FINANCIAL CONDUCT AUTHORITY

Effective competition in non-workplace pensions

Feedback Statement

FS19/5

July 2019

This relates to

DP18/1: Effective competition in non-workplace pensions

Please send any comments or queries to:

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1 Executive summary

Introduction

1.1 Many people in the UK use non-workplace pensions (NWP) to save for their retirement. Ensuring this market works well is an important part of our joint work with The Pensions Regulator (TPR) to address the key causes of inadequate retirement provision. Two key parts of this strategy are to ensure that consumers can make informed decisions and that the pension products they use deliver value for money.

1.2 Competition between pension providers can be an important driver of value for consumers. In 2013, the Office of Fair Trading's (OFT) study of the defined contribution (DC) workplace pension markets found that product complexity made decision making very difficult. This was leading to low levels of competitive pressure and ultimately poorer value for money.

1.3 In recent years, we the Financial Conduct Authority (FCA), in collaboration with TPR and the Department for Work and Pensions (DWP) have taken steps to address weaknesses in this market. This includes putting a charge cap on default funds, banning consultancy and two-tier charging practices and preventing firms from paying commission for advice which is not initiated by scheme members.

1.4 In 2018 we published a Discussion Paper (DP) 18/1 on effective competition in non-workplace pensions. These pensions account for £470bn of consumers savings across 12.7 million accounts. Ensuring this market works well for consumers is critical to meet our strategic aims for the overall pensions market.

1.5 DP 18/1 set out to determine whether the NWP market has the same weaknesses the OFT previously identified. It also explores the differences and similarities between these two markets to determine the potential for harm and help us decide whether we need to undertake further work or introduce remedies.

1.6 Despite differences between workplace and non-workplace markets we find similar competition weaknesses to those the OFT identified. Consumer engagement is weak, and the complexity of products and charges exacerbates this lack of engagement, leading to poor price competition.

1.7 In a competitive market firms win business by offering greater value to consumers; better fund performance, lower charges and better customer service. But in the non-workplace pensions market, complex products and charges mean consumers cannot make comparisons easily and so are reluctant to switch. Once a firm has acquired a customer, it is unlikely to lose them and so firms are not incentivised to compete strongly to keep them.

1.8 We also find that, even though consumers have decided to save for retirement, the process of choosing a pension is so complex that many are disengaged even when setting one up. Consumers frequently try to simplify and shorten the decision-making processes, with non-advised consumers selecting 'standard' products rather than trying to balance costs and benefits. It is our view that this further erodes incentives to compete strongly on price.

1.9 Our analysis of some of the indicators of competitive pressure illustrates the effect. We find very little switching and, even within comparable cohorts, charges can vary significantly. In a market with strong price competition we would expect these discrepancies to be competed away over time but we do not find this here.

1.10 To address these problems, we want to reduce the complexity of charges to make it easier for engaged consumers to compare products. We also want to improve the visibility of charges so that more consumers can consider the charges and benefits of their pension. We think that greater transparency can improve competitive pressure in the market from consumers, but also by making it easier for industry observers, regulators, consumer groups, and market commentators, to scrutinise products.

1.11 However, we know that some consumers will find these comparisons challenging and, despite remedies to support better choices, some will remain unengaged. To help these consumers, we want to explore requiring firms to provide one or more investment pathways. While this may not directly address competition concerns in this part of the market, it can reduce the effects of consumers paying for products with features the consumer does not require.

1.12 We are also considering intervening on charges. However, we intend to make this decision using insights from our upcoming work on assessing value for money across the pensions sector and how effective Independent Governance Committees (IGCs) are at achieving it. Ahead of this, firms should consider the balance of benefits and charges of their own products, given our findings on charges.

1.13 Together with this Feedback Statement (FS), we have also published a report from NMG Consulting: Non-workplace Pensions Consumer Engagement

The market

1.14 The non-workplace pensions market is around double the size of the contract based, workplace defined contribution (DC) market, making it an important source of retirement income for many people. The market is served by over 100 providers, with some of them offering a range of non-workplace pension products.

1.15 To understand market structure, we need to take into account the long-term nature of pension products. Sales of Individual Personal Pensions (IPPs) have been declining, and only around a tenth of IPP products in our sample are still open for new business. Despite this, the market is dominated by IPPs, which make up over half of all assets under management as funds continue to grow.

1.16 By contrast, Self-Invested Personal Pensions (SIPPs) make up around a third of our sample but over 90% of these accounts are in schemes still open to new business. This suggests that IPPs and SIPPs are likely to continue to dominate the market in the future.

1.17 The large number of providers means that concentration in the market is relatively low. If we treat each type of pension product as a separate market, concentration increases, though not to levels we would necessarily find concerning. At both the market and product level we typically find a group of large providers that account for a substantial part of the market, balanced by a long tail of small providers with relatively equal market shares. This level of concentration would typically allow for effective competition and we find no other aspects of market structure that we would expect to limit competition.

1.18 Consumers using non-workplace pensions vary widely in age, income, and financial experience. The sector caters both for consumers without access to a workplace scheme and also to those who want to supplement their workplace pension savings.

1.19 Non-workplace pension products are characterised by a multi-level charging structure. Consumers are charged for the pension product itself (also known as the wrapper). This wrapper holds investments for the consumer which incur a fund charge, which may be paid to a single firm or many different firms. Product and fund charges can be made up of many individual charges, including asset management charges, platform fees and dealing charges, or be consolidated into a single charge. Consumers who pay for regulated advice may also incur an advice charge.

Our findings

1.20 In DP 18/1 we laid out the key differences between workplace and non-workplace pensions. The feedback we received broadly confirmed our view of these structural differences (see Annex 1 for more detail). With non-workplace pensions, it is the consumer, rather than the employer, who must choose the product, bear all costs and make all key decisions. A large proportion of consumers, over 85%, gets regulated advice at the point of sale. Despite these differences, we found that the non-workplace pension market has several key similarities with other pension markets that lead to weak competitive pressure. We found:

- **Low levels of consumer engagement.** Our consumer research found that most of our consumer sample showed a pattern of low engagement throughout their retirement saving journey. Industry responses argued NWP consumers are all actively engaged at the point of sale because they have chosen to open a pension and are mostly advised. Our consumer research demonstrates a clear difference between wanting a pension and engaging in the process of getting one. Engagement at point of sale often extends only as far as the consumer acknowledging that it is 'sensible' to have a pension.
- **Many consumers assume they have selected a 'standard' investment.** When faced with making a decision, consumers sought to make the process as short and simple as possible, rather than attempt to engage in balancing charges and benefits. For example, most fund decisions were delegated to advisers or chosen passively. Few participants seemed to have made a deliberate fund choice. Many non-advised consumers thought they had opted for the 'average' or 'standard' investment. The research also shows that half of advised and non-advised consumers do not know they are paying an ongoing product charge. Consumers that were aware of charges were unsure of what charges they were paying.
- **Charges are highly complex across the market.** The consumer research suggests that charges are not part of consumers' decision-making. This seems to be largely due to the complexity of charges. Products can have multiple charges at the product and the fund level. The basis on which charges are calculated differs between products and providers and there is no consistency in the names given to charges or the costs they are intended to cover. The result is that comparing the cost of products from different providers, even if consumers wished to do so, is not possible.

- **Older products and smaller pots attract higher charges.** Average total charges, made up of mandatory and contingent product charges, advice charges and actual or estimated fund charges, vary between different groups. Our data indicate that, on average, charges were slightly higher than 1% across the non-workplace pension market. However, these averages mask the fact that charges can vary considerably. For some groups of consumers, such as those who joined a pension before the Retail Distribution Review (RDR), and have smaller pot sizes, our data indicate average charges were typically closer to 2%. This may be driven by adviser commission before RDR or by the cost of supply. Our analysis does not establish if charges are too high or if benchmarks used in investigations of other pensions markets are appropriate. Nevertheless, the OFT found that DC workplace pensions with charges over 1% were at risk of, or providing, poor value for consumers.
- **Similar consumers can pay materially different charges for broadly comparable products.** We also find that charges vary within groups of similar customers. The range of charges can vary from a few basis points to several percent. We estimate that for the average consumer 0.1% might equate to around £2,500 and that consumers paying charges at the top of the range might be losing tens of thousands of pounds from their pension pot. For example, the impact of paying charges at the bottom of the range rather than the top of the range could make a difference of over £10,000 to the final value of a pre-2001 pension pot (more than 7 million accounts were sold pre-2001). This variation between similar consumers' charges reinforces our view that competitive pressure is low. In a market that is working well with engaged consumers we would expect to see firms having to compete to attract and keep customers, causing larger charge variance to be competed away over time.
- **There is little switching between pension products.** Non-workplace pension holders can switch between pension providers with greater freedom than those members of workplace pension schemes whose employer contributions are linked to a specific scheme. However, we found low levels of switching in the non-workplace pensions market. While low switching rates are not necessarily a cause for concern, the very low rates we found reinforce our view that low engagement, complex charges and a lack of awareness of charges prevent consumers from finding more competitive products. This leads to a lack of pressure on firms to compete on charges.
- **Price competition is weak.** Although consumers access them differently, we find non-workplace pensions have the same market features that create low levels of competitive pressure in DC workplace pensions. Low consumer engagement and an inability to compare products removes consumers' incentive to switch. It also means firms do not have to work hard to keep their customers. This leads to low levels of price competition and high levels of price variance, which we would expect to be eroded over time under stronger competitive pressure.

1.21 We also had some concerns about specific features of the non-workplace pensions market.

- **Consumers holding cash.** Although this was not the focus of our analysis we find that cash featured among the top five most popular investments for several schemes, particularly in SIPPs. Cash is unlikely to produce the returns needed to meet a consumer's retirement needs. In cases where the consumer initially chooses or is required to invest or hold cash pending an investment decision, cash holdings over a sustained period may indicate the consumer has become disengaged.

- **A minority of schemes have higher charges for customers who stop contributing.** In this paper, we refer to these as paid-up charges. We found that the vast majority of NWP assets and accounts are invested in schemes that do not include paid-up charges in their charging structure. In addition, virtually all schemes that do have a form of paid-up charge in their charging structure are closed to new members. Paid-up charges incurred by consumers in 2017 are reflected in our overall analysis of charges and will be included in our next steps on charges outlined in Chapter 4.
- In DP 18/1, we raised a concern that providers of stakeholder pensions may be levelling up charges to the price cap; 1.5% for the first 10 years and 1% thereafter. Our data do not suggest this is the case. We found that generally providers levy average charges below 1% for stakeholder pensions sold before 2012, and below 1.5% for Stakeholder Personal Pensions (SHPs) sold after 2012.

Our approach

1.22 Our review focused on whether competition is working effectively in the interests of non-workplace pension consumers. Our findings are based on several sources of data:

- Responses to DP 18/1 from 35 industry and consumer representatives. We also received feedback through our webinar conducted in March 2018. Annex 1 includes a summary of what respondents told us.
- We commissioned consumer research to look at levels of consumer engagement. NMG researchers interviewed consumers in groups based on their age and level of savings. They conducted in-depth interviews with additional participants. We publish the findings of this research alongside this report.
- A market overview information request sent to all providers with relevant permissions to establish, operate, or wind-up a non-workplace pension. Of these, 117 providers used permissions and had active NWP accounts under management and were included in our sample (see Annex 2 for further details).
- A follow-up data request on pension charges sent to 106 providers above a minimum size. This was to help us diagnose the extent of any competition issues, tell us whether we needed to carry out further, more detailed, work and help inform our next steps on competition issues. This analysis was not designed to allow us to determine which level of charges would be appropriate.

1.23 Our analysis looks at consumer groups defined by pot size, whether or not they were advised at the point of sale or non-advised, the type of pension product they selected and when it was bought (see Chapter 3 and Annex 3 for our findings and methodology).

- A summary of the feedback received in response to our discussion paper and our response to this feedback (see Annex 1).
- A qualitative assessment of engagement based on feedback and consumer research (see Chapter 3).
- An analysis of charge complexity (see Chapter 3).
- A comparison of the level and variance of pension charges paid by different consumer groups. Our analysis looks at consumer groups defined by pot size, whether or not they were advised at the point of sale, the type of pension product they selected and when it was bought (see Chapter 3 and Annex 3 for our findings and methodology).

- An estimate of the potential impact of the variance in charges that we found for an average consumer (see Chapter 3 and Annex 3 for our estimates and methodology).

Potential remedy proposals

1.24 We have found that the non-workplace pension market has the same low levels of competitive pressure as other pension markets. Competition between pension providers can and should work better for consumers.

1.25 Our aim is to design a package of remedies that is proportionate, addresses these harms and achieves a balance between promoting competition and protecting consumers. As part of this process we have set out questions on each potential remedy so that stakeholders can help us further develop our proposals.

1.26 Our remedies must align with our Mission and reinforce the objectives of the joint FCA and TPR regulatory strategy for the pensions and retirement income sector. We will also ensure our proposals are consistent with our actions in other parts of, and our future work in, the pensions sector.

1.27 **Measures to protect consumers who do not or cannot engage with their investment decision.** Consumers are being asked to make more complex choices about their pension's underlying investments, and few are engaged with this level of decision-making. Our consumer research found many participants assumed they had selected a 'standard' investment option.

1.28 We consider a requirement on all providers to offer one or more investment pathways would benefit consumers who do not want, or find it difficult, to engage with investment choices. One or more investment pathways could also help simplify decision making for consumers that are engaged.

1.29 We welcome stakeholder views on the type of criteria we could introduce to ensure firms' design, governance and communication of investment pathway(s) could secure good customer outcomes.

1.30 **Measures to promote charge transparency.** Effective competition relies on consumers being able to choose products that suit their needs and provide value for money. While charges are only one factor in determining value for money, they are a key component. We found that around half of our consumer research participants were not aware they were paying charges on their pension, others assumed the charges were low or similar across all products and providers.

1.31 We would like to explore a requirement for firms to provide clearer information on the total charges incurred by the consumer and their impact, at the point of sale and on an ongoing basis. The options we would like feedback on include making greater use of pounds and pence charging figures and illustrating the impact of charges.

1.32 The aim of this remedy would be to raise awareness of charges and their impact on the value of consumers' pensions savings and to increase the potential for consumers to make more informed decisions.

1.33 **Measures to reduce charge complexity.** If consumers cannot compare, this limits the pressure on providers to offer competitive products. The data we collected from firms show that comparing charges is currently difficult at best, and unachievable for most consumers. Currently, consumers can incur many different charges and the number, name and type of these charges varies by product and/or provider. Our work on charges also shows that products and providers have different methods of calculating charges.

1.34 For consumers who would like, and are able, to find better value in the market, we want to make charges clearer and more comparable. Earlier this year, we consulted on a requirement for the governance bodies of workplace pension schemes to disclose the transaction costs and administration charges to members for each default and each alternative fund option that a member is able to select, at least yearly, with an illustration of the compounding effect.

1.35 We consider that presenting all charges information within a similarly limited number of charge categories makes it easier for consumers to compare products and providers. It also incentivises each provider to explain how their charges compare given the features of the product and services.

1.36 Before making such rules, or seeking industry-led solutions, we would seek to draw on our current understanding of effective disclosure design. We will also consider whether testing different ways of providing the information could improve our approach.

1.37 We welcome stakeholder views on whether administration charges and transaction costs are appropriate charge categories for non-workplace pensions and which additional categories, if any, we should consider.

1.38 **Measures to expose charges to external scrutiny.** Our consumer research shows that a considerable proportion of non-workplace customers are unengaged and unaware of charges. This creates an inherent limitation on the impact further disclosure can have in the short term, even when well designed. Other parties, however, such as financial advisers, financial press and consumer bodies could exert pressure on charges if they too had access to comparable charges data across the market.

1.39 One way to achieve this might be to require firms to regularly report standardised charges data to an independent body (most likely, the FCA), which would collate and publish the information. The independent body would then combine this information into a single dataset and make it available to the public. This data collection process might operate in a similar manner to our publication of complaints data.

1.40 Consumer groups, market commentators, regulators and other interested parties could then use this information to report on the implications of these figures. Requiring firms to publish this data may put pressure on providers to improve their product offering. We are currently working on a framework for assessing value for money together with the Pensions Regulator, as set out in our joint strategy. This may include benchmarking costs and charges, together with performance and service metrics. We plan to publish further detail of this in the first quarter of 2020, and will consider feedback received to this paper as we carry out this work.

1.41 We know there are risks with publishing charges information, including that it may encourage consumers and advisers to select pensions on the basis of charges alone. We would welcome views on this point.

1.42 **Measures to address charges.** Our work on charges was intended to inform our view on whether competition was working effectively, not to establish if charges are excessive. We also acknowledge that other factors, such as savings level, can have a more significant effect on pensions savings than charges. Despite this our analysis indicates that older products and smaller pots attract higher charges and that there is sufficient variation between what similar consumers are paying to materially affect some consumers' pension pots.

1.43 This disparity creates the concern that some consumers' pensions are at risk of being invested in products that are poor value for money. Firms should consider how their own product charges compare to our findings across the market, in particular where their charges are at the higher end of the variances.

1.44 We propose to decide the appropriate next steps on charges in the non-workplace pensions market after, and in the context of, our upcoming work on driving value for money across the pensions sector:

- developing a framework for assessing value for money (together with the Pensions Regulator)
- the review of IGC effectiveness which will ask how IGCs really achieve value for money (in 2020)

Next steps

1.45 We invite stakeholders' views and welcome alternative suggestions for the way we and the industry can address the issues identified. We have set out questions on each remedy so that stakeholders can provide targeted answers and help us further develop our proposals. Please send your responses to FS19.5@fca.org.uk by close of business Tuesday 8th October 2019. Please provide reasons and evidence in support of your views.

1.46 We aim to issue a consultation paper (CP) on our simplification and disclosure remedies in Q1 of 2020, including a Cost Benefit Analysis for any changes to rules or guidance. We will issue papers on IGC effectiveness and on a proposed value for money framework for pensions (developed with TPR) around the same time.

1.47 After considering the responses to these papers, we will consider next steps for measures on charges and issue a consultation if we decide we need to make rule changes.

2 Introduction and market overview

Why we looked at NWP

2.1 Until relatively recently, the FCA, and previously the Financial Services Authority (FSA), regulated the providers and distributors of these personal pensions without differentiating between the two routes to market: via workplace arrangements or non-workplace arrangements.

2.2 The roll out of auto-enrolment (AE), which harnesses consumers' tendency towards inertia to drive up participation in workplace pensions, began in 2012. AE radically changed the dynamics of the workplace pensions market by simultaneously increasing the number of enrolled individuals, employers offering workplace pension schemes and the value of their assets. These changes sharpened focus on competition in workplace pensions and prompted the OFT to conduct a study into the market for defined contribution (DC) workplace pensions.

2.3 In response to the OFT's findings, the FCA, the Department of Work and Pensions (DWP) and The Pensions Regulator (TPR) worked closely to design a package of measures to address the risks of consumer harm and prevent risks of consumer harm in the future.

2.4 However, that work did not cover non-workplace pensions (includes Individual Personal Pensions (IPPs), Stakeholder Personal Pensions (SHPs) and Self-Invested Personal Pensions (SIPPs) as well as Free Standing Additional Voluntary Contributions (FSAVCs), Section 32 buyout contracts (s32 buyouts) and Retirement Annuity Contracts (RACs)).

2.5 The OFT found that the demand side of the workplace pension market was 'one of the weakest' it had analysed, because of:

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

2.6 The demand-side weakness and charging complexity combined to reduce competition on charges which resulted in consumers over-paying for pensions, owing to:

- poor comparability of charges
- lack of switching and the persistence of legacy schemes
- 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 pay higher charges

2.7 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.

2.8 Our Discussion Paper (DP) 18/1 outlined how the weaknesses previously identified in the market for workplace pensions may exist, wholly or partly, in the non-workplace pensions market. The DP sought views and evidence about:

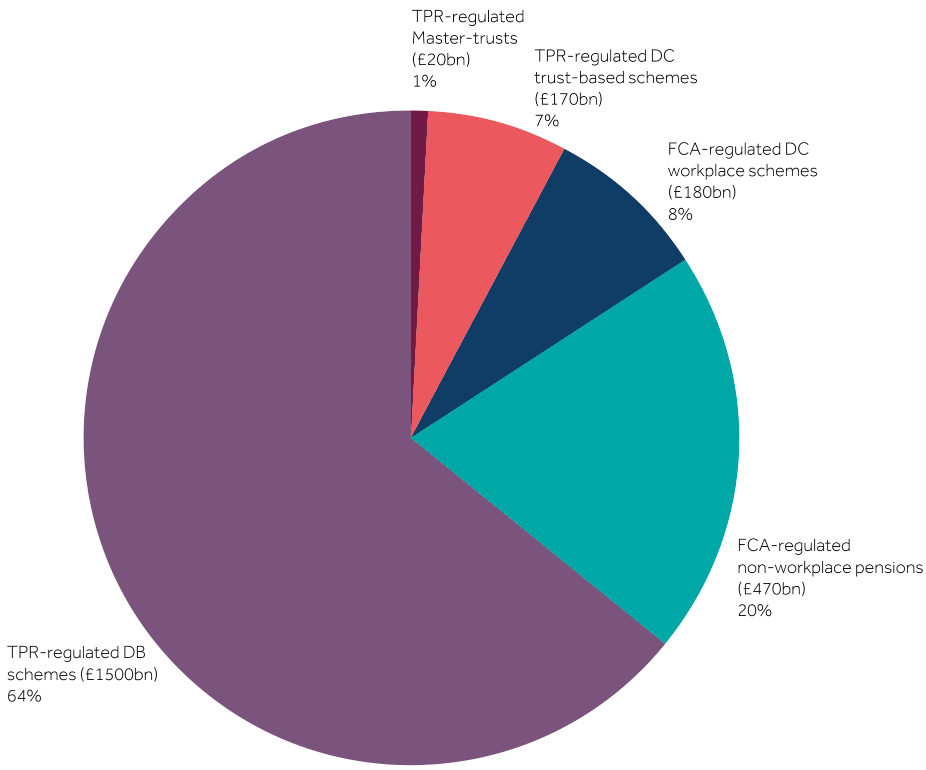
- the differences and similarities between these two markets and how they impact on competition and consumer outcomes
- the factors that influence the behaviours of consumers and providers and whether the current market dynamics ensure fair outcomes for consumers

The NWP market today

2.9 The market for non-workplace pensions is large. It has 12.7 million non-workplace pensions accounts, more than 100 providers or operators (life companies, investment managers, platforms and specialist operators) and around £470bn assets held or invested (Assets Under Administration, or AUA). This is more than double the AUA in contract-based defined contribution workplace pensions (see figure 2.1).

2.10 The DWP is planning to trial activity to prompt self-employed individuals to save for retirement. In time, these trials may lead to growth in consumer numbers in this market.

Figure 2.1: Assets under management in the UK pensions sector

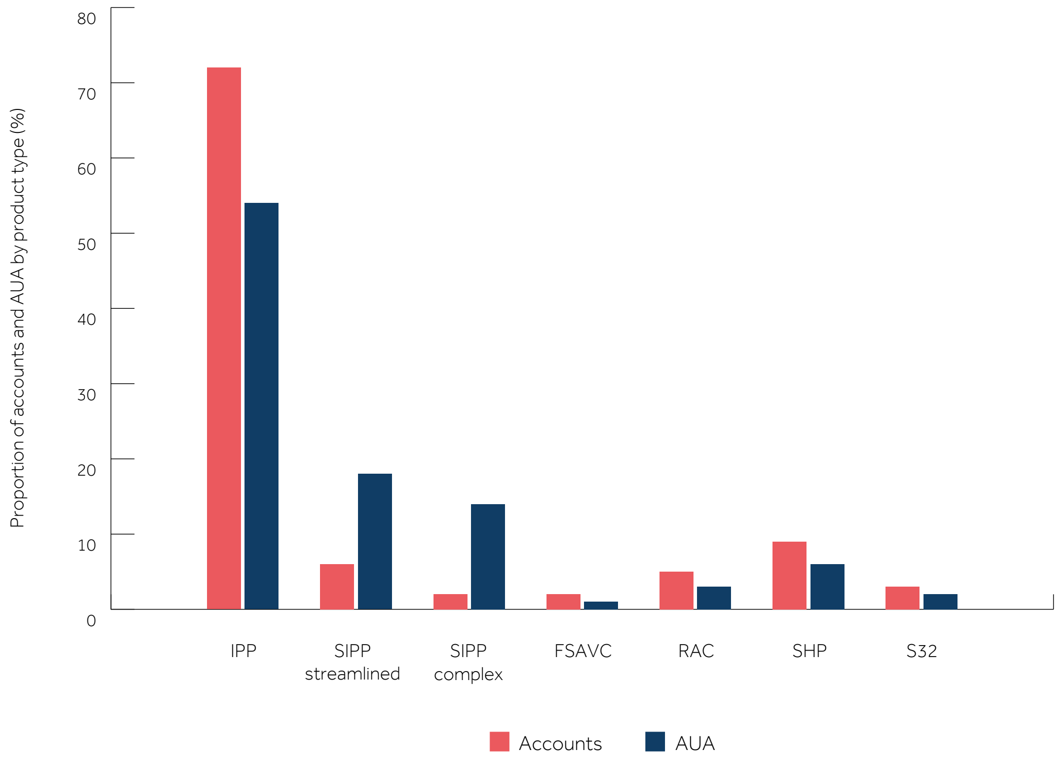


Source: FCA analysis of non-workplace pensions data and our joint call for input on our strategic approach for regulating the pensions and retirement income sector, diagram 4.

2.11 The market for non-workplace pensions serves a broad group of consumers seeking to save for later life: the employed, the self-employed, the unemployed and those in a wide range of other modern employment. It encompasses those who have never had access to workplace pension saving and those who want to increase their workplace pension savings with further tax efficient savings. These consumers are also diverse in age, income and financial experience.

2.12 As shown in Figure 2.2, the existing stock of non-workplace pensions is currently dominated by IPPs (>70% of accounts and >50% of AUA). The next most popular products are SHPs and SIPPs, with streamlined SIPPs more than twice as popular as complex SIPPs. These products attract consumers with very different pension wealth profiles: SHPs account for barely more than 5% AUA, while SIPPs account for close to 35% AUA.

Figure 2.2: Distribution of NWP accounts and AUA by product type



Source: FCA analysis of non-workplace pensions data

2.13 Table 2.1 also shows that market concentration varies between product types using two different measures. We measure the concentration of each product market using the Herfindahl-Hirschman Index (HHI) which is a measure of market concentration that distils the distribution of market share between firms into a single figure between 0 (perfect competition) and 10,000 (a monopoly).

2.14 Using the top 4 concentration method we find concentration is high for stakeholder personal pensions and complex SIPPs, at 87% and 69% of AUA respectively. For IPPs and streamlined SIPPs the market share by AUA of the top four firms is lower, at 46% and 54% respectively.

Table 2.1: The NWP market in terms of AUA, accounts, and number of providers

Product/wrapper type	Assets under administration (AUA)		Accounts		No. of providers	HHI by AUA
IPP	£254bn	54%	9.2mn	72%	32	1,000
SIPP streamlined*	£83bn	18%	0.7mn	6%	47	1,300
SIPP complex*	£67bn	14%	0.3mn	2%	57	1,600
SIPP type not specified	£11bn	2%	0.1mn	1%	15	n/a
SHP	£27bn	6%	1.1mn	9%	12	2,200
RAC	£15bn	3%	0.6mn	5%	19	1,700
FSAVC	£6bn	1%	0.3mn	2%	22	1,000
s32 buyouts	£10bn	2%	0.4mn	3%	17	1,700
Total	**£473bn**	**100%**	**12.7mn**	**100%**	**117**	**600**

Source: FCA analysis of non-workplace pensions data

** There is no formal definition of a streamlined SIPP or a complex SIPP. For the purposes of our data collection, we used 2 simple definitions to support firms in classifying their scheme:*

Streamlined SIPP Investment types: collectives and equities; Range of platforms/counterparties: limited.

Complex SIPP Investment types: broad range; Range of platforms/counterparties: broad.

2.15 This difference in market concentration partly reflects the relative popularity of the product types. SHPs are the product type with the highest HHI (2,200 – moderately concentrated), while IPPs, the most popular product type, have a lower HHI (1,000). Lower levels of concentration do not mean that competition is necessarily working well for consumers, as they may find it difficult to choose providers based on price or quality.

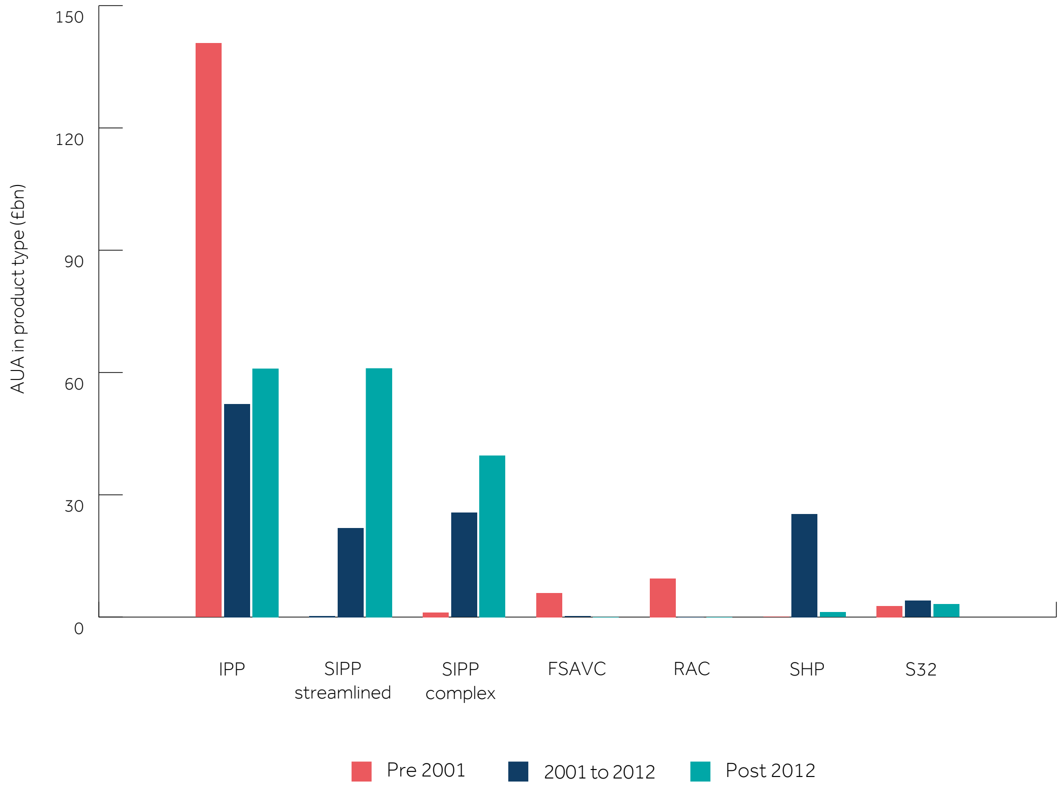
The changing shape of the market: IPPs and SIPPs expected to dominate the future market

2.16 The range of non-workplace pension products available to consumers has changed over time in response to legislative frameworks and changes introduced by HM Revenue and Customs (HMRC), the DWP and HM Treasury.

2.17 89% of IPP accounts are in schemes that are closed to new business, while 44% of SHP accounts are in schemes that are closed to new business. IPPs and SHPs are becoming less popular and SIPPs more so. Our data suggest that IPPs and SIPPs will dominate the future market, with the practical difference between these two personal pension labels continuing to fade.

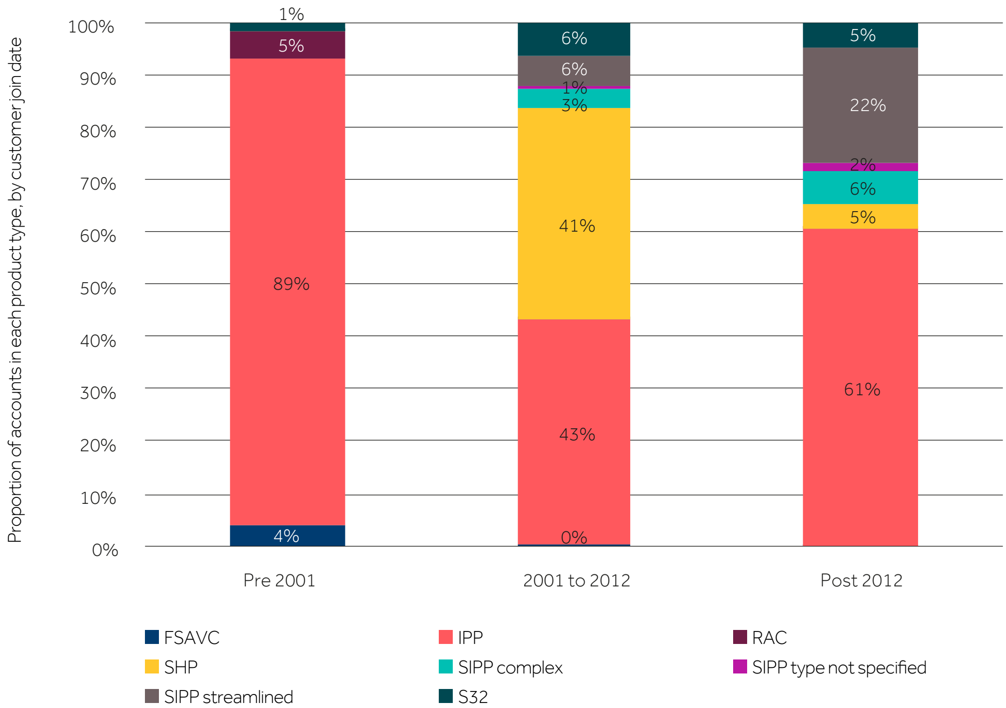
2.18 RACs and FSAVCs are no longer open to new business, though consumers can continue making contributions to existing plans.

Figure 2.3: Distribution of AUA by product type and customer join date



Source: FCA analysis of non-workplace pensions data

Figure 2.4: Proportion of accounts in each product type, by customer join date



Source: FCA analysis of non-workplace pensions data

Advice: reliance on regulated financial advice has decreased over time

2.19 Initially, most non-workplace pensions were sold with advice but, in more recent years, a growing proportion of pensions were sold without regulated advice. In the period 1988 to 2012, 92% of accounts were advised at point of sale. Since then, the proportion of advised sales has dropped to 72%.

2.20 Reasons for this may include advances in digital and platform technology offering easy online accounts, the 'do-it-yourself' nature of SIPPs and the impact of the RDR. After the RDR, firms could only charge for advice as either an upfront fee or as a deduction from the amount invested, rather than indirectly via commission.

2.21 The data we collected from providers indicate that reliance on regulated advice at the point of sale varies by product: around 50% of streamlined SIPPs were sold with advice, while the percentage rises to 90% for IPPs.

How we assessed NWP

2.22 As well as considering the DP responses received (summarised in Annex 1), we have conducted empirical work focusing on:

- Demand-side weaknesses – tested through consumer research, examining the factors that influence consumer decisions and behaviour, before buying and while invested in a non-workplace pension.
- Reduced competition on charges – tested through analysis of industry data on a range of charges paid by consumers in 2017 (the nearest full calendar year to the date on which we issued our data collection). We know that some firms may have amended their charging structures or taken other action to improve the outcomes of consumers in the intervening period. In response to the DP, many firms told us that they were still in the process of evaluating their business in light of Finalised Guidance 16/8: Fair treatment of long-standing customers in the life insurance sector. We plan to assess the progress firms have made in addressing causes of harm to longstanding customers when we evaluate our thematic review on this subject. This work will seek input from selected firms on how they have measured the progress made, for example through product reviews.

2.23 We explain how we assessed NWP and outline our findings in Chapter 3.

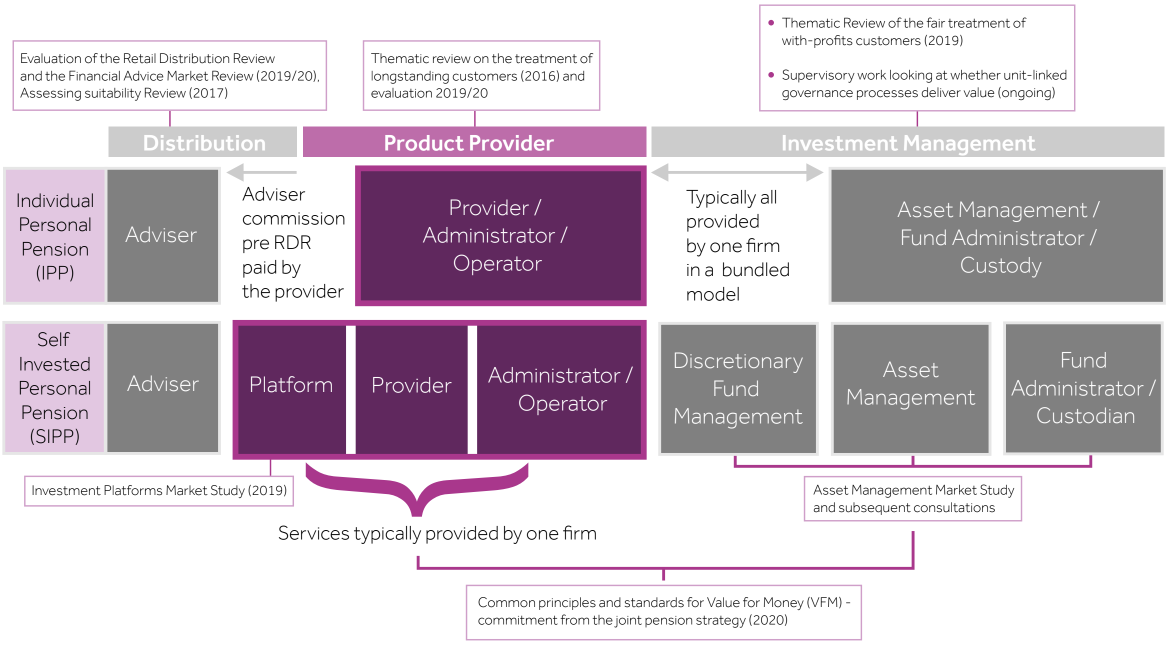
How this work links with other FCA work

2.24 The pension savings value chain comprises many industry participants beyond the pension provider, each of which:

- has an impact through their actions on how consumers' pension contributions translate into a pension pot in later life
- may generate charges to be paid by the consumer, either upfront or deducted from pension contributions or pension pot

- Figure 2.5 shows that our investigation of competition in the NWP market examines competition in the product provider part of the chain. Where possible, our charge analysis also takes into account the investment management charges passed onto the customer. Figure 2.5 also shows other recent or current FCA work addressing harms in other parts of the value chain.

Figure 2.5: FS19/5 in the context of FCA work across the pension saving value chain



2.25 Last year, we and TPR published our joint regulatory strategy for the pensions and retirement income sector, which summarised our priority workstreams and initiatives, and our corresponding objectives:

- pensions and retirement income products support people to increase their financial provision for later life
- pensions are well-funded and invested appropriately
- pensions are well-governed, well-run and deliver value for money
- people access helpful information, guidance and advice that enables them to make well-informed decisions

2.26 In common with our work on NWP, many of our recent and forthcoming initiatives on both the workplace and non-workplace DC pension savings value chain support the above regulatory objectives. They aim to assess and address consumer harms and weak competition from poor consumer engagement, complex charges and opaqueness, barriers to switching and value for money. Our work includes:

- Advice and distribution: Evaluation of the Retail Distribution Review and the Financial Advice Market Review (2019/20), Investment Platforms Market Study (2019), Assessing Suitability Review (2017)
- Investment Management: Asset Management Market Study – and subsequent consultations, Thematic Review of the fair treatment of with-profits customers (2019), supervisory work looking at whether unit-linked governance processes deliver value (ongoing).
- Decumulation: Retirement Outcomes Review – and subsequent consultations

2.27 When considering the potential remedies that we set out for discussion in Chapter 4, we suggest an approach that we consider is consistent with:

- the actions we have taken on similar harms across the pensions saving value chain
- important forthcoming work on value for money in the sector and Independent Governance Committees' (IGCs) effectiveness

2.28 We also acknowledge that access to impartial financial guidance and regulated financial advice can play an important role in helping consumers to achieve good outcomes from their pension. These matters are not within the direct scope of our review, however:

- With effect from January 2019, the Money and Pensions Service brought together three respected bodies of financial guidance: the Money Advice Service, The Pensions Advisory Service and Pension Wise into one organisation. Its mission is to ensure that all UK citizens can easily access the information they need to make the right financial decisions throughout their lives. MAPS will launch its National Strategy and three-year corporate plan in the Autumn.
- We recently conducted a Call for Input to launch our evaluation of the Retail Distribution Review (RDR) and Financial Advice Market Review (FAMR). We are reviewing their impact on the market to date: how consumers engage in the market and whether the industry delivers what consumers want and need. We also want to assess future trends that may have an impact on the future need and availability of services to consumers. and assessing how the market may develop in the future. We expect to publish our conclusions in Autumn 2020.

3 Findings

Chapter summary

3.1 Our Discussion Paper (DP) 18/1 explained we wanted to explore the differences and similarities between workplace and non-workplace pension markets. We were particularly interested in establishing whether the weaknesses the OFT previously identified in DC workplace pensions also apply to non-workplace pensions. The analysis in this chapter seeks to determine whether this is the case.

3.2 In Chapter 2 of this Feedback Statement (FS), we showed that there are no structural features of the market that seem to be limiting competition. Despite moves to consolidate over the last few years, concentration levels appear moderate across non-workplace pensions, except for more specialist products such as stakeholder pensions.

3.3 We commissioned consumer research to understand how far consumers of non-workplace pensions are engaged, informed, and empowered to make effective decisions on their retirement savings. We also used data from providers to investigate the complexity of charging structures, assess the actual charges consumers pay, the difference in charges paid by similar consumers and identify the proportion of consumers who switch pension provider.

3.4 We found a pattern of low engagement throughout the non-workplace pensions consumer journey. Our consumer research shows that engagement at point of sale often only amounts to the consumer acknowledging that it is 'sensible' to have a non-workplace pension. We saw limited active engagement in the other aspects of pension selection. A consumer's decision to get a non-workplace pension is often triggered by family, friends or advisers, and is usually made on limited information - which consumers use to simplify and shorten the process. This includes brand recognition and recommendations by others. Where participants were required to make a decision, they reverted to proxies such as picking a 'middle' option – rather than making a deliberate fund choice or making an active choice on charges. Once purchased, the consumer's level of engagement decreases as they are not motivated to engage on an ongoing basis, and comparison is difficult.

3.5 Our research also indicates that charge types and levels rarely influenced the consumer's pension selection. Most participants in the sample were unaware of charges or misunderstood them. Using information from providers, we found charges to be highly complex across the market, to the point that it is not possible for consumers to compare the cost of different providers' products, even if they wanted to do so.

3.6 The OFT found that DC workplace pensions with charges over 1% were at risk or providing poor value for consumers. Our data indicate that, on average, charges were slightly higher than 1% across the non-workplace pension market. However, these averages mask the fact that charges can vary considerably. For some groups of consumers, such as those who joined a pension before the RDR, and have smaller pot sizes, our data indicate average charges were typically closer to 2%. At this point, however, we cannot establish if charges are excessively high or if benchmarks used in other pension markets are appropriate.

3.7 We found that within comparable groups of consumers there was further variation in the charges paid. For example, consumers who bought an Individual Personal Pension (IPP) before 2001, over 6ml consumers, can pay charges ranging from a minimum of 0.3% to a maximum of 2.4% of their pot value.

3.8 Whilst we acknowledge that fund performance and customer service may explain some differences. Our concern is that in a market with low levels of competitive pressure, charges where both consumers and products are similar may not be driven entirely by differences in the product offering.

3.9 Due to the long-term nature of the product this variation can have a substantial impact on the value of a non-workplace pension. Our estimates suggest that, over the length of their pensions saving journey, consumers paying charges at the top of the range might lose thousands of pounds from the final value of their pension pot. For example, for pre-2001 IPP investors even the difference between the higher and lower quartile average charges could mean a difference in retirement savings of over £10,000 pounds across the full life of a pension.

3.10 We found that the vast majority of consumers do not hold products which have paid-up charges. 3.2% of assets under administration (AUA) and 4.8% of accounts are in products with a paid-up charge for consumers who stop contributing. Virtually all schemes that have a form of paid-up charge in their charging structure are closed to new members.

3.11 We also found consumers rarely switch between pension providers. We recognise that low switching rates are not necessarily a cause for concern in a long-term investment market like this. However, they reinforce our view that low levels of engagement and charge complexity may be stopping consumers from identifying and choosing the best deal for them.

3.12 As a result, and in line with the OFT investigation into DC workplace pensions, we believe providers have limited incentives to compete on charges to attract new customers or keep existing ones.

3.13 Finally, we wanted to understand whether providers of Stakeholder Personal Pensions (SHPs) had levelled up their charges to the cap imposed by legislation rather than competing on charges. We found this not to be the case.

Consumer engagement

3.14 In response to DP 18/1, industry told us that NWP consumers are actively engaged and informed at the point of sale because they choose to open a pension, and they are mostly advised. To understand how far consumers are engaged, we commissioned qualitative consumer research consisting of focus groups and in-depth interviews.

3.15 The data we gathered from providers revealed that most existing NWP customers were given regulated financial advice at the point of sale. Our consumer research included a roughly even split of both consumers who were advised at the point of sale and those who were not. This was to allow us to develop a good understanding of the engagement levels of both advised and non-advised consumers and the extent to which they differ (just over half of the consumer sample participants were advised).

3.16 To reflect the broad range of NWP consumers, the consumer research included a mix of participants, taking into consideration a range of factors such as: age, NWP wealth and geographical spread. Around two thirds of the participants in the sample shared characteristics such as not seeing the NWP as a priority and treating it as a tick box exercise. These characteristics were defined as low levels of engagement with their NWP at time of purchase. The research stratified participants into three levels of engagement, characterised by interest and activity with their NWP. The consumer research defines engagement as 'interest and involvement in the NWP, where involvement is a positive decision to do, or not do, something in relation to their pension'. Most participants were in the less engaged group, and a substantial proportion of this group had a strikingly high degree of disengagement across the pensions journey. The smallest group was the more engaged type. Information on the three levels of engagement are below.

Table 3.1: Types of NWP consumer by level of engagement at time of purchase

Engagement type	Perceived need	Trigger to purchase	Financial mindset
Less engaged	Low – not considered a priority or tick-box attitude	Often prompted by a third party. May be bought with another financial product (such as a mortgage)	• Low levels of knowledge, interest and confidence in finances and pensions. • Very low understanding of the underlying features and benefits of NWPs • Focused on short terms goals • May have taken out the NWP several years ago and had some involvement in the purchase but NWP has since been largely forgotten about, sometimes stopped contributing
Moderately engaged	Moderate – generally in response to a need to reduce uncertainty about their medium to longer-term financial future	Often prompted by a change in requirements or outlook (eg a divorce, becoming self-employed or concern about lack of workplace pension)	• Low to moderate pensions knowledge, less experienced with long term investments – often a desire to know more • Likely to have consulted a financial adviser as part of the process – may not rely on adviser ongoing; if so likely to have delegated decision making • Engagement levels often vary over time – peaking at purchase and then reducing over time
More engaged	Higher - often as part of a complex and proactive decision (ad hoc or ongoing) to plan their current and future financial provision	Often has a strong desire to plan ahead, may be reaching a milestone age, or sometimes related to increasing NWP wealth	• More knowledgeable, numerate, financial 'hobbyists', taking an active interest in finances • Have a better understanding of financial products and an active interest in financial planning • May demonstrate informed understanding of underlying investments, fees and tax benefits, not frequently seen in other types • Have an ongoing relationship with an adviser or are self-directed

Source: NMG consumer research. See the consumer research report for further detail of characteristics of each engagement type.

Most consumers are not engaged

3.17 The research found that most participants are not engaged, both when buying an NWP and afterwards. Most participants' involvement in the buying process was light touch and sometimes entirely delegated to advisers. For the majority, ongoing engagement was very low. The decision to get an NWP did not equal a decision to engage with it. In particular:

- Having an NWP is often seen as a 'sensible thing to do' to secure funds for retirement - but little thought is given beyond having one.
- Where family or advisers prompted 'less engaged' participants to get an NWP, they didn't feel an active functional need for the product or realise the benefits. Participants didn't appear to be very driven in their decision to take out an NWP, which translated to low involvement when buying the product. Once bought, the participants' level of engagement decreases as they weren't motivated to engage on an ongoing basis.

"I got a pension 20 years ago, my parents told me to do it before I had children and bought a house. I thought it was a waste of money and I didn't think about it for years."

Less engaged, moderate NWP wealth, advised, Gen X. Source: NMG consumer research

Consumers lack knowledge about NWPs

3.18 Our 2013 occasional paper explained that 'consumers are likely to find making decisions related to financial products, such as DC pensions, complex, hard, unpleasant and time-consuming. Consumers 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 decisions (good or bad) 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'. The findings from our consumer research suggest these factors also apply to NWPs.

"**The pensions world is not interesting because it is invisible;** you can't see what you are saving for and you don't know when you are going to need it. It also feels a bit dark because it might need to be used in my old age which I don't want to think about. I put money in a pot and don't think about it too much."

Less engaged, higher NWP wealth, advised, Gen X. Source: NMG consumer research

3.19 The consumer research found that most participants had low knowledge, interest and confidence levels in NWPs, and most assumed there was little difference between products and providers. Many participants lacked the skills needed to weigh up costs and benefits of their NWP. Confidence and experience with financial products did not always equal participants' confidence in being able to set up a NWP without support. Even participants who were financially experienced and confident treated their NWP purchase entirely differently from other financial products. Participants saw pensions as particularly complex and technical, with a heightened risk of making poor decisions which are irreversible.

3.20 Most participants were unable to evaluate outcomes for their NWP, as most had insufficient knowledge. When probed, they had limited desire to acquire the knowledge needed to make more informed judgements across all aspects of their NWP. There was a wide knowledge gap and lack of incentives for participants to spend time bridging it, which means that they 'don't know what they don't know'.

There are several barriers to engagement

3.21 There are many aspects of NWPs that might be considered complex, such as: product classifications, underlying features and benefits, technical language, the nuances around tax relief and varying charging structures. Participants also had concerns about how to compare providers. These concerns included: it's impossible to see across the whole of market, a lack of comparability of features and a lack of standard industry comparison tools. In this environment, it's very hard for many consumers to make informed decision on NWPs.

Most participants were unaware of charges or misunderstood them

3.22 The consumer research found that most participants, both advised and non-advised, were unaware of charges or misunderstood them, both when purchasing an NWP and on an ongoing basis. For example, participants thought product fees were one-off and only payable at the outset. Participants who were advised at the point of sale thought of charges only in the context of advice fees, and a few participants confused their contribution levels with charges. Participants rarely used charge types or levels as a reason for choosing a provider when purchasing a NWP. Participants also assumed charges were very low and consistent across providers, and so of very little consequence.

"I had no charges. I knew the guy really well. No, there were no charges but he got commission."

Less engaged, lower NWP wealth, advised, Millennial. Source: NMG consumer research

3.23 Around half of the participants were unaware they were paying an ongoing product charge. Of the remaining participants, most were unsure of the amount they were paying. Participants also didn't consider the impact of ongoing charges initially or on their eventual retirement pot. Even 'more engaged' participants who were aware they had charges struggled during the research to either find them on their annual statement, or to understand the description of them.

"How easy is it to find out how much you are paying in charges on that statement?

I am looking for the charges, where are the charges? I can't see them. No, it doesn't stand out, I would like to know the charges and it's not on here, it says the charges are deducted from your pension pot. But it doesn't say how much it is? No."

More engaged, moderate NWP wealth, advised, Millennial. Source: NMG consumer research

We discuss charge complexity in more detail in the charges section in paragraphs 3.50-3.59.

When required to make a decision, participants sought to make the process as short and simple as possible

3.24 Industry respondents to DP18/1 told us that consumers are required to make decisions to start an NWP. The consumer research revealed that limited knowledge and engagement often led participants to inadvertently shorten the process when buying an NWP. In some cases, they were unaware of the number of decisions they had to make: they simplified the buying process to focus on a very small range of information, such as limiting the selection to provider, or delegating all decision making to their adviser.

3.25 Participants relied on:

Recommendations from family, friends or advisers

- Decisions could be entirely delegated for advised participants. Most relied on their advisers to make all decisions including product, provider and investment selection - with little validation of the adviser's recommendation. Participants who were not advised at the point of sale arrived at the decision to start a pension due to pressure and recommendations from family or friends. Relying on recommendations from others gave easy access to perceived expertise and assurance that someone who knew more than they did was driving the decision. This was a common way for participants to avoid inertia and reduce the conflict they felt when having to make a decision they considered necessary but too hard given their low knowledge levels.

"I don't know much about pensions but feel I should understand them better, I need to focus on the plan for when I retire. **I have left involvement of my personal pension to my adviser and I trust him to do that."**

Moderately engaged, higher NWP wealth, advised, Gen X. Source: NMG consumer research

Providers brand (driven by brand recognition and trust)

- Decision making was largely limited to the choice of provider (driven by brand recognition and trust), with little or no shopping around. This was very common for non-advised participants. Participants largely did not feel qualified to judge on other criteria and felt comparing was too hard. Participants rarely considered the type of product when starting the purchasing journey (eg Self-Invested Personal Pensions (SIPP), IPP or SHP). Relying on brand gave them assurances, such as indicating the providers' financial strength and longevity in the market. Participants or family members may also have an existing relationship with the brand (eg through general insurance) and extending the relationship was considered an easy way to choose a NWP provider. This usually provided sufficient comfort, particularly for the 'less engaged'.

"It could have been any company, that was the one that my parents also have a pension with, I feel warm towards them and have insurance products as well."

Less engaged, lower NWP wealth, non-advised, Millennial. Source: NMG consumer research

3.26 Most participants did not recall a deliberate fund choice. When confronted with a decision it appears that many participants used proxies such as selecting an assumed average option. Many participants who did not get regulated financial advice at the point of sale thought they had opted for the 'standard' or 'middle' investment, and said that information about funds quickly became too technical. This led them to default to the average offering – sometimes without being aware of any distinction between the product and the fund. Advised respondents largely left the fund selection to their adviser.

"I specifically remember looking at that and a booklet with graphs in it so they did give me a nice range of information when I set it up. It all seems so far away in terms of when you are going to benefit from it and I didn't have the inclination to read it all; **I just thought I'd go with the general average one."**

Less engaged, lower NWP wealth, non-advised, Gen X. Source: NMG consumer research

3.27 We also found that cash savings accounted for at least £3.2bn: 0.7% of total assets and 1.3% of the top 5 investments (our data request asked for the AUA and type of asset for the top 5 most popular investment choices so these figures exclude cash holdings outside of the top 5 most popular investments or where it wasn't counted as an investment). At certain points in the pension savings journey, some level of cash holdings may be suitable for some customers. But holding substantial proportions of their assets in cash is unlikely to be suitable for consumers' long-term pension objectives, as they would forgo market returns. Substantial cash holdings could also be an indicator of low consumer engagement, particularly engagement with investment decisions.

3.28 Some 'more engaged' non-advised participants undertook some research and some evaluation of providers. This included using online review sites, newspapers, consumer forums and provider websites, or phoning their provider for more information. However, the range of sources and number of providers (2-3) appeared limited even for this more engaged type of consumer.

3.29 Participants simplified the buying process to just focus on a very small range of requirements and, from their perspective, the buying process worked reasonably well. Participants mostly believed they made the best decision they could at the time given their limited experience and ability to evaluate differences between providers. Most were satisfied that doing something was better than doing nothing, and simply having the pension in place was a source of satisfaction and, in some cases, relief.

Ongoing engagement with the NWP is very low

3.30 Most participants did not engage with their NWP on a regular basis or give any active consideration to whether it was meeting their needs from year to year. At best, they skimmed the annual statement to find the current value of the NWP and how it compared to the previous year. There were extremely few incidences of checking charges, reviewing for suitability, switching or consolidating pots and only the 'more engaged' type did this.

"Reviewed pension to make sure it is still right for you? No. I have given it very little thought over the past couple of years. **It is just there - suitable or not."**

Less engaged, lower NWP wealth, non-advised, Millennial. Source: NMG consumer research

3.31 For both advised and non-advised participants, ongoing engagement seemed to be lowest where they relied on a third party for recommendations on the original choice of NWP provider. Not all consumers who receive advice at the point of sale will have an ongoing relationship with their adviser (nor was this a general requirement under pre RDR adviser commission arrangements) and consumers may be unaware of the need to monitor their pension, trusting that the advice given at the outset remains appropriate. In these cases, consumers are rarely engaged.

3.32 Even participants with a higher perceived need at the start, and with an ongoing relationship with their adviser, can fall in to a low engagement group on an ongoing basis if they delegate decisions to a professional financial adviser.

3.33 Both non-advised participants and those who took one-off advice were highly reliant on providers to prompt and enable engagement. The annual statement was not enough to act as a call to action to review the pension.

"I do look at what the units are worth and what they were worth the previous year but in terms of the detail, I am not really interested and **I rely on the adviser."**

Moderately engaged, higher NWP wealth, advised, Gen X. Source: NMG consumer research

As in other pension markets, the lack of consumer engagement reduces providers' incentives to compete

3.34 Our concern is that, like other pensions markets, consumers cannot identify if another product would provide better value, which alters firms' normal commercial incentives and leads to limited price competition.

3.35 Participants said they would like a simpler and easier way to compare across the market. They believed providers could offer more to help them engage with their NWP on an ongoing basis, including further nudges to review their NWPs and making the information they received simpler. However, there are risks that further engagement activity by providers does little to change current behaviours given the number of barriers, complexity, wide knowledge gap and current low levels of engagement.

3.36 The consumer research suggests that participants know they ought to engage or that it would be a good thing if they did. However, their current behaviour indicates that they don't engage for a number of reasons already covered. To increase consumer engagement at all levels, a change would be required to address the key obstacles they encounter around complexity and comparability of NWPs. Some of these barriers can be addressed and Chapter 4 lays out potential ways to support engaged consumers make better choices. Some of these barriers will remain and whilst some consumers will become more engaged as making choices becomes easier we will also need to take steps to secure good customer outcomes for consumers that remain unengaged.

Charges

Why we looked at charges

3.37 Effective competition relies on consumers being able to weigh up the costs and benefits of different products and choose the one that provides best value for them. When consumers can make these comparisons and take informed decisions, firms are incentivised to lower charges, improve quality, and innovate to keep existing customers and attract new ones.

3.38 A consumer trying to find the best value product needs to take into account a combination of factors, including investment performance, additional benefits (eg options, guarantees), customer service, and charges. Charges are the main cost consumers incur for their non-workplace pension and they can have a material effect on the size of the pension pot over time. In addition to buyer side weaknesses, the OFT's investigation into DC workplace pensions found that charging complexity contributed to reduced competition on charges. So we looked at charges to understand whether consumers are realistically able to compare them and shop around effectively. We set out above our findings on consumer engagement.

3.39 The charges consumers pay are therefore an important market outcome that informs our view of how competition is working. When competition is working well, firms can win market share by offering better value to consumers. Any market analysis must consider the differences between products and the consumers using them. However, if similar consumers, using similar products, were paying materially different charges it would indicate a market where competition was not working effectively to erode these differences over time. The cumulative impact of small differences in charges may then make, over the life of a pension product, material differences to the size of the final pot.

3.40 Looking at charge variations can also tell us where charges are highest. We recognise that differences in charges can be due to factors our analysis does not include, such as different levels of risk and reward for a particular product or underlying investment. Moreover, our analysis was not designed to identify whether charges in this market are excessive. However, an analysis of the level and variance of charges provides insight into whether competition is working, the potential for harm and where consumer harm may be concentrated. This will inform our future work and potential remedy design. Our section on the level and spread of charges explores these aspects in more detail.

Which charges we looked at

3.41 There are four types of charges that consumers may pay for their non-workplace pension:

- **Mandatory product charges:** these are charged by the pension provider for providing a non-workplace pension and include mainly administration charges that all consumers generally pay. Most of these are ongoing charges, while others are one-off charges (eg setup fee).
- **Contingent product charges:** these are also charged by the pension provider but are only paid by consumers that take certain actions, such as dealing in shares or exit fees for surrendering the policy before the end of the term.
- **Fund charges:** these are charged by the fund manager for running the funds the pension is invested in. These charges include the ongoing charge figure (OCF) and other additional charges, such as fund transaction charges and fund performance charges.
- **Advice charges:** since RDR in2012, these are charged separately by regulated advisers. Before RDR, providers paid commission to advisers and recovered that cost from the consumer through product charges.

3.42 Pensions are complex, with a variety of potential different outcomes for consumers. So, we gathered information for different groups of consumers based on the value of their pots, when they joined their pension scheme, and whether they were advised or not at point of sale.

3.43 For pensions sold before RDR, our analysis incorporates the commission that was charged for advice, as this cost is necessarily included in product charges for those pensions. For accounts sold after RDR, we recognise that the cost of advice, at point of sale and often on an ongoing basis, is an additional cost that consumers pay to advisers.

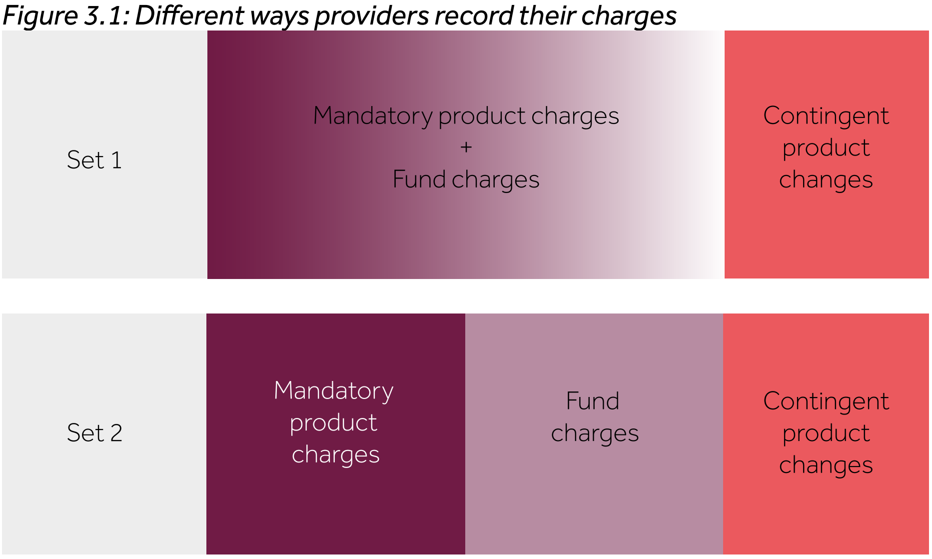
3.44 We collected scheme-level data from 106 providers on product charges and on fund charges for their top five most popular investment choices when applicable.

3.45 Some providers reported a single charge figure including both product charges and fund charges. This means that, these providers' charges are close to the whole cost incurred by consumers for their non-workplace pension. In the following sections, we call these providers Set 1. These cover around half of the market in terms of AUA and more than half of the market in terms of accounts.

3.46 Other providers have reported their product charges and some information on fund charges separately. This allowed us to calculate an indicative figure of the cost of investing in funds. We recognise that the whole cost incurred by all of these providers' customers could be higher. In the following sections, we call these providers Set 2. These cover around half of the market in terms of AUA and around one third of the market in terms of accounts. See Annex 2 for more details on how we defined our sets of providers.

3.47 The difference in the way firms provide data on fund charges affects how we present and interpret our results. For some products, for example IPPs, the top five most popular investments are a large proportion of total fund investment. For these, our set 1 data is broadly representative, but for other products, such as complex SIPPs, the top 5 funds are less representative – as a result, we need to interpret our results more cautiously. In the rest of this chapter, we therefore present our results for both sets separately. Unlike other splits of our data (eg pot size, joining period), these sets were not designed to be part of our analysis and we need to be careful in drawing comparisons between them.

Figure 3.1: Different ways providers record their charges



*Advice charges are included in product charges for pensions sold pre RDR

3.48 Our data request was designed to help us:

- establish whether the non-workplace pension market presented similar concerns as those identified in the market for DC workplace pensions, and
- determine the need for remedies and / or further work, if any

3.49 We did not collect transaction level data nor data on costs and profits. This would have been disproportionate in terms of the time and cost before diagnosing the potential for harm.

What we found on charge complexity

3.50 We wanted to understand whether the charging structures in the market can make it more difficult for consumers to shop around. So we looked at the types of charges consumers can pay and how different factors that can make consumers' choices more complicated affect their engagement.

Multiple charges at product and fund level that are hard to understand

3.51 A consumer can be paying product charges, fund charges and potentially also advice charges. So considering each charge in isolation, without considering their combined effect, would not necessarily be informative for consumers. For example, one pension product could have lower pension charges but more expensive funds. Consumers would have to consider the totality of both charges, and identify comparable funds across both. This is not a simple task.

3.52 Some providers operate a single charge on some products, with no clear separation between fund charges and product charges. While this may reduce complexity, it also makes it harder for consumers to compare charges for products which do not bundle these charges together.

3.53 Product charges are made up of mandatory and contingent charges. As we set out above, contingent charges depend in part on the actions of the consumer. For example, there can be extra charges for buying property, or hourly rates for one-to-one services. Comparing these charges with the charges at other firms, which may use different terminology, makes the process more complicated.

3.54 Mandatory product charges can include several different components. The number of different charges a consumer might pay varies a lot between product types. Older product types, such as Free Standing Additional Voluntary Contributions (FSAVCs) and Retirement Annuity Contracts (RACs), tend to have more mandatory product charges than newer types of product, such as some SIPPs. Among SIPPs, we also see that streamlined SIPPs have on average a smaller number of mandatory product charges.

Even when the consumer is looking at the same charge the way it is calculated can differ between products and providers

3.55 Even comparing a single ongoing mandatory product charge can be challenging. It is common for products to have charges which depend on the pot size. For example, a product Annual Management Charge (AMC) charge may be 0.3% for the first £50,000 and 0.1% afterwards. To compare this to a scheme which has a single 0.2% charge, the consumer will have to consider their how much they contribute, how this will change over time, and the likely growth of the pot. While these tiered charging structures can help ensure charges reflect costs more accurately (though less so than fixed pound value fees), they also add to the complexity consumers have to deal with.

3.56 Extra charges made once a consumer stops contributing (referred to in this paper as paid-up charges), can also increase charge complexity. Products with this structure charge less while the consumer is contributing and more if they stop contributing. To effectively compare products, a consumer would have to know when they intend to stop contributing.

3.57 We found that, for older products, the structure of the main ongoing charge can be even more complex, because they use separate charges for accumulation units and capital units. For some products, a consumer will initially buy capital units, before then buying accumulation units, with the charges on capital units being significantly higher. To compare these charges, consumers would need to understand the formula that assigns purchased assets to capital or accumulation units, as well as the impact of the different charge levels.

3.58 We also note that, in with-profits investments, consumers pay for their product through lower returns rather than explicit charges. This means that consumers cannot easily compare products with a with-profits charging structure to products without.

Inconsistency in the names given to charges

3.59 We found that the terminology of product and fund AMCs adds to this complexity. OCFs (Ongoing Charges Figures) and AMCs (Annual Management Charges) can be used to describe the fund charges a non-workplace consumer will pay. This fund AMC can be separate to any product AMC.

What we found on the level of charges

3.60 Our consumer research suggested that consumers are unaware of charges or found them too complicated to understand. Using data from providers, we also found that comparisons between different products was further complicated by charging structures. Our next step was to look at the effect that this lack of pressure on price competition might have on charges.

3.61 We first looked at average total charges for different groups of consumers. As outlined in Chapter 2, the vast majority of non-workplace pension schemes open to new contributions are made up of IPPs and SIPPs. So the next sections focus on our findings for these products. Findings for other products are included in Annex 3.

Average total charges vary significantly depending on when consumers joined their pension scheme and their pot size

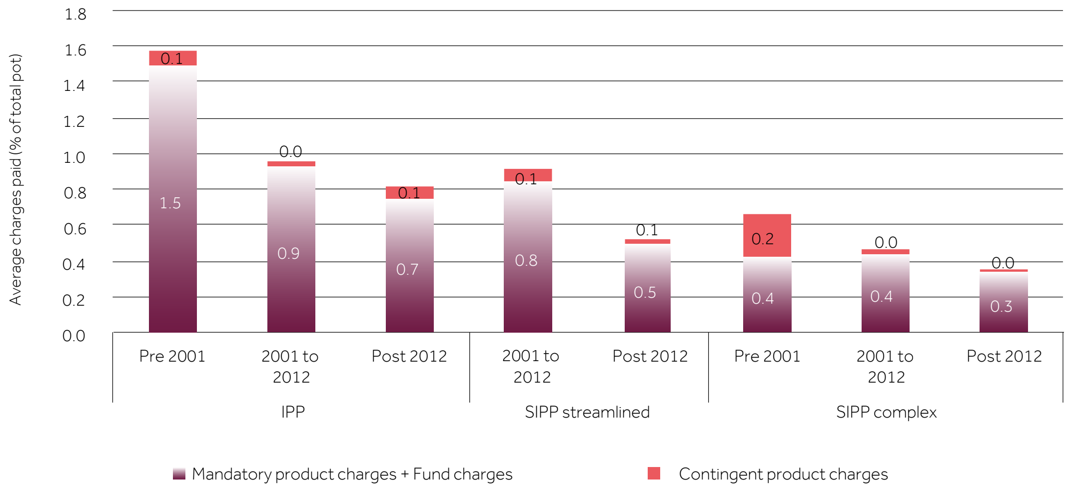
3.62 We have calculated total charges including product charges and fund charges, as a percentage of the total pot. Our estimates are based on the actual charges consumers paid over 2017. We then used consumers' pot sizes to turn those into percentage charges (see Annex 3 for more detail on how we calculated average charges).

3.63 We looked at total charges consumers pay, on average, depending on when they joined the scheme. Most IPP schemes were sold before 2001, while almost all SIPP schemes were sold after 2012.

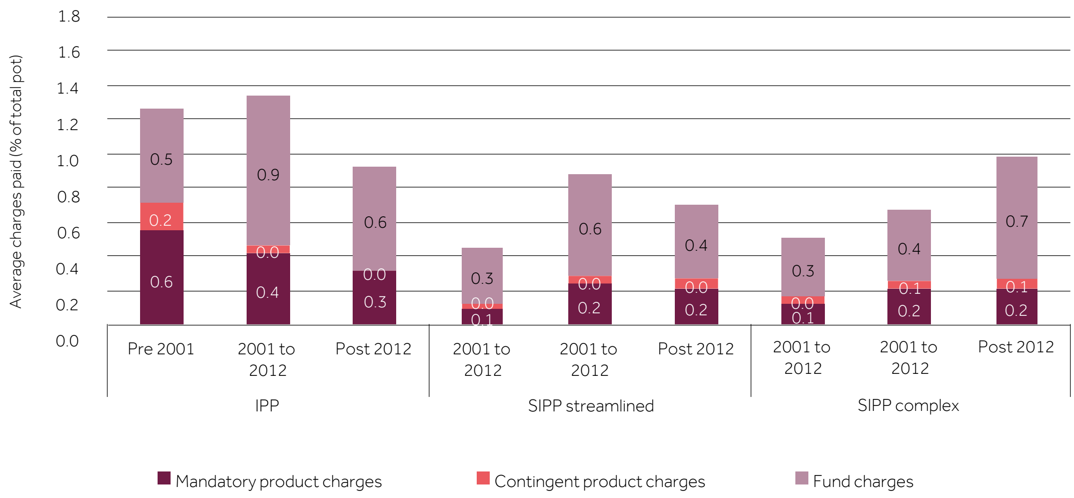
3.64 Figure 3.2 shows that consumers who joined before RDR pay on average higher total charges (except for some SIPP complex products). In particular, for IPPs we found that consumers who joined the scheme before RDR pay on average the highest charges. These consumers account for the majority of IPP holders for both sets of providers.

3.65 We recognise that some of the higher average figures we found for older schemes may be partly due to adviser commission paid before RDR. So the changes RDR introduced may have contributed to the lower charges we find after 2012. Our data do not tell us whether those charges are due to older charging structures being higher.

Figure 3.2: Average total charges by joining period - Set 1



Set 2

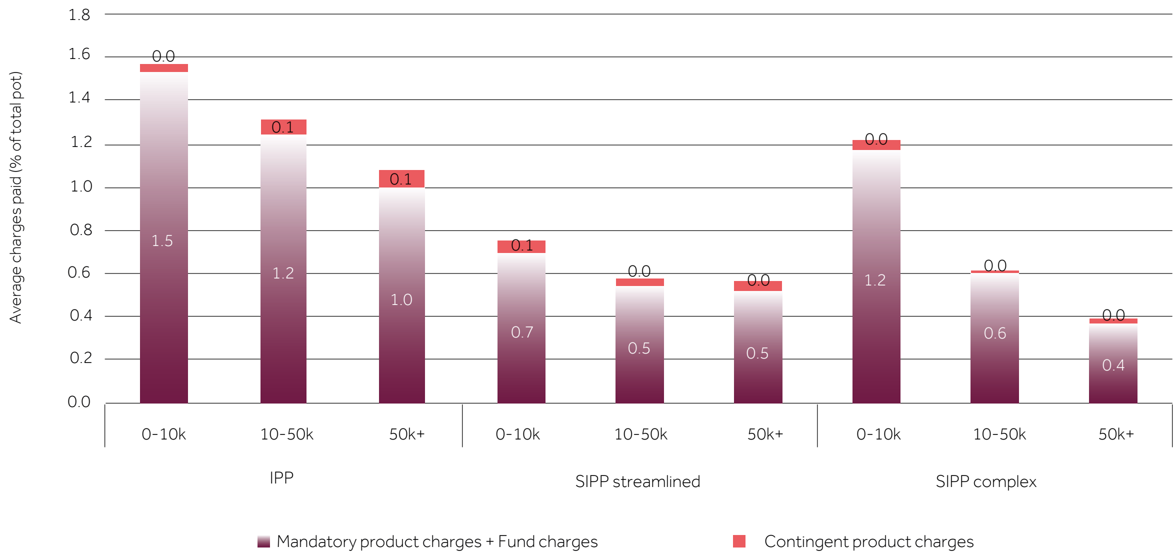


Note: SIPPs products pre 2001 make a few thousands of accounts. Source: FCA analysis of non-workplace pensions data collected from 106 providers

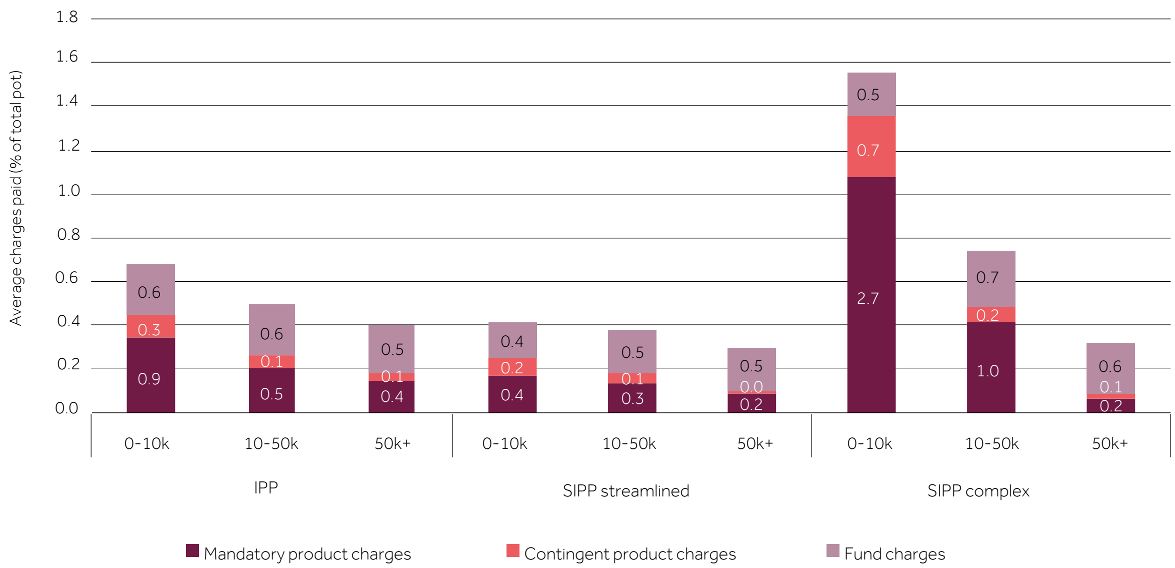
3.66 We then looked at the total charges consumers pay on average, based on different pot sizes. Consumers holding IPP products tend to have smaller pots, while most consumers holding a SIPP product generally have pots in the over £50,000 segment.

3.67 Figure 3.3 shows that consumers with smaller pots pay on average higher total charges. In particular, we found that, for our Set 2 providers, consumers with complex SIPPs and pots smaller than £10,000 pay on average the highest charges. These consumers account for 10% of SIPP complex products for this set (around 16,000 accounts). We acknowledge that these accounts may represent only a proportion of some consumers' retirement savings and that consumers may be consciously holding that in high risk SIPPs. However, we remain concerned that there can be consumers for which these products are at risk of being poor value for money. We propose to decide the appropriate next steps on charges in the context of, our upcoming work on driving value for money across the pensions sector.

Figure 3.3: Average total charges by pot size - Set 1



Set 2



Source: FCA analysis of non-workplace pensions data collected from 106 providers

3.68 Our data also enable us to look at charges consumers pay based on whether they were advised at point of sale, when they joined their pension, and the size of their pot. In particular, we found that:

- For IPPs (Set 1), consumers who joined their pension before 2001 pay on average total charges around 2.2% if they have pots smaller than £10,000, and around 1.6% (Set 1) if they have pots from £10,000 to £50,000. These consumers were advised at point of sale and cover more than 40% of IPPs within this Set 1 of providers.
- For complex SIPPs (both Set 1 and Set 2), charge figures are particularly high for consumers who did not receive advice at point of sale and have pots smaller than £10,000. These consumers pay on average total charges of 4.9% (Set 1) and 4.5% (Set 2) if they joined between 2001 and 2012, and of around 3.3% (Set 1) and 5.6%(Set 2) if they joined after

2012. These consumers cover around 2% of SIPP complex accounts within the market (around 5,000 accounts).

3.69 We recognise that average charge levels for complex SIPP investors with small pots are notably higher than for other groups. As discussed above, providers within Set 2 have reported their product charges and fund charges for their top five most popular investments, which allowed us to calculate an indicative figure of the cost of investing in funds. For products like IPPs, the top five most popular investments make a good portion of all funds invested in IPPs. For SIPP complex, the top five most popular funds make less than 20% of all funds invested in complex SIPPs. We therefore think our indicative figures for complex SIPP products might be less representative of the charges consumers end up paying.

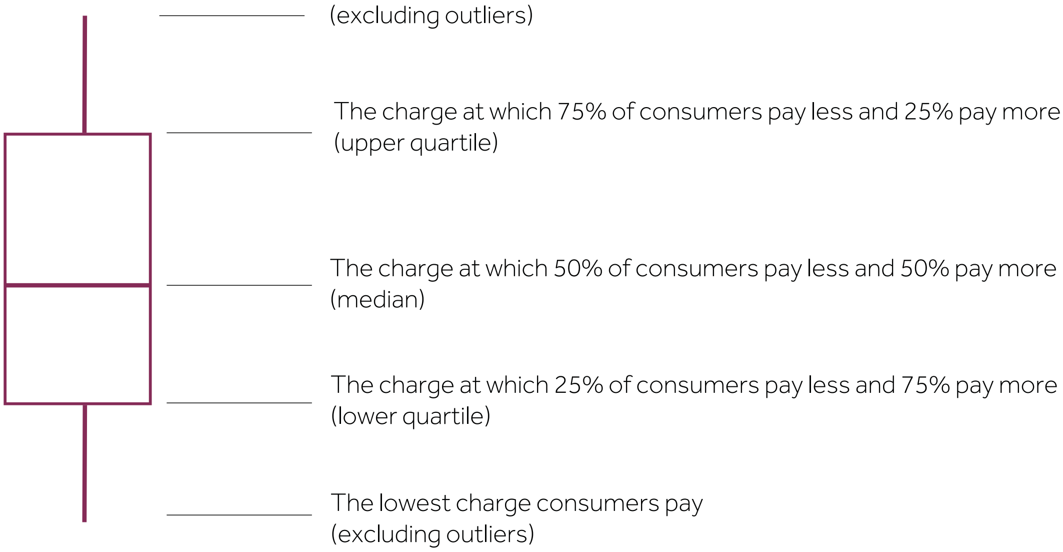
3.70 We also note that some of the higher average figures we found are likely to reflect the different ways that providers charge. For example, some providers levy charges as a percentage of the value invested. Other providers do not charge different percentages for different pot sizes but instead charge flat fees regardless of the pot size. Such charges will decrease in percentage terms as the pot size increases.

3.71 Different charges might also reflect the different quality of a product or service, such as performance, additional benefits, options or guarantees. The data we collected do not include this information nor was our analysis designed to determine if any charge is too high.

What we found on variation in charges

3.72 Average charges help us understand the charges consumer pay. But they mask whether consumers are actually paying even higher charges and variations in charges for similar consumers buying broadly comparable products. This is why we looked at the distribution of charges within similar groups of consumers.

3.73 Figures in this section show the distribution of charges by joining period and by pot size. Each box in each figure corresponds to the charge distribution for a specific group of consumers and aims to show five summary statistics:



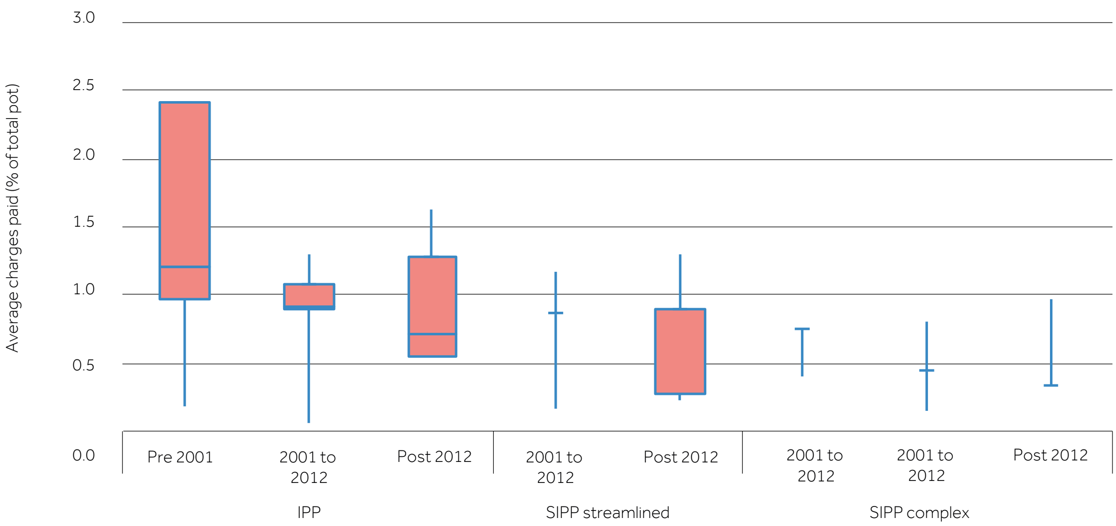
3.74 There are some cases where our data do not show the lower and the upper quartiles (ie the coloured box is 'missing' - eg Set 1, SIPP complex, pre-2001). This occurs when the upper and lower quartile charges coincide for a specific consumer group. In our analysis we weight the data by number of accounts so when a major provider makes up a substantial percentage of a consumer group's figures this provider's charges tend to dominate our results.

3.75 There are also other cases in which the median might coincide with the maximum charge consumers might pay (eg Set 1, SIPP complex pre-2001) or with the minimum (eg Set 1, SIPP complex post 2012). We describe how we estimate charges variation in Annex 3.

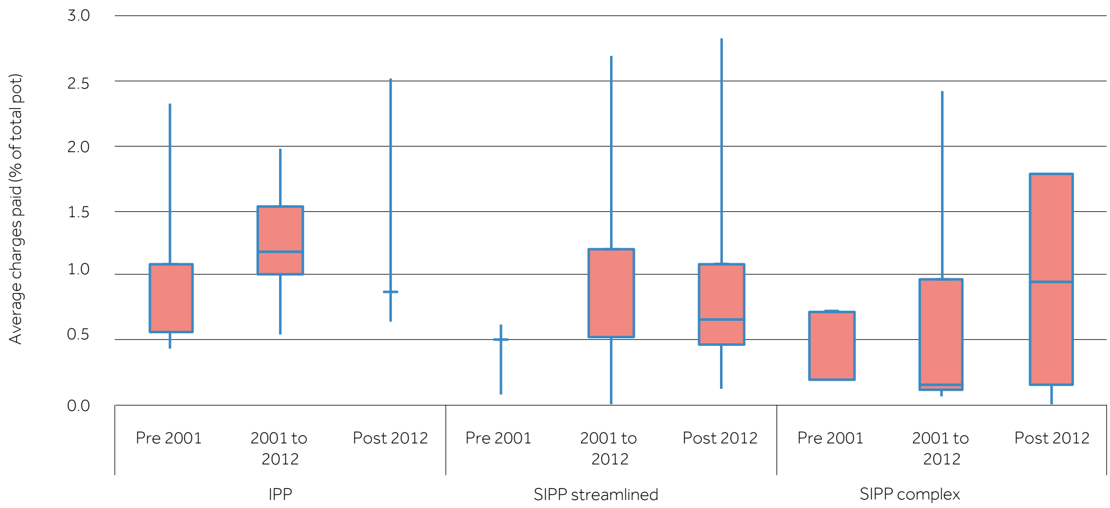
There is material variation in the charges paid by similar consumers for broadly comparable products

3.76 Charges vary widely depending on when consumers bought the pension scheme. The median charge differs significantly across different periods for each product type (Figure 3.4). For example, for our Set 1 providers, consumers who bought an IPP before 2001 can pay charges ranging from a minimum of 0.2% to a maximum of 2.4% of their pot value.

Figure 3.4: Distribution of total charges by joining period - Set 1



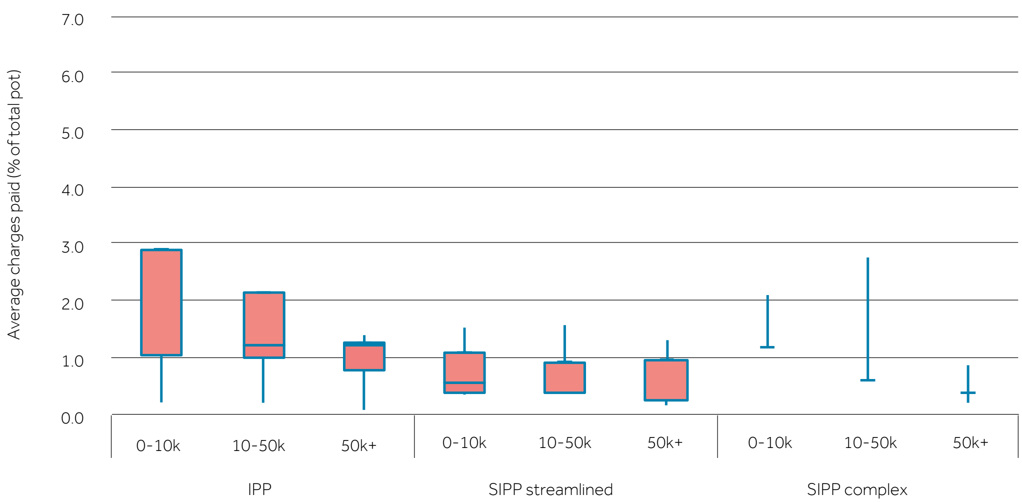
Set 2



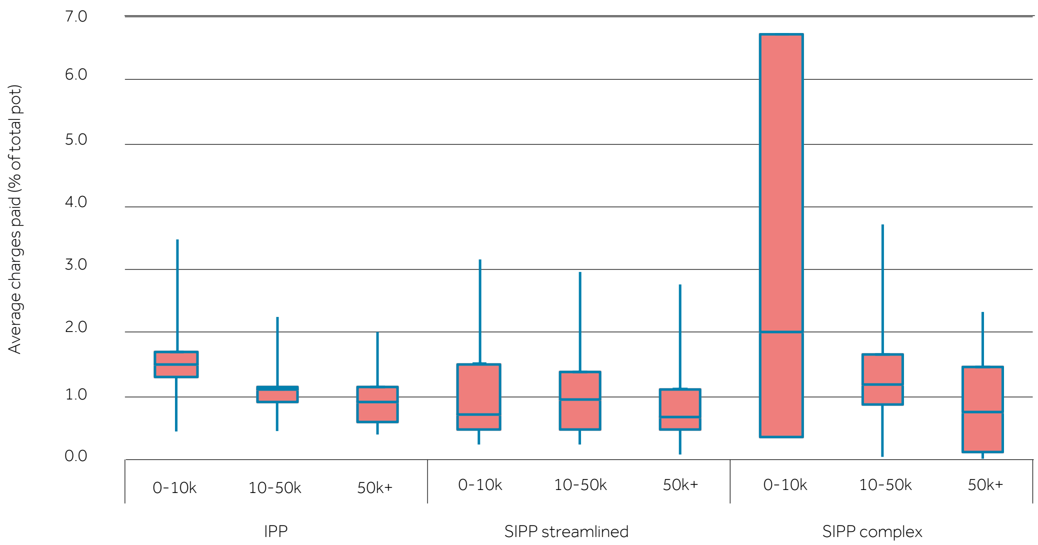
Source: FCA analysis of non-workplace pensions data collected from 106 providers

3.77 Our data also indicate that the median charge differs significantly for different pot sizes for each product (Figure 3.5). For example, for our Set 2 providers, consumers who have an IPP holding a pot size smaller than £10,000 can pay charges ranging from a minimum of 0.4% to a maximum of 3.5% of their pot value.

Figure 3.5: Distribution of total charges by pot size - Set 1



Set 2



Source: FCA analysis of non-workplace pensions data collected from 106 providers

3.78 Large differences in charges are not in themselves proof of weak competition. We must take other factors into account, such as the costs of providing the product and its quality, to establish whether charges are too high. Some of the high charges we see may be unrepresentative or be anomalies in the ways providers recorded the data.

3.79 However, the large variation we found for some groups of consumers is a conservative estimate. First, our figures already exclude the most extreme data points, which we considered could be outliers. Second, even when we remove the influence of minimum and maximum charges, we still see material variation in charges paid by half of the consumers because their concentration in the interquartile range is relatively large.

3.80 We used the scheme-level data we collected to calculate a charge metric which is an average of charge averages. So the charges described in this section are probably even more varied in reality. We describe our methodology for estimating charges in Annex 3.

Potential impact of charge variation on consumers' pensions

3.81 We saw large differences in the charges consumers holding a non-workplace pension pay.

3.82 We then constructed a simple model to explore the impact of this variation on consumers' final pension pots (see Annex 3 for more detail). This model uses a consumer with a median income for their age who contributes 5% of their pre-tax income between the ages of 20 and 65. It assumes that real income and fund growth grow by 1% and 3% a year respectively. It does not include separate advice charges. The model also uses the minimum and maximum charges when illustrating the impact of charge variation on the value of a pension pot.

3.83 Tables 3.2 and 3.3 show all our estimates for both sets of providers in our sample. For example, we found that for consumers who joined their IPP before 2001, paying the maximum average charge compared to the minimum average charge would mean a final pot that reduced by £54,000 (if they are customers of Set 1 of providers) or by £45,000 (if they are customers of Set 2). All figures are actual 2016 values in pounds.

Table 3.2: Set 1 of providers, impact of charge variation on pension value

Product / wrapper type	Joining period	Minimum and maximum charges (% of total pot)	Final pot sizes corresponding to minimum and maximum charges
IPP	Before 2001	0.2% - 2.4%	£83,000 - £137,000
	2001-2012	0.1% - 1.3%	£106,000 - £142,000
	After 2012	0.5% - 1.6%	£98,000 - £126,000
SIPP streamlined	Before 2001	N/A	N/A
	2001-2012	0.2% - 1.2%	£109,000 - £138,000
	After 2012	0.2% - 1.3%	£105,000 - £136,000
SIPP complex	Before 2001	0.4% - 0.8%	£120,000 - £130,000
	2001-2012	0.1% - 0.8%	£118,000 - £138,000
	After 2012	0.3% - 1.0%	£114,000 - £133,000

Table 3.3: Set 2 of providers, impact of charge variation on pension value

Product / wrapper type	Joining period	Minimum and maximum charges (% of total pot)	Final pot sizes corresponding to minimum and maximum charges
IPP	Before 2001	0.4% - 2.3%	£84,000 - £129,000
	2001-2012	0.5% - 2.0%	£91,000 - £126,000
	After 2012	0.6% - 2.5%	£81,000 - £123,000
SIPP streamlined	Before 2001	0.1% - 0.6%	£123,000 - £141,000
	2001-2012	0.0% - 2.7%	£78,000 - £143,000
	After 2012	0.1% - 2.8%	£76,000 - £139,000
SIPP complex	Before 2001	0.2% - 0.7%	£120,000 - £137,000
	2001-2012	0.1% - 2.4%	£83,000 - £141,000
	After 2012	0.0% - 2.5%	£81,000 - £143,000

Source: FCA analysis of non-workplace pensions data collected from 106 providers

3.84 Although the potential impact of these differences is concerning, we recognise that not all consumers will see the same impacts on their pots as those estimated in Tables 3.2 and 3.3. We also noted that our analysis did not take into account investment performance. However, we think consumers may still be at risk of paying higher charges than necessary.

3.85 To reduce the risk of data anomalies influencing our estimates, we looked at the interquartile ranges. We still find substantial differences between the lower and upper quartile charges, and the associated final pots. For example, for set 2 consumers who joined their scheme in the period between 2001 and 2012, the lower and upper quartile charges were 1.0% and 1.5% for IPPs (£100,000-£113,000), 0.5% and 1.2% for streamlined SIPPs (£108,000-£126,000) and 0.1% and 1.0% for complex SIPPs (£114,000-£140,000).

What we found on paid-up charges

3.86 In the context of this review, an account is 'paid-up' when the customer is considered by the firm to be no longer contributing to their pension. Many providers told us their products do not have any requirements concerning frequency of contribution – all their customers are considered active. Other firms allow a certain number of missed payments before classifying the customer as no longer contributing.

3.87 We use the term paid-up charges to indicate where charging practices result in a charge increase for consumers when they stop contributing, become 'paid-up'.

3.88 We found that the charging structure for the vast majority of schemes does not include paid-up charges. Similarly, the vast majority of assets (96.8% AUA) and accounts (95.6%) are not invested in schemes which attract paid-up charges.

3.89 Among those schemes where paid-up charges can apply, the charges typically take the form of:

- A one-off reduction in fund value – sometimes only applicable if the customer becomes paid-up within a specified number of years of starting the policy. 4.4% of accounts (536,000) and 2.8% of AUA (£13bn) are invested in schemes where this charge could apply if contributions stop.
- An increase in ongoing charges (or replacing the ongoing fee with a higher charge). 0.2% of accounts (22,000) and 0.2% of AUA (£830mn) are invested in schemes where this charge could apply if contributions stop.
- A combination of the above two approaches.

3.90 Any paid-up charges incurred by NWP customers in 2017 are reflected in our overall analysis of charge levels and distribution earlier in this chapter. They will also be included in our next steps on charges outlined in Chapter 4. In 2013 the OFT identified a similar differential charging practice based on contribution status in its study of the DC workplace pension market. These 'active member discounts' (AMD) resulted in higher charges for non-contributing members. The OFT also found that 94% of schemes with AMDs were open to AE.

3.91 By contrast, virtually all schemes that have a form of paid-up charge in their charging structure are closed to new members. These charges typically apply only to pre-RDR contracts as they were primarily designed to ensure the recovery any portion of the up-front sale and adviser commission costs left unrecovered at the point the customer stops contributing.

Conclusions on charges

3.92 Our consumer research indicates that consumers do not look at charges to inform their choice of a non-workplace pension. But even if they did, we think it would be impossible to compare products from different providers on the basis of charges, because of the complicated charging structures we found across the market.

3.93 Given this, it appears unlikely that consumers could exert sufficient pressure on providers to offer lower charges and better quality of products and services.

3.94 Our analysis of providers' actual charges is consistent with this assumption. We found material variation in the charges that similar consumers pay for broadly comparable products. In particular, variation in charges is higher for consumers who bought their non-workplace pension in the early years and those with smaller pot sizes.

3.95 Although large differences in charges are not in themselves proof of weak competition, we are concerned that consumers might be paying too much for what they get (see paragraphs 3.81-3.85 and Annex 3 for further details). We estimated that an average consumer paying charges at the top of the range could lose thousands of pounds on retirement savings throughout the pension's lifetime.

3.96 We also looked at the level of charges consumers pay. We found that, for both IPPs and SIPPs, consumers who joined before RDR tend to pay on average higher total charges. These charges are higher than the 1% level that the Independent Project Board considered to be at risk of poor value for money for workplace pensions following the OFT investigation. However, at this point we do not know what the 'right' charge for non-workplace pensions is. This would require further extensive analysis including, for example, identifying providers' costs and profits.

3.97 We looked at paid-up charges. We found that:

- the charging structure for the majority of schemes does not include paid-up charges
- the vast majority of assets and consumers are not invested in products that can levy paid-up charges if a customer stops contributing
- virtually all schemes that have a form of paid-up charge in their charging structure are closed to new members

3.98 Our findings provide an overview of charges across the market and raise a number of potential concerns that we will take into account in our further work. Firms should consider their charges in light of our findings.

Switching provider

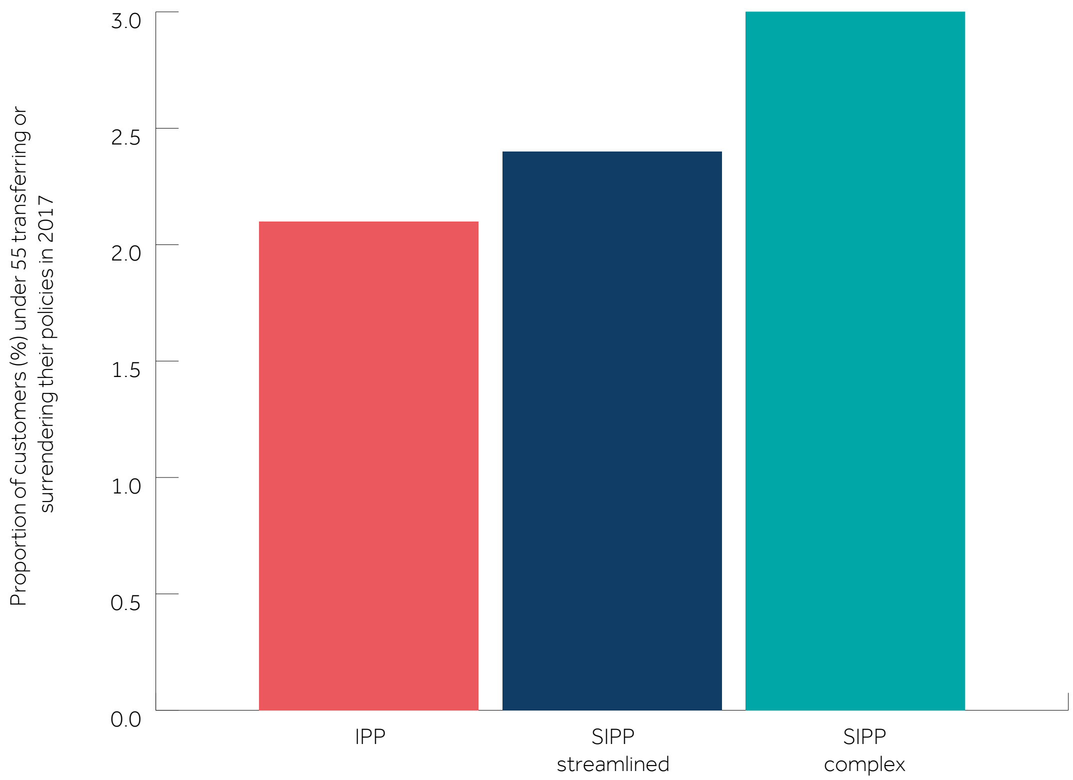
3.99 Our consumer research raised concerns that unengaged consumers do not review the suitability of their NWP, and do not switch when other products could better meet their needs. To check this, we looked at switching levels and found they were very low. This reinforces our view that low engagement, complex charges and a lack of awareness of charges prevent consumers from identifying more competitive products.

3.100 The consumer research found that most participants in the sample had not switched or considered switching provider or consolidating different pots. Participants mentioned lack of awareness, understanding, and confidence in being able to carry out what they saw as a complex process as barriers. A small number of participants tried to switch or consolidate pots but abandoned the process due to the complexity involved. A very small number faced issues during the transfer process (largely around the time involved) but most who switched did so without difficulties.

3.101 Another potential barrier which could deter consumers from switching is exit fees. While some consumers do incur exit charges, the consumer research found that participants generally have low awareness of charges so awareness of exit charges is unlikely to be the main barrier to switching.

3.102 We found that switching levels are low across all products and join dates. We have data on the number of accounts that transferred or surrendered their policies during 2017. This excludes consumers who are over 55 and therefore qualify for pensions freedoms. Consumers could transfer or surrender their policies for other reasons than switching, such as consolidation, and so actual switching levels will be even lower than shown below. To reduce the impact of these outliers we have excluded groups where over 50% of accounts exited in 2017, as we believe these are less likely to be due to customers individually deciding to switch.

Figure 3.6: Proportion of customers under 55 transferring or surrendering their policies in 2017



Source: FCA analysis of non-workplace pensions data collected from 106 providers

3.103 We also wanted to consider the transfer times consumers' typically experience and what factors might affect this. We asked providers for information about average transfer times in our data request. Overall, we found that there was variation in the way providers recorded and reported the data, which limited comparability. The availability of average transfer time by transfer type (such as cash transfers or re-registrations) was very limited, and so the results should be interpreted with caution. Re-registration means the asset is transferred and registered rather than being sold and re-bought.

3.104 There was a wide variation in reported numbers. Re-registrations could take nearly 4 times longer than cash transfers, based on average reported times. Most average transfer times or cash transfer times reported were 20 business days or below. Around half of average cash transfer times were 10 business days or below. Transfer times for re-registration transfers were considerably longer, with the vast majority more than 20 business days. We also noted that some average transfer times for re-registrations took several months. See Annex 2 for more detail on the data we collected.

3.105 Apart from the transfer type and providers involved in the transfer, other factors that could influence transfer times were transfer services and electronic or manual processes. Firms also reported that the nature of assets (number and type), number of counterparties involved and due diligence checks were also the main factors which could influence transfer times.

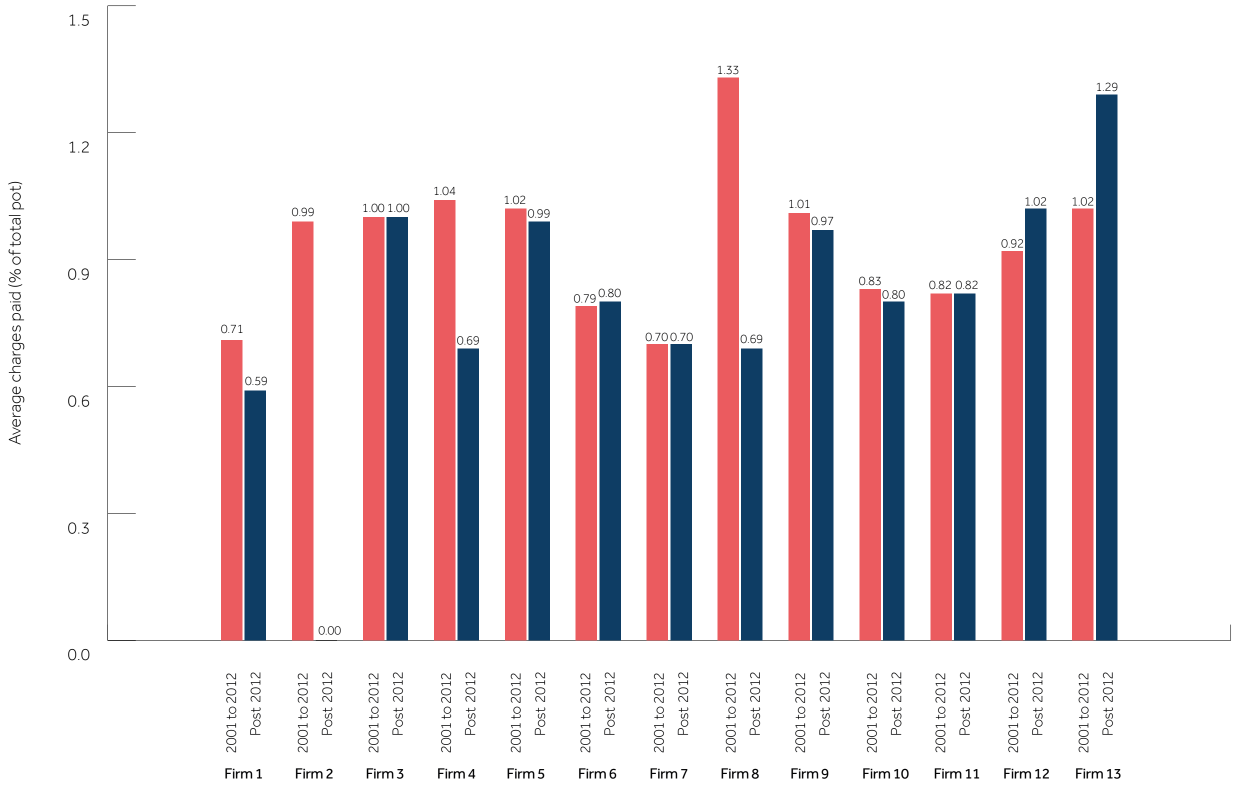
Stakeholder pensions charge cap

3.106 DP 18/1 explained we wanted to understand how far the SHP cap influences the charges on new and existing schemes. We were particularly interested in checking whether SHP providers would level up to the cap rather than compete on charges. As outlined in Chapter 2 of this FS, our data on SHPs include 13 providers which cover around 6% of the market in terms of AUA (£27 bn) and around 9% in terms of non-workplace pension accounts (1.1ml).

3.107 The stakeholder regulations capped the level of charges on SHPs at 1.5% for the first 10 years of the pension policy, and 1% thereafter. The data we collected relate to 2017, so providers could levy charges up to 1% on products opened before 2007, and up to 1.5% for products sold from 2007 onwards.

3.108 Although we do not have the exact split before and after 2007, our evidence suggests that providers have not levelled up to the cap (Figure 3.7). Indeed, we found that generally providers levy average charges below 1% for SHPs sold before 2012, and below 1.5% for SHPs sold after 2012. For many providers, our data also indicate that average charges are lower for policies opened more recently.

Figure 3.7: SHP – average total charges by joining period



Source: FCA analysis of non-workplace pensions data

Conclusions

3.109 Using consumer research and data from providers, we found that:

- There is a pattern of low engagement throughout the consumer non-workplace pensions journey. This includes low awareness and understanding of charges, both at point of sale and on an ongoing basis.
- Charges are highly complex across the market, in a way that makes it impossible for consumers to compare the cost of products for different providers, even if they wished to.
- There is material variation in the charges similar consumers pay for broadly comparable products. Variation in charges is higher for consumers who bought their non-workplace pension in the early years and for those with smaller pot sizes. We have also found these consumers are paying on average higher total charges.
- The variation in charges may have a substantial impact on the value of a non-workplace pension. Our estimates show that, for an average consumer, paying charges at the top of the range could reduce their retirement savings by thousands of pounds throughout the pension's lifetime.
- The vast majority of products do not include paid-up charges, and the vast majority of assets and consumers do not hold products which have paid-up charges.
- Consumers rarely switch between pension providers. Although we know that low switching rates are not necessarily a cause for concern, they reinforce our view that

low levels of engagement and complex charges are preventing consumers from identifying and choosing the best deal for them.

- Our evidence indicates that providers of SHPs have also not levelled up to the cap imposed by legislation.

3.110 As a result, and in line with the findings of the OFT investigation into DC workplace pensions, we believe providers have limited incentives to compete on charges to attract new customers or keep existing ones. The next chapter sets out our thinking on potential remedies to address these features of the market. We are not currently making specific proposals but would like to get stakeholders' views on potential remedies we could consider. We will consult on any proposals for the non-workplace pensions market in 2020.

4 Potential remedies and next steps

4.1 In light of our findings, we are considering remedies in several areas to protect consumers from potential harm and to support greater competition in this market.

4.2 We invite stakeholders' views and welcome alternative suggestions to address the issues we have identified, with the aim of developing and consulting on future remedies in the first quarter of 2020. The consultation will include a supporting cost benefit analysis for those remedies that require changes to our rules or guidance.

4.3 This chapter:

- explains the approach we have taken when developing potential interventions
- sets out our current thinking on potential remedies
- sets out the next steps

Our approach to considering potential remedies

4.4 Our approach to intervening in this market is aligned with our general regulatory approach set out in our Mission and with the regulatory objectives underpinning our joint FCA and TPR regulatory strategy for the sector. We aim to ensure that any intervention is both effective and proportionate to the concerns we have identified, consistent with our approach in other parts of the pensions value chain and coordinated with related work in the sector.

4.5 When considering potential remedies, we consider:

- how the different remedies are effective as a package of interventions to help make competition work effectively
- the appropriate balance between measures aimed at promoting effective competition and consumer protection

Measures to protect consumers who do not or cannot engage with their investment decision

One or more investment pathways

4.6 The data we collected suggest that most new business is, and will continue to be, in IPPs and Self-Invested Personal Pensions (SIPPs). These products offer consumers considerable investment choice, far more than they would have had when personal pensions were introduced in 1988.

4.7 This means consumers will be asked to make correspondingly more complex choices on underlying investments. These investments determine what returns the customer might receive in the long term and also the total level of charges they pay for their pension.

4.8 However, our consumer research found some participants assumed they had selected a 'standard' investment option, while those who recalled seeing some fund information soon found it too technical and overwhelming. This is consistent with the finding that most non-advised consumers choose their pension based on recognition of the provider's brand alone.

4.9 These findings highlight the potential for non-advised consumers to make choices that do not match their needs and objectives when they set up their pension.

4.10 We also find that consumers do not generally engage with their pension on an ongoing basis over the course of what is often a long-term investment. As a result, they do not consider whether their pension investments remain suitable and if they continue to offer value for money. This lack of ongoing engagement increases the risk that consumers do not consider changing the risk profile of their investments as they get closer to the age when they want to use their pension savings.

4.11 These risks are mitigated in the DC workplace pension market through the operation of default funds or default investment strategies in which any member that does not make an active investment choice is invested. 92% of workplace scheme members (not just AE) are invested in a default fund.

4.12 To mitigate these risks for NWP consumers who do not wish to engage with, or find it difficult to make, investment choices, we would like to explore requiring firms to provide ready-made investment solutions (with lifestyling) to align with consumers' broad objectives. The requirement could be for a single pathway (akin to an actively chosen default) or multiple pathways tailored to different objectives.

4.13 We consider that a requirement on all providers to offer one or more investment pathways with lifestyling could also potentially:

- reduce the number of customers inappropriately 'selecting' cash (see paragraph 4.18)
- increase the number of accounts that are appropriately de-risked in the final years before the consumer plans to access their savings: currently only 13% of all NWP accounts have a lifestyling option. Lifestyling is where the provider switches the customer into investments with an appropriate risk profile in the years before access.

4.14 Providing one or more investment pathways would most directly benefit the significant number of consumers that do not seek advice when starting a pension (25% of post RDR sales). It could also deliver benefits for consumers that seek regulated financial advice if it were accompanied by a corresponding requirement on advisers. This would require them, when making recommendations about personal pensions, to explain why, taking account of the terms available under the firm's pathway(s), the recommended personal pension is at least as suitable as the pathway(s).

4.15 This sort of adviser requirement would be similar to an existing Handbook rule, which is sometimes still known as RU64 (the name of an earlier Personal Investment Authority requirement). In this way, we consider one or more investment pathways could help ensure greater engagement with fund choice among advised consumers and, in doing so, reduce the risk of consumers choosing products that have (and charge for) features the consumer does not require.

4.16 The design, governance and communication of the investment pathway(s) will play an important role in ensuring good outcomes for customers. There are several options we could pursue to ensure that this is the case:

- setting conditions including, for example, a charge cap

- extending the role of Independent Governance Committees (IGCs) to ensure that the pathways are appropriate and provide value for money (see our discussion of IGCs in paragraphs 4.44-4.49)

4.17 We welcome stakeholder views on introducing investment pathway(s) requirements and the nature of any related criteria. For firms that already offer defaults for workplace pensions, we recognise there may be operational efficiencies in adopting these as a non-workplace pension pathway. Other criteria specific to the non-workplace pension customer base (among them the self-employed and other modern employment) might also be considered appropriate, for example contribution flexibility.

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

Investments in cash must reflect an active decision

4.18 Our data collection showed that cash was among the top five most popular investments for several schemes, with at least £3.2bn held in cash. At certain points during saving for a pension, some level of cash holdings may be suitable for some customers. Some consumers may also consciously choose not to invest in assets with a risk of fluctuating value. Over the longer-term, there is a significant cumulative impact from holding cash for a long period of time, due to missing out on investment growth. For many non-workplace pension customers, being invested in a fund that aims to provide growth will be crucial to making sure they meet their long-term objectives.

4.19 The level of cash in SIPPs (at least £1.03bn in complex SIPPs and £1.76bn in streamlined SIPPs) is consistent with our recent Investment Platform Market Study finding. This is that 32% of the 43% cash held by consumers in pension wrappers on platforms is in SIPPs that are in accumulation. This may reflect that some SIPP operators' business models allow consumers to make an initial cash investment until they decide whether they would like to invest the cash. This is an investment decision that, given what our research indicates about ongoing engagement, consumers may not make in good time or at all. In such cases, cash holdings over a sustained period may indicate that the consumer is disengaged.

4.20 In the decumulation market, our retirement outcomes review work found 32% of non-advised drawdown customers at seven large providers (and 18% of non-advised customers of SIPP operators) were highly invested in cash. In response, we recently finalised rules requiring drawdown providers to:

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

We consider that consistent proposals could be appropriate for non-workplace pensions.

> **Q2:** **Do you have any views on applying an 'active decision' requirement to non-advised investments in cash, and**

additional warnings to all consumers about the impact of such a decision? Can you suggest a proportionate alternative?

Promote competition by making the costs clearer and comparisons easier

4.21 Effective competition relies on consumers shopping around across products and providers to choose products that suit their needs and provide value for money. By 'shopping around' we do not necessarily mean switching or even getting multiple quotes. We mean consumers being aware of other options available in the market. To do this, consumers need to be able to easily find, understand and compare the relevant information. It is also important that consumers find it easy to switch where better offers are available.

4.22 Charges are only one factor in determining value for money but they are a key component. However, we found that around half of investors were not aware they were paying charges on their pension, others assumed the charges were low and / or similar across all products and providers.

4.23 So we want to explore how a package of different measures could work together to make it easier for consumers to find, understand and compare charges, and switch easily where a suitable product offers better value.

- Visibility of charges and their impact

4.24 Our consumer research suggests that consumers' awareness of the impact that charges can have on the value of their pensions savings is low. We want to explore a requirement for firms to provide clearer and more salient communication of total charges paid by the consumer and their impact, at the point of sale and on an ongoing basis. The options we would like feedback on are:

- making greater use of pounds and pence charging figures
- illustrating the impact of charges

"I think it is going to be similar across the board like interest rates on your bank account."

Less engaged, lower NWP wealth, advised, Gen X. Source: NMG consumer research

"...there is a percentage figure and I need it in pounds and pence and I need a graph. I am a chart person."

More engaged, Moderate NWP wealth, advised, Gen X. Source: NMG consumer research

4.25 The aim of this remedy would be to:

- raise awareness that charges apply and that they have an impact on the value of the customers' pensions savings, and
- increase the potential for more-informed decision making

4.26 Presenting the information in this way might prompt some consumers to shop around, particularly those that are engaged, and those that need only a little help to engage. However, it may not be sufficient to support the process of shopping around as it would not enable consumers to compare other products and providers.

- Reducing charge complexity

4.27 If consumers cannot compare, this limits the pressure on providers to offer competitive products. The data we collected from firms revealed that comparison of charges is currently difficult at best, and unachievable for most consumers. This is because:

- a consumer can incur many different charges
- the number, name and type of charges a consumer might incur varies by product and/or provider
- the basis on which charges are calculated can differ between products and providers
- the names of some charges assume a level of industry knowledge that a customer may not have:

Any information on charges? I can't see it just scanning through .. It is not easy to see .... Annual Management charge - it is there... initial 7.75% and then 1%. It is not overly easy to understand. It says 1% ordinary unit type and 7.75% initial unit type so is that 7.75% on any initial fund... I don't really understand the split between ordinary and initial.

Less engaged, lower NWP wealth, advised, Millennial. Source: NMG consumer research

4.28 Transparency is an essential element of a healthy market. For consumers who want and are able to find better value in the market, we want to make charges clearer and more comparable. When the pensions dashboard is introduced, access to information about all of a customer's pensions might prompt their curiosity and increase the number of consumers who would like to understand charges and seek better value.

4.29 Earlier this year, we consulted on a requirement for the governance bodies of workplace pension schemes to disclose the transaction costs and administration charges to members for each default and each alternative fund option that a member is able to select. These disclosures would be made at least yearly, with an illustration of the compounding effect of the aggregated costs and charges.

4.30 We consider that presenting all charges information within a similarly limited number of charge categories on all paper and online statements, other customer communications and on websites would:

- increase consumers' likelihood of engaging with charges information
- increase consumers' ability to understand the impact over time of seemingly small percentage-based charges
- enable consumers to compare across all products and providers on a meaningful basis, and
- incentivise each provider to consider and explain how their charges are proportionate relative to the functionality of their product and services

4.31 We welcome stakeholder views on whether administration charges and transaction costs are appropriate charge categories for non-workplace pensions and which additional categories, if any, ought to be considered.

4.32 In making such rules, or seeking industry-led solutions, we will draw on:

- what we have learned about making charge disclosure effective in other markets and sectors
- what we will learn from the review of the consumer pensions journey that we committed to in our joint regulatory strategy for the sector. This work will examine how disclosures and information from pension schemes and providers combine with available guidance and advice services to help consumers make well-informed decisions. This work will be strategic in nature, taking a step back and considering all the previous and ongoing work in this space.

Q3: Do you have any views on the ways we have suggested charges could be made clearer, less complex and more easily comparable? Can you suggest a proportionate alternative?

- Shining a light on charges

4.33 Our consumer research shows that a large proportion of non-workplace customers are unengaged and unaware of charges. We recognise the limitations of disclosure, even when well designed. We consider that the above disclosures are unlikely, in the short term, to be enough on their own to stimulate sufficient numbers of engaged investors to drive value for money. Other parties, however, such as financial advisers, the financial press and consumer bodies could exert this pressure if they also had access to comparable charges data across the market.

4.34 One way to achieve this might be to require firms to report standardised charges data on a regular basis to an independent body (which could include the FCA), which would collate and publish the information. The independent body would then combine this information into a single dataset, which they would then publish. This data collection process might operate in a similar manner to our publication of complaints data.

4.35 Consumer groups, market commentators, regulators and other interested parties could then use this information to report on the implications of these figures. We are currently working on a framework for assessing value for money in conjunction with the Pensions Regulator. This may include benchmarking of costs and charges, together with performance and service metrics. We expect to make further announcements on this in the first quarter of 2020.

4.36 We recognise there are risks with publishing charges information, including that it may encourage pension selection to be made on the basis of charges alone. We welcome views on this point.

Q4: Do you have any views on publishing charges information? Can you suggest a proportionate alternative?

Ease of switching

4.37 The ability to switch is an important part of a competitive market. Increased shopping around is only effective if consumers can actually switch easily (when this would benefit them) and do not see switching as complicated or time consuming.

"I sort of presumed you could but it was going to be an absolute *** ache. You hear horror stories of people trying to contact pension companies but they have moved or don't exist."

Less engaged, lower NWP wealth, advised, Gen X. Source: NMG consumer research

4.38 Most of the consumer research participants that did switch pensions, did so without difficulties. A small number, however, tried to switch or consolidate pots but abandoned the process due to the perceived complexity involved. A very small number faced issues during the transfer process (largely around time involved).

4.39 We therefore welcome and support the progress industry is making to improve the switching process in the platforms, retail investments and pension sectors through STAR, a not-for-profit joint venture. STAR is in the process of implementing a framework which sets expectations for end-to-end standards, consumer communications, and provides oversight and transparency. We strongly encourage firms in the platforms, retail investment and pension sectors to get behind this initiative.

Measures to address charges

4.40 Our analysis of charges in Chapter 3 identified some instances where the total of average mandatory product charges and average fund charges may be higher than caps or benchmarks on other pension products. These benchmarks are the 1% yardstick given by the OFT to the IPB for DC workplace pensions sold post 2001, the 1% cap on SHPs, and the 0.75% cap on administration charges specifically on the default funds in AE schemes.

4.41 The market for workplace and non-workplace pensions differ in some important ways that may or may not legitimately make it more expensive for providers to operate non-workplace pensions than workplace schemes. For example, large workplace schemes can benefit from economies of scale, while non-workplace pensions must be actively marketed to consumers and advisers (including commission arrangements pre RDR).

4.42 Our data collection was not designed to determine if any NWP charges (individually or in aggregate) are too high compared to the costs to providers (service and administration, but also cost of adviser commission on pre RDR sales) and the benefits and services to customers. As a result, it would not be appropriate to recommend direct price intervention such as a cap at this stage.

4.43 However, this charge disparity opens-up the concern that some consumers' pensions are at risk of being invested in products that are poor value for money. It is important that in addressing this concern, we ensure a coherent approach in the context of the FCA's wider work on pensions. So, we propose to decide the appropriate next steps on total charges and / or specific charges (eg AMC, paid-up, or exit charges), in the context of, our upcoming work on driving value for money across the pensions sector:

- Developing a framework for assessing value for money (together with the Pensions Regulator). This work will consider value across workplace and non-workplace, accumulation and decumulation. It will start with the publication of a consultation and discussion paper, currently planned for Q1 2020.
- The review of IGC effectiveness which will ask questions around how IGCs really achieve value for money (2020).

4.44 We consider that (independent) governance may be an additional part of the answer. In other markets where consumers are not well placed to exert competitive pressure, (eg members of DC workplace pension schemes and retail consumers in the asset management market) we introduced a requirement for independent governance to challenge firms on value for money issues.

4.45 Many respondents to our DP, however, argued that any additional oversight would be inappropriate until the impacts of firms' responses to FG16/8, the Senior Managers and Certification Regime and MiFID II are known.

4.46 Some respondents recognised there may be a case for the proportionate extension of IGCs in the non-workplace pensions market but, most respondents said, only if there is evidence that the same inertia and harms exist that prompted their introduction for workplace pensions.

4.47 Therefore, when we consider next steps we will also consider whether and to what extent introducing independent governance would be appropriate and proportionate for non-workplace pensions.

4.48 At the same time, we will consider possible governance for unit-linked funds. In our 2017 consultation on implementing asset management market study remedies we sought views on extending similar remedies to unit-linked funds. Unit-linked funds are used in a range of retail investment products, including non-workplace pensions. Almost 60% of non-workplace accounts are invested in unit-linked schemes or funds.

4.49 Our April consultation on extending the remit of IGCs explained that we would consider possible governance measures for unit-linked funds after completing our diagnostic work on non-workplace pensions. So we will consider this paper's findings and those from our ongoing supervisory work (see para 2.27) when deciding whether we need to introduce further governance remedies for unit-linked funds.

> **Q5:** **Do you have any views on what remedies or further analysis would be appropriate in relation to the level of charges identified in this market?**

4.50 During this time firms should consider how their own product charges compare to our findings across the market, in particular where their charges are at the higher end of the variances.

4.51 As discussed above, we will determine next steps on charges in the context of our upcoming work that considers a VFM framework for pensions. This may involve developing metric and benchmarks across workplace and non-workplace pensions so that scheme operators, members and other stakeholders can compare value for money between schemes and products.

> **Q6:** **Do you have any views on what such a framework should consist of?**

Next Steps

4.52 We will continue to develop our thinking on how to address the issues identified in our findings and consider what interventions would be most effective.

4.53 To reach a view, we will continue to engage with stakeholders. Your views on the questions posed above are an important part of this process. Please send us your views by close of business Tuesday 8th October 2019 to FS19.5@fca.org.uk.

4.54 We aim to issue a consultation paper (CP) on our simplification and disclosure remedies in Q1 of 2020, including a Cost Benefit Analysis for any changes to rules or guidance.

4.55 During 2020 we will carry out the review of IGC effectiveness and publish our discussion paper on value for money. After considering the responses to these papers, we will consider next steps for measures on charges and issue a consultation if we decide we need to make rule changes.

Appendix 1
Abbreviations used in this document

AE	Auto-enrolment
AMC	Annual Management Charge
AUA	Assets Under Administration
s32 buyouts	Section 32 buyout contracts
CP	Consultation Paper
DC	Defined Contribution
DP	Discussion Paper
DWP	Department for Work and Pensions
FCA	Financial Conduct Authority
FS	Feedback Statement
FSA	Financial Services Authority
FSAVC	Free-standing Additional Voluntary Contributions
HHI	Herfindahl-Hirschman Index
HMRC	Her Majesty's Revenue and Customs
HM Treasury	Her Majesty's Treasury
IGCs	Independent Governance Committees
IPPs	Individual Personal Pensions
NWP	Non-Workplace Pension
OCF	Ongoing Charge Figure
OFT	Office of Fair Trading
RAC	Retirement Annuity Contract
RDR	Retail Distribution Review

SHP	Stakeholder Personal Pensions
SIPPs	Self-Invested Personal Pensions
TPR	The Pensions Regulator

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

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