participants in the pension savings value chain.

Figure 2: ***Non-workplace pensions value chain participants***



26 With-Profits requirements are primarily set out in COBS 20.
27 A thematic review of the fair-treatment of with-profits customers was announced in our 2017/18 business plan and is currently underway.
28 www.abi.org.uk/globalassets/sitecore/files/documents/publications/public/2014/conduct/abi-guide-to-good-practice-for-unit-linked-funds.pdf

2.32 Many recent FCA initiatives assess and seek to address consumer harms and ineffective competition at the various stages of the pension savings value chain for all DC pensions, workplace and non-workplace. For example:

Advice / distribution

- **Assessing suitability review:** We have an important role to play in supporting the sector to deliver suitable financial advice to consumers. In May 2017 we published the results of our review of more than 1,100 individual pieces of advice. We found that in 93.1% of cases, the sector provides suitable advice. We will continue to communicate our findings and expectations with the sector over the coming year. We intend to repeat the review in 2019.

- **Financial Advice Market Review (FAMR):** the final report published on 14 March 2016 outlined recommendations aimed at:

  - providing affordable advice to consumers
  - increasing the accessibility of advice
  - addressing industry concerns relating to future liabilities and redress, without watering down levels of consumer protection

  The review builds on improvements made to the financial advice industry brought about by the Retail Distribution Review (RDR), which raised the standards of professionalism across the financial advice market.

- **Investment Platforms Market Study (MS17/1)**: the terms of reference published in July 2017 explained that we will explore how investment platforms compete to win new, and retain existing retail consumers, in order to assess whether we can improve competition between platforms and develop better outcomes for platform customers. Customers who access a non-workplace DC pension through a platform are within the scope of this market study.

Investment Management

- **Asset Management Market Study (MS15/2.3):** Our final report proposed an overall package of remedies to make competition work better in this market.We are strengthening the duty on asset managers to act in investors' best interest. The remedies package also seeks to enable those investors who are able, to exert greater competitive pressure on asset managers. It will increase the transparency and clarity of costs, objectives and performance so that those seeking information can get it.

Accessing pension savings

2.33 The funds that a consumer saves for later life via a DC pension (workplace and non) typically become accessible from age 55.[29] The pension freedoms have given consumers much greater flexibility over how they access their pension savings. Consequently, 'pensions decumulation' has been an area of significant regulatory attention over the last 2 years. Examples include requiring providers to

29 A consumer becomes eligible for the freedoms when he / she reaches either (a) normal minimum pension age of 55 or, in certain specific cases (b) protected pension age. Earlier payments from the fund are possible, but would be deemed 'unauthorised' for tax purposes and therefore subject to a tax charge of 55%.

deliver retirement risk warnings, undertaking retirement income data collections, introducing pension reform rule changes and capping early exit pension charges.

2.34 Most recently, in July 2016, we launched the Retirement Outcomes Review (ROR) to look at how the retirement outcome market is evolving since the introduction of the pension freedoms in April 2015. We focused particularly on consumers who don't take advice.

2.35 The pension freedoms have shifted the landscape for both savers and the pensions industry. Our research found that savers have welcomed the freedoms and made use of them to access their savings in new ways, with over 1 million pension pots accessed since the freedoms came into effect. The majority (72%) were accessed by consumers under 65, and over half (53%) were fully withdrawn. Flexible drawdown is now twice as popular as annuity purchase.

2.36 It is still early days, with both savers and the industry adjusting to the reforms. DC pension pot sizes are projected to grow over time and become a more important component of consumers' provision for retirement.

2.37 Looking to the future, there are some emerging issues that cause us concern. Competition is not working well for consumers who don't seek advice, and we have concerns about how a competitive market will develop in the future. We also have concerns that consumers who move into drawdown may struggle with the complexity of the decisions they have to make, particularly where they have not taken advice.

2.38 We have identified a range of possible remedies to address these issues. We will develop a package of potential remedies, considering whether we need to intervene at this stage, how effective any remedies are likely to be and how we can design any interventions to best manage the risks we have identified. We will do further work to assess harm that may come from consumers buying drawdown without advice. We will publish our final report in the first half of 2018, alongside a Consultation Paper on the remedies we propose to take forward.

Q1: Do you agree with our high-level description of the market? Have we omitted any significant elements or dynamics?

3 Demand-side weaknesses

In all markets, we want consumers to be able to buy the products and services they need, sold in a way that is clear, fair and not misleading. Where competition is working well, we will see confident consumers able to exercise choice. This requires consumers to have access to the information and professional support they need, and requires firms to present choices in a way that does not unfairly exploit behavioural biases.

In 2014, the OFT concluded that competition alone could not be relied upon to drive value for money for savers in the DC workplace pension market. Engagement and product complexity were highlighted as interconnected contributory factors.

In this chapter, we compare what we know about the non-workplace pension and workplace pension markets through the lenses of a range of market features:

- product complexity: most pensions are complicated products and product performance may not become apparent for many years.
- consumer engagement: behavioural biases may reduce consumer ability and motivation to engage in decisions related to their pension.
- propensity to switch: the potential loss of employer contribution cannot act as a barrier to switching for non-workplace pensions but levels of switching suggest there may be other barriers to consumers identifying and freely moving to more competitive products. We plan to use consumer research to explore this issue.
- reliance on third parties (employers or advisers): employers do not sponsor non-workplace pensions. Instead, the consumer must select the provider, the product and the investment choice. Many consumers seek regulated advice in making these decisions. We want to explore whether these differences and similarities between the two markets impact competition and consumer outcomes
- fund choice and the use of defaults: informal defaults may be operating in the market for non-workplace pensions that are not subject to the same protections as the default funds in which the vast majority of workplace pension scheme members are invested

The products are equally complex across both markets and while evidence suggests the demand-side is slightly stronger in the market for non-workplace pensions, it still points to areas of potential concern which we will test further through consumer research and data from industry.

Complexity

3.1 Financial products have little interest for many people and, for some, limitations with numeracy and literacy make many product concepts and descriptions difficult to understand. Consumers often lack motivation to invest time and effort to make informed decisions and, because of the complexity, can't easily evaluate some products.[30]

30 FCA Occasional Paper 1: Applying Behavioural Economics www.fca.org.uk/publication/occasional-papers/occasional-paper-1.pdf.

3.2 While SHPs were specifically designed to be simple, most pensions are complicated products irrespective of whether they are workplace or non-workplace. The same providers dominate the market for workplace pensions and non-workplace pensions. In design and structure, these schemes are often very similar. In fact, the most commonly used set-up of DC schemes is a group arrangement of a personal or stakeholder personal pension.[31]

3.3 It is difficult for consumers to see or assess the quality of pensions (of all varieties) and overall outcomes may not be apparent for several years. This makes decision-making difficult, exacerbates behavioural biases[32] and increases the likelihood of consumers relying on cognitive heuristics or 'rules of thumb'.

3.4 In addition, the complexity of charging structures makes it challenging for investors to compare offerings across pension providers effectively. (See chapter 4 for more on charging complexity).

Engagement

3.5 The OFT noted a lack of active member engagement in assessing the value for money of workplace pensions which, it acknowledged, could be explained by behavioural economics. As explained in our 2013 occasional paper, 'consumers are likely to find making decisions related to financial products, such as DC pensions, complex, hard, unpleasant and time-consuming, and are likely to lack motivation to invest time and effort in these decisions. This is because the benefits of saving products such as pensions accrue in the future, with consequences of bad decisions revealed only after a long delay. Furthermore, decision making is difficult as performance is inherently uncertain and it is hard to judge the quality of investments over and above the performance of financial markets.'[33]

3.6 Awareness of pension contribution levels among DC workplace pension scheme members is limited (52%, Financial Lives Survey 2017[34]). This is perhaps a consequence of the fact that employer contributions are paid directly to the fund and member contributions are deducted directly from members' salary.

3.7 By contrast, the Financial Lives survey indicates that most non-workplace pension customers (72%) are aware how much they contribute to some or all of their pensions. They are less aware, however, of how much their pension(s) is/are worth.

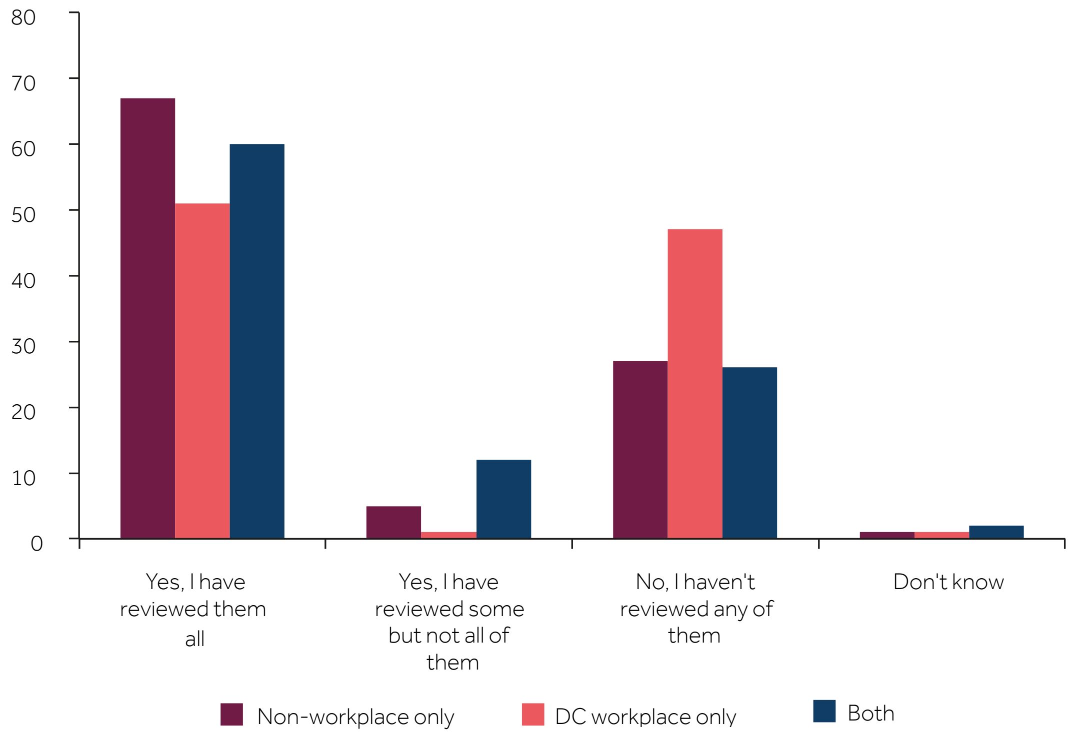
31 PLSA Annual Survey 2016

32 Behavioural biases are specific ways in which normal human thought systematically departs from being fully rational. Biases can cause people to misjudge important facts or to be inconsistent. FCA Occasional Paper 1: Applying Behavioural Economics.

33 www.fca.org.uk/publication/occasional-papers/occasional-paper-1.pdf

34 FCA Financial Lives Survey 2017: Understanding the financial lives of UK adults www.fca.org.uk/publications/research/understanding-financial-lives-uk-adults

Figure 3: ***Have you reviewed in the last 12 months how much your non-workplace pension[35] is worth?***



3.8 The survey also showed that, of those respondents who have ever reviewed where their pension is invested, similar percentages of workplace pension scheme members (69%) and non-workplace pension customers (72%) did so in the last 12 months and in both cases fewer than 10% made subsequent changes to where their pensions are invested.

3.9 Of course, levels of engagement may vary according to type of consumer or product type. For example, transfer and switching levels are generally higher in the SIPP market (workplace and non) than in the market for IPPs and SHPs. This could suggest higher levels of investor involvement and engagement, and could perhaps be expected from the 'sophisticated' investors for whom these products were originally designed.

3.10 However, it should not be assumed that all SIPP investors are 'sophisticated', active investors:

- the growth of platforms fuelled a corresponding growth in the most popular SIPPs, the streamlined SIPP. Streamlined SIPPS are often similar to more traditional personal pensions, (there was a more apparent distinction between these two products when permitted investment restrictions applied to SIPPs before 2006) and the boundary between the two is increasingly blurred.

- SIPPs have become streamlined and have experienced rapid sales growth following the implementation of RDR and, more recently, the pensions freedoms[36]

35 Described as 'DC – personal only' in the survey.

36 Streamlined/platform SIPPs account for 86% of plans, and represent the main growth area - Mintel SIPPS report, December 2016 (NB: these figures do not distinguish between individual and group arrangements).

- routes to market are increasing and reliance on advice is diminishing[37]

3.11 Investor activity in the SIPP market might also be attributable to advances in digital and platform technology. This offers investors easy online account access, through which they can obtain valuations, and access online investment tools and resources such as online share dealing service, leading to increased engagement.[38] However, it does not necessarily follow that a consumer who is technology-savvy better understands how to assess their pension than any other consumer.

Barriers to scheme switching

3.12 For competition to work effectively, consumers need to be able to assess whether their products are delivering fair outcomes / value for money and switch (free of barriers) to alternative products that offer better, more suitable outcomes, if they so choose.

3.13 The OFT noted that even if workplace scheme members considered their scheme to be poor value for money, they would be deterred from switching to a more competitive provider as, in doing so, they would lose employer contributions to their scheme. No such structural barrier exists for non-workplace pensions customers who are free in principle to switch funds and / or providers.

3.14 Moreover, in the absence of employer contributions[39], customers of poor value non-workplace pensions may face a greater incentive to switch to a more competitive fund or provider than members of workplace schemes whose employer's contributions can minimise the impact of a poor value workplace scheme on net returns.

3.15 Non-workplace pensions customers may, however, face other barriers to accessing more competitive funds, products or providers (see chapter 4). Our Financial Lives Survey 2017 showed that, of those respondents who have ever reviewed where their pension is invested, similar percentages of workplace pension scheme members (69%) and non-workplace pension customers (72%) did so in the last 12 months. In both cases fewer than 10% made subsequent changes to where their pensions are invested.

3.16 It is hard to know whether this level of switching is appropriate or signifies a lack of engagement and, ultimately, consumer harm. We will investigate this further.

3.17 Our consumer research will examine if and how consumers know whether they would be better off switching funds, products or providers, and whether this knowledge informs their actions.

3.18 The FCA's Business Model and Sector Analysis on SIPP and Platform providers in 2015 identified potential issues with both the timeliness and quality of communication for transfers and re-registrations, prompting industry to establish the Transfers and Re-registration Industry Group (TRIG).

37 Many streamlined SIPP products can be bought by consumers without advice, usually transacted online, typically via a platform - Mintel SIPPS report, December 2016 (NB: figures do not distinguish between individual and group arrangements).

38 Switching between SIPP providers is rare, however - Mintel SIPPs report December 2016 (NB: figures do not distinguish between individual and group arrangements).

39 While it is permissible for employers (and others) to make contributions to a non-workplace pension scheme, this is not standard practice.

3.19 We welcome industry endeavours to improve competition for the benefit of consumers who want to switch providers. We await the delivery of TRIG's next steps[40] for improving the ease and timeliness of transfers between providers. Their proposals are to:

- create clear service expectations for pensions and investment transfers/re-registrations
- publish service level management information
- address significant process improvement opportunities
- create common industry standards and good practice guidelines
- introduce an independent governance and oversight body

Principal-agent problem

3.20 Additional factors led the OFT to deem the buyer side of the DC workplace pensions market one of the weakest it had analysed. The employer, rather than scheme member (employee), selects the scheme but:

- the employer may lack the capability and/or the incentive to ensure that members of their schemes receive long term value for money
- the risks and rewards of the employer's decisions are borne by the employee

3.21 The same dynamic doesn't exist in the market for non-workplace pensions. Most non-workplace pensions customers must actively decide to join a pension scheme, suggesting that at the point of sale they understand and appreciate the merits of saving for retirement via a pension. This understanding may have been reached independently, or with the help of an adviser as part of the sales process.

3.22 It does not necessarily follow, however, that these customers are inherently better placed than members of workplace pensions to engage with their pension throughout the rest of their retirement saving journey.

3.23 In the market for non-workplace pensions, providers would have been incentivised to make products attractive to the target consumer and/or distributors, as opposed to employers. We would like to understand to what extent consideration of long term outcomes and value for money influenced product design.

3.24 The relationship between the customer and the provider is contractual, providers have responsibilities to ensure the products they are selling are fit for purpose and take account of the needs of their target market. As stated in the Regulatory Guide on The Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD)[41], and in line with Principle 6, we expect firms to periodically review a product to check that it still meets the general needs of its target audience.

40 www.abi.org.uk/globalassets/files/publications/public/lts/transfers-and-re-registrations-progress-update-100817.pdf
41 www.handbook.fca.org.uk/handbook/RPPD/link/?view=chapter

Use of advisers

3.25 Historically, the vast majority of non-workplace pensions were sold with regulated advice.[42] However, over the last 5-10 years, the reliance on advice has declined, owing to:

- technological developments supporting the rise of investment platforms
- the implementation of the Retail Distribution Review in 2012 (after which advice could only be charged as either an upfront fee or deducted from the amount invested, rather than indirectly via commission).

3.26 Nevertheless, advice continues to be significant in this market: our product sales data indicate that in the last 2 years, around 40% of new sales were advised. In respect of such advised sales, our assessing suitability project recently found that the advice sector made suitable recommendations in 93% of cases (which included pensions advice cases).

3.27 However, acting upon a personal recommendation from a qualified financial adviser does not prove that the consumer has any particular level of investment experience or knowledge. Rather, it may suggest that the consumer recognises that the complexity of the product(s) may exceed their level of knowledge or comfort. Reasons offered for choosing to take advice included: a lack of own knowledge about the products on offer; the adviser's ability to provide a recommendation on both performance and suitability; and, their ability to trust the adviser.[43] In 2014, research we commissioned found that while 65% of investors are willing to save for a 'rainy day' without taking advice, 81% would seek advice in relation to starting a pension and 83% in relation to planning for retirement.[44] Delegating decision-making to a more skilled individual at the point of sale might therefore indicate that the customer is less likely to independently engage with pension considerations for the remainder of the product term.

3.28 While suitable advice at the outset should minimise the risk of consumers incurring poor outcomes in the foreseeable future, one piece of financial advice at the point of sale may not necessarily ensure that the pension remains good value throughout the saver's lifetime:

- Since the introduction of RDR, advisers have the option to receive ongoing adviser charges in return for providing ongoing services to their clients. However, not all personal recommendations result in the provision of continuing adviser services (or are part of existing ongoing arrangements).
- Advice given before the Retail Distribution Review was often commission driven so the incentives of the adviser and the consumers were not always aligned.[45]
- The 'set and forget' mentality is common among pension customers.
- Consumers may be unaware of the need to monitor their pension, trusting that the advice given at the outset remains appropriate.

42 Although an employer might take advice in respect of a workplace scheme, that advice is not regulated.
43 www.fca.org.uk/publication/research/fsa-crpr84.pdf
44 Impact of the Retail Distribution Review on consumer interaction with the retail investments market: a quantitative research report, NMG, September 2014: www.fca.org.uk/publication/research/impact-of-rdr-consumer-interaction-retail-investments-market.pdf
45 A review of advice on personal pensions (and FSAVCs) between 1988 and 1994 was set up by our predecessor the FSA.

3.29 One of the issues our consumer research will explore is the extent to which consumers who enter into a non-workplace pension scheme without advice, shop around before doing so. It will also examine what features these consumers compare when shopping around and the extent to which an adviser was involved in or influenced these decisions, and why.

Fund choice

3.30 The OFT noted that one element of the demand-side weakness in the workplace market stemmed from the employer, rather than the employee, making the scheme selection. This also removes some of the choice complexity from the members of these schemes.

3.31 While the choice of scheme may be restricted by the employer, members of workplace pension schemes have some degree of choice between fund managers once a scheme has been selected and can switch their investments into lower charging or higher performing funds, where available, through their scheme.

3.32 In 2016, the median number of different funds available to contract-based DC workplace pension scheme members was 57 but 92% of members (a heterogeneous population in terms of age, wealth, and financial experience) nevertheless invested in the default fund.[46] We suspect this is not only a consequence of defaulting consumers into pension saving through auto-enrolment, but may also be symptomatic of consumers':

- limited ability to make strategic investment decisions that suit their needs and preferences
- susceptibility to behavioural biases such as choice overload and default biases[47]

Use of default funds

3.33 In workplace pensions, members invested in default funds do not need to review their funds to make sure they are value for money: the provider must comply with the cap on charges and the Independent Governance Committee (IGC) will assess the scheme and challenge the provider in relation to value for money. Even if better investment returns may be available through other fund choices, members of workplace pension schemes, whether engaged or not, benefit from IGCs challenging value for money on their behalf.

3.34 These protections do not extend to non-workplace pensions. Non-workplace default funds for customers that do not want to make an investment choice are formally only available in stakeholder personal pensions which are already subject to the protections and constraints in the stakeholder regulations. However, our rules in respect of default funds in auto-enrolled workplace schemes explicitly recognise that a fund can operate as a default even if it is not labelled as such.[48]

46 PLSA Annual Survey 2016

47 Occasional Paper 1 found that when faced with complex decisions, individuals often tend to put off making a decision or accept the status quo.

48 An arrangement, into which at least 80% of the scheme is invested, is deemed a default arrangement.

3.35 Due a number of factors such as lack of engagement, confusion and specific labelling used, we suspect that de-facto defaults operate in the market for non-workplace pensions and these defaults are not subject to the protections mentioned above:

- In response to our recent Financial Lives survey 2017, 35% of consumers whose only pensions are non-workplace indicated they had made an active investment choice. 41% claimed they didn't choose where their pension contributions are invested, 14% did not know and a further 11% claimed to have actively opted into the default fund (though it is unlikely this was formally recognised as a default fund). In all of these cases, it is possible that the fund selection may have been made on the recommendation of an adviser

- For several years, 'lifestyle' options have been available on non-workplace pensions other than SHPs. Lifestyling involves the provider switching pension funds from riskier assets to less risky assets as a means of locking-in investment growth as the consumer approaches their expected retirement date. While not as common as in workplace pensions, where it is typically a feature of formal default strategies, the selection of a lifestyle option when entering into the contract for a non-workplace pension might lead a consumer to conclude no further engagement is required and that the only relevant investment changes will be undertaken by the provider without any further input from the consumer.

- By virtue of the label or description given to them by the provider, certain funds have the potential to be perceived by consumers as defaults. Research on the motivation, needs and drivers of non-advised investors[49] found examples of personal pension customers interpreting 'balanced' as synonymous with 'mainstream', 'popular' and/or 'low-risk'.

3.36 To test our hypothesis and concerns, we plan to collect data from industry concerning non-workplace pensions for which consumers have elected lifestyle options. Our consumer research will explore consumers' perceptions of fund labels and the existence of defaults.

Q2: **Do you have any comments, observations or evidence about engagement levels among non-workplace pensions customers?**

Q3: **Do you have any comments, observations or evidence about the factors that influence consumers to switch between or transfer into non-workplace pensions?**

Q4: **Do you have any comments on the impact of regulated advice on consumers' ability to understand and assess their pension throughout the product lifecycle?**

Q5: **Do you have any comments about whether certain funds are seen by consumers as default arrangements and whether these should be subject to additional standards and protections?**

49 This research was conducted for the FCA by NMG consulting in June 2014, www.fca.org.uk/publication/research/non-advised-investors-research-paper.pdf.

Q6: **Do you consider that demand-side weaknesses are present in the market for non-workplace pensions? Do they apply across the market or are they specific to particular consumer groups, products or sales channels?**

4 Charges

In all markets, we want good value products and services that meet consumers' needs. Where competition is working well, we will see firms winning business by making the best offer to consumers and delivering it. If firms can't win business by offering better value, they have less reason to cut prices, improve quality or innovate. If there is weak competition at any level, it is typically the consumer who ends up paying as firms pass on higher costs.

In 2013, the OFT identified reduced competition on charges in workplace pensions, which it attributed to charging complexity and the difficulty of comparing charges in a market with demand-side weaknesses.

In response to these findings, we introduced the following measures to workplace pensions:

- a cap on default fund charges in auto-enrolment schemes
- a ban on differential charging (ie a practice of applying higher charges to customers who are no longer contributing to their pension)
- an independent audit of charges on pre 2001 workplace schemes was also conducted

In this chapter, we look at:

- some of the charges that non-workplace customers incur (for example, AMCs, paid-up and exit charges)
- whether providers are competing on charges (we highlight in particular that fund charges on pre-2001 policies may be higher than on more recent versions of the same fund)
- whether there are barriers to consumers identifying and choosing from more competitive products (for example, because of difficulties identifying and comparing charges).

After assessing the responses to this DP, we will collect further data from providers and operators to better assess the prevalence, level and impact of the various charges.

The impact of charges

4.1 The value of the pension savings available to a consumer in later life depend on a number of factors, notably:

- the value and volume of contributions
- the investment performance of the pension fund
- the charges levied by the pension provider[50]

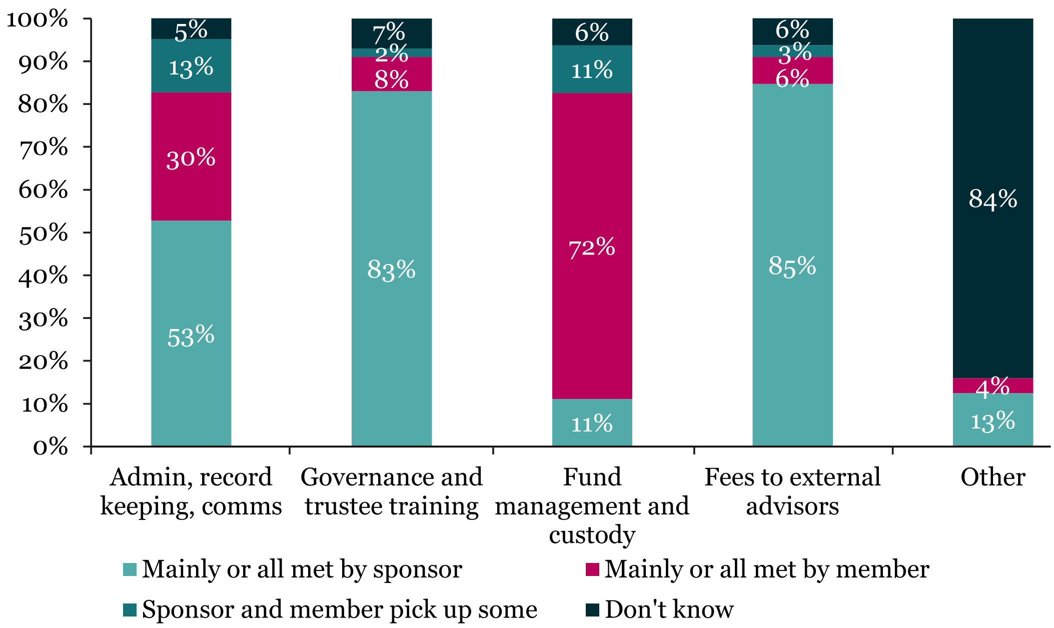
50 Taxation is another influencing factor and one which may change over time: tax relief on contributions, taxation of fund and taxation of benefit. Taxation is a matter of government policy and not directly influenced by the behaviour of pension providers or customers.

4.2 While we can't directly influence how much consumers pay into their pension, we have an important role to play in making sure that consumers can be confident that the contributions they pay in will deliver good outcomes and value for money.

4.3 Charges are certain but investment performance is unpredictable. Evidence from our recent Asset Management Market Study suggests there is no clear relationship between charges and performance – expensive funds do not necessarily perform better than less expensive funds. Charges will always act as a drag on performance and reduce what investors actually receive. At its most extreme, where charges are high, fund values are small and investment returns don't keep pace with deductions from the fund, charges that continue after contributions cease to be paid have the capacity to erode the value of the pension pot completely.

4.4 The costs associated with non-workplace pensions are typically borne exclusively by the customer whereas, the PLSA Annual Survey 2016 revealed that the costs in some workplace DC pension schemes might be borne completely or partially by the sponsoring employer (see figure 4). The OFT also noted that, in some cases an employer scheme might be able to negotiate lower charges due to economies of scale.

Figure 4: DC workplace pension scheme cost-bearers[51]



Base: 144 respondents

Competition on charges

4.5 Workplace and non-workplace pensions share a similar charging history. A variety of charging structures can apply, some of which can date back more than two decades and span multiple tax regimes.[52] The charges within these structures can vary in name, type, calculation methodology, frequency and purpose.

51 PLSA Annual Survey 2016, figure 32
52 The intent behind the 2006 tax reforms was to simplify the preceding eight regimes.

4.6 Since 2001, the charge common to most DC pensions is the annual management charge (AMC).[53] Broadly speaking, the AMC covers the cost of administering the scheme and investing contributions. The AMC may vary according to the fund in which the scheme is invested. In an efficient market, the AMC is likely to be the charge on which firms are most likely to compete, but we need to collect further data to determine whether this is happening in practice.

4.7 The AMC on a fund can vary depending on the route of access (eg bundled life company charge versus unbundled SIPP/platform charge) and the time at which the contract was entered into. As a result, customers in older pension schemes may be paying higher charges for funds that are now available at a lower cost, acting as a drag on performance when compared to more modern contracts invested in the same fund.

4.8 We are concerned that some older personal pensions may have a relatively high AMC when compared to modern versions of the same fund (bundled or unbundled), even within the same firm/scheme. In such cases, if the provider doesn't reduce charges in line with a modern version of the same fund, customers can only benefit from lower charges if they switch fund, product or provider.

4.9 Customers will only be incentivised to switch if they know they can get better value elsewhere. A considerable share of recent switches and transfers were made primarily to avail of the pension freedoms. We need to investigate to what extent, if any, consumers are switching to benefit from more competitive charges.

4.10 Through this project we would like to understand the level of AMC charges on non-workplace pension funds, including to what extent and why they differ from the AMC on workplace funds, particularly where the same funds are available in capped workplace schemes and stakeholder schemes:

- the AMC on stakeholder (group and personal) pension plans is capped at 1.5% per year for the first 10 years and 1% thereafter
- £24.9 bn of pre-2001 workplace pension schemes (contract and trust based) now incur an AMC of 1% or less[54]
- since April 2015, charges within default funds of qualifying auto-enrolment schemes are capped at 0.75% per year of funds under management

4.11 We will collect data from industry to investigate this issue and welcome any additional comments.

Stakeholder pension charges

4.12 In March 1999, the Personal Investment Authority (PIA) issued RU64 to guide firms in the lead-up to the introduction of SHPs. RU64[55] reminded firms that, when making recommendations about personal pensions to consumers, they must take account of the advantageous terms available under SHPs. It created an environment where the SHP, even before its introduction, was the benchmark personal pension product with many non-stakeholder contracts adopting stakeholder-like charging structures.[56]

53 The introduction of single-charge (AMC) stakeholder pensions in April 2001 prompted the industry to move towards an AMC based structure.

54 www.fca.org.uk/news/news-stories/further-success-reducing-pension-funds-costs-charges

55 RU64 no longer has any regulatory status. However, the requirement to take account of SHPs when selling a personal pension became an established standard and has been carried forward into COBS 19.2.2R (1).

56 Thereby making it easier for firms to demonstrate that other pensions are at least as suitable as SHPs.

For a period of time, consumers benefited from lower prices because of stakeholder pensions and the RU64 rule. We are concerned that this may no longer be the case as more competitive products may have emerged outside the SHP structure.

4.13 From December 2001, legislation[57] required employers with 5 or more employees to provide them with access to a SHP. This requirement has since been superseded by auto-enrolment. Charges on the default fund in a qualifying auto-enrolment scheme are now capped at 0.75% of funds under management per year. SHPs remain available as individual arrangements subject to the original charge cap of 1.5% per year for the first 10 years and 1% thereafter. The stakeholder regulations continue to apply to both individual and group SHPs, but existing group SHPs are now also within the scope of IGCs' value for money assessments.

4.14 We will collect data about SHP charges to work out the extent to which the SHP charge cap now influences the charges on new and existing policies. We note that, in giving evidence to the Work and Pensions Select Committee on Improving Governance (2013), the then Minister for Pensions, Steve Webb, noted that the 1.5% cap imposed on charges for stakeholder pensions "seemed reasonable at the time but would now be considered a ridiculous level, given the current downward trajectory of charges".

4.15 We don't have the power to amend the cap contained within the stakeholder regulations; these are the responsibility of Government under powers granted by Parliament. However, if we identify that the funds in SHPs are available through auto-enrolment or lower charging non-workplace pension plans, we may need to consider whether COBS19.2.2R(1) (which requires the adviser to explain why the personal pension scheme is considered to be at least as suitable as a stakeholder pension scheme) remains appropriate, taking into account the other features assured by the SHP regulations.[58]

Paid-up and exit charges

4.16 The OFT found that members paid lower charges while they continued to contribute through their employer, but were subject to higher charges when contributions stopped (ie when members left the employment of the sponsoring employer). The OFT found that this differential charging prevented any competition on headline AMCs from benefiting these 'deferred' members of workplace pension schemes.

4.17 Consequently, differential charging practices based on contribution status[59] have been banned in workplace pensions schemes used for auto-enrolment (AE qualifying schemes) since April 2016.

4.18 A form of differential charging can be found in the market for non-workplace pensions in the form of 'paid-up' charges. A policy is made paid-up when a customer stops paying premiums before the end of the term but doesn't cancel or surrender the plan.[60] These charges typically take the form of either a one-off reduction in fund value or an increase in ongoing charges.[61] Paid-up charges are primarily designed to ensure the recovery of initial commission costs paid by the provider.

57 The requirement was laid down in the Welfare Reform and Pensions Act 1999 but the detailed legislation is set out in The Stakeholder Pension Schemes Regulations 2000.

58 Stakeholder pensions must meet minimum standards set by the government. These include: charge-free transfers, penalty-free contribution flexibility, low minimum contributions, a default investment fund and lifestyling strategy.

59 This is the practice of charging different AMCs to active and deferred members.

60 Where premiums are reduced rather than ceased this is sometimes referred to as being 'partially paid-up'.

61 A less typical form was an ongoing charge which remained level but was taken for a longer period.

4.19 As at 30 June 2015 there were more than 6.5 million paid-up unitised pension policies, both workplace and non-workplace, on the books of 25 life insurers. In an efficient market, non-workplace pensions' customers who incur paid-up charges could be expected to switch into newer, more competitive schemes to avoid the erosive effect of paid-up charges. However, it is unlikely that consumers who no longer pay contributions to a policy remain engaged with it.

4.20 Additionally, the FCA's Thematic Review of the fair treatment of long-standing customers in the life insurance sector (TR16/2) found that exit charges often apply to life insurance policies that attract paid-up charges. It cited a specific example where the AMC on a pension increased by 6% when the policy became paid-up and, 22 years later, an exit charge reduced its value by more than 50%.[62] To determine the current prevalence and impact of paid-up and exit charges on non-workplace pensions, we will gather further data from industry, for example the number, value and age of policies affected by these charges, as well an explanation of when the charges apply and details of how and why the charges are calculated.

4.21 We understand that over the last two years, life companies have been considering whether these two forms of charges remain appropriate and some firms have announced changes to their charging approaches for products, including non-workplace pensions.

4.22 We anticipate our data collection will find that the number of paid-up policies has reduced as a consequence of consumers accessing the pension freedoms (over 1.5 million of the 6.5 million policies were held by consumers eligible to access the freedoms) and steps taken by providers following the publication of TR16/2. However, some of this reduction may have been offset by newly auto-enrolled consumers ceasing contributions to an existing personal pension.[63]

4.23 In addition, a further reduction in the number of paid-up policyholders may have flowed from the introduction of the cap on 'early exit pension charges'[64], with effect from 31 March 2017. This cap may have reduced the number of paid-up customers who are deterred from seeking more competitive products.

4.24 We also believe that awareness of paid-up charges should have increased in response to actions taken by firms responding to the guidance we issued in December 2016 (Finalised Guidance FG16/8: Fair treatment of long-standing customers in the life insurance sector)[65]. The guidance re-emphasised our expectations under Principle 7 and clarified that, within the context of closed-book customers, firms should:

- provide regular communications consistent with the customer's needs
- include, for example, sufficient and clearly explained details regarding the performance of the product, its value and the impact of fees and charges

62 TR16/2 paragraph 3.46
63 PS11/08, paragraph 3.10.
64 Early exit charges are defined in legislation. In summary, these are charges imposed on the members of group and individual personal and stakeholder personal pensions, when accessing the pension freedoms, on or after the age at which they become eligible to do so but before their expected retirement date (ie the vesting date).
65 www.fca.org.uk/publication/finalised-guidance/fg16-8.pdf

4.25 Your responses to this DP and the data we will subsequently collect will give us a better understanding of how these charges currently impact consumers and any potential for harm.

Charges on policies sold before 2001

4.26 2001 marked the launch of SHPs. The only charge permissible on these schemes is a single AMC. The stakeholder regulations cap the level of AMCs on SHPs.[66] The introduction of SHPs prompted providers of other pensions (workplace and non-workplace) to also adopt a single AMC structure.

4.27 The OFT noted that charges for contract-based workplace schemes sold before 2001 are extremely complicated and vary from provider to provider. In addition to AMCs, other charges and charging structures might include (but are not limited to):

- up-front deductions (the 'allocation rate' and the initial 'bid-offer spread')
- initial units[67] and accumulation units
- 'product management' fees
- policy fees

4.28 In response to OFT's findings, the Association of British Insurers (ABI) established an Independent Project Board (IPB) to oversee an audit of legacy schemes at risk of delivering poor value for money. The IPB undertook a comprehensive assessment of charges and found that approximately 1.5 million customers were potentially exposed to costs and charges of more than 1%. Since the publication of the IPB audit of legacy charges, actions taken by the FCA, the DWP and pension providers, together with IGCs and trustees, have resulted in members incurring lower costs and charges on workplace pension schemes with assets worth £24.9bn.[68]

4.29 Many providers of pre-2001 workplace schemes also provided non-workplace pensions over the same period. Some of these firms have confirmed that their charging structures were the same or similar for both.[69] This would suggest that non-workplace pensions sold during this same period are also at risk of delivering poor value for money.[70]

4.30 We would like to understand:

- to what extent the charges on pre-2001 policies remain at pre-2001 levels in non-workplace pensions
- why providers consider the charges appropriate for non-workplace pensions

Transparency and comparability of charges

66 AMCs must not be more than 1.5% per year for the first ten years of scheme membership and thereafter not more than 1%.
67 Initial units are also known as 'capital units'.
68 www.fca.org.uk/news/news-stories/further-success-reducing-pension-funds-costs-charges
69 Disclosed to the FCA during the legacy audit progress review.
70 Employer buying power and lower distribution costs for group pensions mean that (particularly over the last 10 years) large and medium-sized employers can usually secure lower charges than individuals for the same product.

4.31 Engaged pension savers need to be able to find information about costs and charges so that they can satisfy themselves that they get value for money from their pension, and that their pension will meet their needs in later life.

4.32 In the workplace market, the OFT concluded that a number of factors had the potential to weaken price competition, and to prevent some scheme members from benefitting from price competition:

- the complexity of charging structures makes it difficult for members to compare offerings across pension providers effectively
- lack of transparency of charges, makes it difficult for members to assess whether funds are good value for money

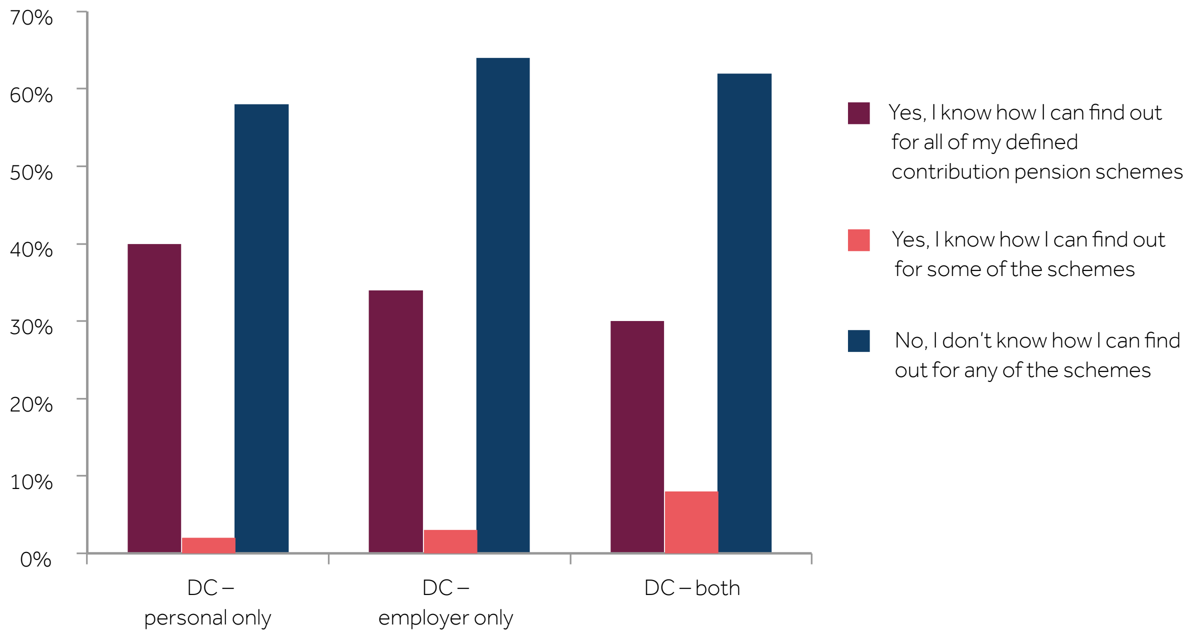
4.33 Improving the clarity of investment related charges has been a priority not only for the FCA (disclosure remedies have been recommended by a number of recent FCA market studies) but also the European Commission – contemporary directives which address these issues include the revised Markets in Financial Instruments (MiFID II) Directive and Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation.

4.34 Notwithstanding that disclosure of charges in related markets in the value chain has and will improve as a result of these initiatives, we would like to explore whether, at a product level, the factors identified in the workplace market might also be present in the market for non-workplace pensions.

4.35 FCA COBS rules require the disclosure of charges at the point of sale, via a key features illustration. However, the visibility of such charges to consumers over time may be minimal, particularly as they are deducted from the fund value (rather than invoiced for payment).

4.36 Our Financial Lives Survey found that 58% of non-workplace customers were not aware of the charges on their pension. The survey also indicated that workplace pension scheme members and non-workplace pensions customers were similarly unaware of how to find out about the charges on their pensions (see figure 5).

Figure 5: ***Do consumers know how to find out what charges they might pay?***



4.37 Consumers of both workplace and non-workplace pension schemes receive an annual statutory money purchase illustration (SMPI). This is the statutory minimum level of information a firm should share with their customer. According to our Financial Lives Survey, SMPIs in respect of both DC workplace and DC non-workplace pensions are understood by the majority of recipients who read them (87% personal only, 75% employer only, 79% both).

4.38 For non-workplace pensions, the SMPI shows projections net of charges, but the specific charges and their level may not be disclosed, so that even consumers who read and understand their statements may find it difficult to assess their pension in relation to others that might be available to them.

4.39 In 2013, the ABI introduced a voluntary charges disclosure agreement requiring signatories to annually disclose to employees in workplace pension schemes the total charges taken in the previous year, in £, where reasonably practical. There is no such agreement in place for individual pensions, so not all providers include charging information in annual statements for non-workplace pensions.

4.40 Comparability can be particularly difficult for consumers as not all policies have the same charges. Old policies feature numerous charges with limited consistency between providers in how they are explained or calculated. Since 2001, the AMC has been the predominant charge in schemes adopting a bundled charging structure[71] (typically IPPs and SHPs), but other charges can apply. These can't be compared on a like-for-like basis with charges on SIPPs. SIPPs more typically adopt an unbundled charging structure where charges are explicit and activity driven eg fees each time a trade takes place.

Effective communication of charging information

4.41 SMPIs are not the only information that firms share with their customers. If additional information is given, firms must have due regard to the information needs of their customers, and communicate in a way that is clear, fair and not misleading.[72]

4.42 Consumers can best assess the quality of a product or service and if it meets their needs when they know its key benefits and features. It is for firms to determine the information needs of their customers, both on a regular and ad hoc basis, so that customers have a clear understanding of how their product is performing and its benefits, risks and costs, to help them make informed decisions about their pension.

4.43 As explained in our Smarter Consumer Communications Discussion Paper[73], simply giving cost information doesn't necessarily empower consumers to make effective decisions. For charges, we highlighted our concerns that consumers may:

- pay more than they expect because of the opaque nature of some costs
- not appreciate the full suite of costs a product or service can attract over its lifetime
- be unable to identify how costs described as 'fees' and 'charges' differ from each other in terms of operation and effect, if at all

71 The provider factors in all assumed costs over the term based on assumptions about consumer behaviour and premium payment pattern.
72 Principle 7 of the FCA Principles for Business.
73 www.fca.org.uk/publication/discussion/dp15-05-smarter-consumer-communications.pdf

- find it difficult to compare total costs

4.44 We have published a number of Occasional Papers concerning effective communications in financial services, which present our own research and summarise developments and theories in behavioural science. Through these, we have found that more effective communications tend to be easy to read and understand, use behavioural insights to attract attention and be presented in a timely way. This could include, for example, expressing costs as £ amounts rather than percentages, which are more cognitively taxing to calculate; breaking up and simplifying large amounts of text; using colour, font and size to attract attention; and appearing at a stage in the consumer journey when the customer is attentive, but before they are psychologically invested in the product.

4.45 We also know that context is very important. It is desirable to test how consumers understand and respond to different versions of communications before launching them for all customers as well as to consider other ways to increase consumer understanding.

Q7: **Do you have any comments or evidence relating to our discussion of SHPs?**

Q8: **Can you provide any relevant comments or evidence relating to charges on pre-2001 policies?**

Q9: **How might we and industry improve non-workplace customers' awareness of the charges they may or will incur and the impact of those charges on their pension savings?**

Q10: **Do you have any comments on how industry might better support consumer choice (including monitoring and identifying when it might be appropriate to switch to a more competitive product and / or provider)?**

Q11: **Can you provide any evidence or examples of where competition is not working well on non-workplace pension charges (applicable across the market or specific to particular products)?**

5 Summary and next steps

5.1 This paper asks you to give us your insight on:

- the factors that influence the behaviours of consumers and providers of non-workplace pensions; and
- whether the current market dynamics ensure fair outcomes for consumers.

5.2 The responses you provide to the questions in this paper will help us better understand whether competition is working well in the market for non-workplace pensions, the existence of harm and our thinking of appropriate interventions as necessary.

5.3 Competition is most effective when consumers are able to judge which products offer the best value and reward firms with their business. This applies pressure on firms who know that their customers could move easily if their products and services are not good enough.

5.4 However, while we have regard to the general principle that consumers should take responsibility for their choices and decisions, we know that there are factors that might limit their ability to do so. In the context of the non-workplace pensions market, we think it possible that the weaknesses previously identified by the OFT in the market for workplace pensions may exist, in whole or in part, in the market for non-workplace pensions.

5.5 In the earlier chapters of this paper, we outlined areas of potential concern relating to the demand-side of the market and the charges that apply to non-workplace pensions, alongside the reasons for our concerns. But we have not yet reached any conclusions. To do so, we need to test our theories against current industry evidence and feedback from other relevant stakeholders. This paper marks the first step in the process. Your responses will help us ensure that we focus on the appropriate issues and subsequently collect the relevant evidence to assess the potential for harm.

5.6 We do not assume that the same FCA rules and remedies should apply to both workplace and non-workplace pensions. Rather, if and where there is evidence of harm, we will develop appropriate proportionate interventions for consultation in a subsequent publication. We would nevertheless be interested in starting the discussion on the scope and limitation of applying similar remedies to non-workplace pension schemes.

5.7 The majority of remedies we introduced to address the risks of harm identified by the OFT in the market for DC workplace pensions related to charges:

- a cap on the charges within default funds; and
- bans on a) the payment or receipt of consultancy charges; b) commission payments or other advice charges which are not initiated by scheme members and c) differential (two-tier) charging practices.

5.8 However, we adopted a wider reaching approach to mitigate the risk of poor outcomes arising from the combination of demand-side weaknesses and weak charge competition. With effect from April 2015, our rules have required firms operating workplace personal pension schemes to establish and maintain Independent Governance Committees. These rules give IGCs clear duties and strong powers to challenge providers on value for money issues.

5.9 Assessing whether actions taken by firms were sufficient to address any IPB recommendations for industry-level actions was one of the IGCs' initial priorities. In this respect, our Legacy Audit Progress Review[74] found IGCs to be generally effective, and acting in accordance with their Terms of Reference, by influencing, supporting and advancing the reduction in costs and charges incurred by customers of workplace pension schemes with assets worth £24.9bn.

5.10 More recently, our Asset Management Market Study proposed a role for independent governance in addressing harms identified in a market where consumers are not well placed to exert competitive pressures.

5.11 We welcome views, in the event harm is identified, on whether independent governance could play a role in delivering fair outcomes for non-workplace customers by enhancing providers' existing governance and oversight arrangements and thereby drive better outcomes for non-workplace customers.

Q12: We would like to understand whether and how providers' oversight arrangements differ between workplace and non- workplace pensions.

Q13: We would like to hear views on the merits of enhancing oversight arrangements for non-workplace pensions in the event that harm is identified.

5.12 Equally we welcome views on the extent to which any of the other interventions introduced in the DC workplace market have the potential to improve effectiveness of competition in the interests of non-workplace pension customers.

Q14: In the context of the potential harms in this market, are there any other interventions that you think we should consider? Please explain what the impact might be and why such remedies would be appropriate.

Next steps

5.13 Over the next three months, we invite feedback to the ideas in this paper and responses to the questions it contains. The deadline for responses is 27 April 2018.

5.14 Qualitative consumer research will be undertaken during the discussion period to examine the drivers and behaviours specific to non-workplace pension customers and whether these vary according to the product in which the customer is invested.

74 www.fca.org.uk/publication/research/remedying-poor-value-legacy-workplace-pension-schemes.pdf

5.15 After we have considered the responses to this paper, we will issue a data collection request to the industry. Throughout this paper, we have highlighted some of the areas the request is likely to cover, most particularly relating to a) the charges that apply to non-workplace pensions; and b) whether and how value for money and fair outcomes for non-workplace pension customers are addressed by providers' oversight arrangements.

5.16 Towards the end of the year, we aim to publish a further paper which will provide feedback on the themes arising from the responses to the DP and the data collection. It will also include consultation proposals if the evidence we gather demonstrates harm to consumers.

5.17 In this paper, we outlined the measures introduced to address harms in the workplace market. We welcome comments on the scope and limitation of applying similar remedies to non-workplace pension schemes but we do not assume that the same FCA rules and remedies should apply to both workplace and non-workplace pensions. Rather, that if and where there is evidence of harm, appropriate proportionate interventions will be developed.

Q15: **Do you have any other comments on the matters discussed in this Discussion Paper?**

Annex 1
List of questions

Chapter 2 – Overview

Q1: **Do you agree with our high-level description of the market? Have we omitted any significant elements or dynamics?**

Chapter 3 – Demand-side weaknesses

Q2: **Do you have any comments, observations or evidence about engagement levels among non-workplace pensions customers?**

Q3: **Do you have any comments, observations or evidence about the factors that influence consumers to switch between or transfer into non-workplace pensions?**

Q4: **Do you have any comments on the impact of regulated advice on consumers' ability to understand and assess their pension throughout the product lifecycle?**

Q5: **Do you have any comments about whether certain funds are seen by consumers as default arrangements and whether these should be subject to additional standards and protections?**

Q6: **Do you believe that demand-side weaknesses are present in the market for non-workplace pensions? Do they apply across the market or are they specific to particular consumer groups, products or sales channels?**

Chapter 4 – Charges

Q7: **Do you have any comments or evidence relating to our discussion of SHPs?**

Q8: **Can you provide any relevant comments or evidence relating to charges on pre-2001 policies?**

Q9: **How might we and industry improve non-workplace customers' awareness of the charges they may or will incur and the impact of those charges on their pension savings?**

Q10: **Do you have any comments on how industry might better support consumer choice (including monitoring and identifying when it might be appropriate to switch to a more competitive product and / or provider)?**

Q11: **Can you provide any evidence or examples of where competition is not working well on non-workplace pension charges (applicable across the market or specific to particular products)?**

Chapter 5 – Summary and next steps

Q12: **We would like to understand whether and how providers' oversight arrangements differ between workplace and non- workplace pensions.**

Q13: **We would like to hear views on the merits of enhancing oversight arrangements for non-workplace pensions in the event that harm is identified.**

Q14: **In the context of the potential harms in this market, are there any other interventions that you think we should consider? Please explain what the impact might be and why such remedies would be appropriate.**

Q15: **Do you have any other comments on the matters discussed in this Discussion Paper?**

Annex 2
A brief history of non-workplace pensions

Retirement annuities (RACs)

These typically with profits policies were designed for consumers without access to an occupational pension, primarily the self-employed and other consumers with net relevant earnings from non-pensionable employment. RACs were available between 1956 and 1988. Contributions can still be made to existing policies.

s32 buyouts (buyout contracts)

Buyouts were introduced in the early 1980s and were used to transfer pension benefits built up in a workplace pension (which may have included contracted out benefits known as Guaranteed Minimum Pensions (GMP)[75]) to an individual policy, usually after the worker had left the employer's service or if the scheme was winding up .They were largely superseded by individual personal pensions but existing policies remain.

Individual personal pensions (IPPs)

From July 1988, IPPs replaced RACs as the means for individuals without access to a company sponsored scheme to build up their own pension entitlement. In addition, they gave individuals the opportunity to contract out of SERPS[76] on an individual basis.

Initially with profits focussed, providers began increasing their fund ranges from the mid-1990s and from 2001, moved towards more open architecture distribution.

Freestanding Additional Voluntary Contributions (FSAVCs)

FSAVCs were introduced to allow members of workplace pension schemes to build up additional pension benefits in a product that is not connected to the employer's pension scheme. FSAVCs were offered by insurance companies. FSAVCs declined in popularity following the pensions tax reforms in 2006.

Stakeholder personal pensions (SHPs)

SHPs were introduced on 6 April 2001 to address the Government's concern that personal pensions were, at that time:

- difficult to understand
- difficult to buy
- subject to high administration charges

SHPs are subject to minimum standards set out in regulations, including that they must provide:

- a default fund for investment if members do not want to make investment choices

75 In these circumstances, the scheme must pay out at least the GMP at retirement and the provider should make up any shortfall in the policy.

76 Contracting-out meant rebates were paid from HMRC in lieu of 'State Earnings Related Pension Scheme' (SERPS) benefits (formerly known as 'protected rights'), also known as the additional state pension, ran until 5 April 2002.

- an investment option that is subject to lifestyling[77]

SHPs widened access to individual pension arrangements: they were aimed primarily at the self-employed and employees earning £10-20k pa, but also serve groups outside the workplace, such as carers and those in ill-health.

From 2006, contributions of up to £3,600[78] could be made without reference to earnings. IPPs typically attract greater individual contribution levels than SHPs, reflecting the different income and wealth profile of subscribers to both types of pension.

Self-Invested Personal Pensions (SIPPs)
SIPPs were introduced in 1989 as a specialist pension: offering a wider investment choice than IPPs, SIPPs were designed for wealthier, entrepreneurial investors. Sales volumes were low in the early years[79] but SIPPs became more attractive to their intended audience following the relaxation of the some of the original investment restrictions in 2001 and the 2006 pensions tax reforms (which increased the appeal of pension saving to high net worth consumers).

SIPPs therefore tend to be established by (and for) individuals who are experienced investors comfortable with taking investment risk and who want to actively manage their own fund by dealing with, and switching, their investments. According to Mintel, the typical SIPP investor is a mid-to-high income earner or someone with at least £50,000 in investible or pension assets, who is aged 35-54. The average plan value is currently around £90,000 for streamlined and £240,000 for full-range SIPPs.

However, over the last 5-10 years, the 'do-it-yourself' nature of SIPPs has grown increasingly popular owing to:

- technological developments supporting the rise of investment platforms
- the implementation of the Retail Distribution Review in 2012 (after which advice could only be charged as either an upfront free or deducted from the amount invested, rather than indirectly via commission)[80]

The freedom and choice reforms prompted a further surge in the popularity of SIPPs. Data from Origo Options Transfer Service indicates that almost a quarter of transfers between April 2015 and February 2017 were from IPPs to SIPPs.

The boundaries between IPPs and SIPPs are, however, starting to blur:

- some life insurers' personal pension offerings are now exclusively SIPPs (but normally offer an insured element)
- many new IPPs (developed specifically to accommodate the pension freedoms) are now difficult to distinguish from the streamlined, platform-based mass-market SIPPs

77 Other investment choices offered must meet diversification and suitability criteria.
78 This figure includes basic rate tax relief.
79 We are aware that some of these early plans may have been sold to traditional IPP customers as 'deferred SIPPs': an IPP that could converted to a SIPP later on should the consumer want to use the flexibilities.
80 SIPP sales more than doubled in 2013.

Annex 3
Abbreviations used in this paper

AE	Auto-enrolment
AMC	Annual Management Charge
DC	Defined Contribution
DP	Discussion Paper
DWP	Department for Work and Pensions
FCA	Financial Conduct Authority
FSA	Financial Services Authority
FSAVC	Free-standing Additional Voluntary Contributions
GARs	Guaranteed Annuity Rates
HMRC	Her Majesty's Revenue and Customs
HM Treasury	Her Majesty's Treasury
OFT	Office of Fair Trading
PIA	Personal Investment Authority
PLSA	Pensions and Lifetime Savings Association
RAC	Retirement Annuity Contract
RPPD	The Regulatory Guide on The Responsibilities of Providers and Distributors for the Fair Treatment of Customers
SHP	Stakeholder Personal Pensions
SIPPs	Self-Invested Personal Pensions
TPR	The Pensions Regulator

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