

MS16/1.3: annex 1

Retirement Outcomes Review

Final report annex 1: Scope, approach, and summary
of the interim report

June 2018

1. In this annex we:
 - Set-out the scope of the study.
 - Summarise the issues we looked at and the evidence we gathered.
 - Provide a summary of the interim report, including our interim findings and potential remedies we considered. We also set out the consultation process on the interim report.

Scope of the study

2. We focused the review on provision of retirement options in the UK by the providers regulated by the FCA. Our review discusses the following products and options under pension arrangements that allow consumers to access their DC savings or convert them into retirement income:
 - annuities
 - flexi-access income drawdown
 - hybrid and blended products that combine the features of drawdown and annuities
 - Uncrystallised Funds Pension Lump Sum (UFPLS) cash withdrawals
 - full cash withdrawals
3. In assessing how competition works for the retirement income market, where appropriate, we have also considered the provision of related services, such as pension accumulation products. However, assessing the effectiveness of competition for consumers at accumulation is out of scope of this review.
4. Consumers may use other products to save for retirement and draw on those savings, such as Individual Savings Accounts (ISAs) and equity release products. These products are out of scope of this review. The terms available on these products, such as charges, interest and also other factors such as consumer trust may affect demand for retirement income products. For example, in our review we found that many consumers prefer to keep their savings in ISAs or other savings accounts instead of pension products. However, we do not believe that the inclusion of these products within the scope of our review would have significantly changed our findings.
5. In light of the wide-ranging other FCA work that is focused on financial advice, the scope of this review does not include issues relating to access to, or the value and quality of financial advice. Our focus is on consumers who are making decisions without regulated financial advice. Between October 2015 and September 2016, sales to consumers who did not take advice accounted for 63% of annuity sales and 30% of drawdown sales. This trend remained largely unchanged in the year between October 2016 and September 2017 (see details in annex 2).

Our approach

Issues we looked at

6. We have explored the following topics through ROR:
- shopping around and switching
 - non-advised consumer journeys
 - business models and barriers to entry
 - impact of regulation on retirement outcomes
 - investment decisions by consumers in drawdown
 - charges paid by consumers in drawdown

Evidence we gathered

7. Throughout the review, we analysed a wide range of data and information, and conducted consumer research. We also met with providers, trade associations and consumer groups, and received input from interested parties in response to both the terms of reference and the interim report. This is summarised in table 1.

Table 1: Evidence supporting the Retirement Outcome Review

Source	Description
Responses to our Terms of reference	We received 35 responses from 21 providers, 7 trade bodies, 2 non-governmental organisations, 2 charities and 1 government department. ¹
Responses to our interim report	We received 56 responses from 27 providers, 12 trade bodies, 4 consumer groups and 13 others (see annex 3).
Consumer research	<p>We commissioned three main pieces of qualitative consumer research:</p> <ul style="list-style-type: none"> • to understand non-advised consumer journeys² • to understand consumer decisions to fully withdraw their defined contribution pension savings³ • to understand the consumer engagement with their drawdown investment decisions <p>We also reviewed publicly available consumer research on how consumers have responded to the pension freedoms.</p>
Data from retirement income providers	<p>We used five main sources of provider data:</p> <ul style="list-style-type: none"> • Retirement income data collected by the FCA. We collect data on quarterly basis from a representative sample of retirement income providers and have been publishing high-level statistics based on this data since January 2016. • Bespoke data request on distribution channels and charges. We issued a data request to 56 providers on charges paid by advised and non-advised consumers

¹ See details in annex 1 of interim report - www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report-annex1.pdf

² See details in annex 3 of interim report - www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report-annex3.pdf

³ See details in annex 4 of interim report - www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report-annex4.pdf

Source	Description
	<p>through various distribution channels. These data cover annuity and drawdown sales made between April 2015 and April 2016.</p> <ul style="list-style-type: none"> • ABI data. These cover data on ABI members’ sales since the pension freedoms. • Bespoke data request to providers on drawdown investment choices and charges. We undertook analysis of charges paid by advised and non-advised drawdown consumers and their investment choices. The providers selected for the sample accounted for around two thirds of the total non-advised drawdown market (see annex 4). • We also used data from Moneyfacts to assess trends in annuity rates paid on the open market.
Experimental testing	We commissioned experimental research on the extent to which different types of cost summary metrics may help consumers shop around for drawdown. ⁴
Meetings with external stakeholders	We met with a range of stakeholders, including ten providers, to understand how the market has developed and how providers have adjusted their business models following the pension freedoms.
International comparisons	<p>We held interviews with regulators and government bodies from Canada, Denmark, Ireland, New Zealand and the US to assess whether other countries have faced or face similar issues to those in the UK and whether there are any lessons to be learnt.</p> <p>We undertook detailed work with Australia to ensure our thinking on potential remedies harnessed the Australian experience. Chapter 5 includes a case study on the lessons learned and how they informed our remedies.</p>

Interim report summary

Interim findings

8. In July 2017, we published our interim report. This set out our initial observations on how the retirement income market is evolving after the introduction of the pension freedoms in April 2015, and highlighted areas of potential concern.
9. As set out in the interim report, we found that consumers have welcomed the pension freedoms. Over 1.5 million defined contribution pension pots were accessed between April 2015 and September 2017.
10. Our review identified a number of key emerging issues:
 - Consumers who accessed their pension pots did so early, with 70% of pots accessed before the age of 65. Most are choosing to take lump sums rather than regular income.

⁴ See details in annex 4 of interim report - www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report-annex4.pdf

- Over half (55%) of pots accessed have been fully withdrawn. In the majority of cases DC pots that were accessed were relatively small (64% were under £30k)⁵ compared with the value of the state pension (worth about £200,000).
- Of those pots that were fully withdrawn, the vast majority of them were under £30k (90%).⁶ Also, of those consumers who fully withdrew their pots, 94% had additional sources of income in addition to the state pension.⁷
- Consumers who fully withdrew their pots did so partly because they do not trust pensions. Most of them did not spend their savings but rather moved them to non-pension products (such as ISAs).⁸ This could cause them harm by missing out on investment growth, employer contributions, and paying more tax. Their mistrust in pensions was typically not based on personal experience, but rather influenced by pension scandals, a perception that their pension money is 'doing nothing sitting there', and a belief that pension rules were constantly changing.
- Most non-advised consumers choose the path of least resistance, accepting drawdown from their current pension provider without shopping around. Many consumers focused on taking the tax-free cash and did not consider the rest of the pot. Many did not even realise they had accessed drawdown. This might lead them to pay higher charges and to make investment decisions that do not provide the best outcomes.
- The proportion of consumers entering into drawdown contracts without taking advice had risen from 5% pre-reforms to 30%.⁹ These consumers may need further support and protection to manage their drawdown effectively.
- More than twice as many pots are moving into drawdown than annuities. Approximately 30% of pots have entered into drawdown, compared to only 12% that have been used to purchase annuities (compared with 90% of pots moving into annuities and only 5% into drawdown before the pension freedoms).¹⁰
- Many providers are leaving the open annuity market with only seven providers offering annuities in the open market.
- There is limited innovation for mass market consumers, as providers have focused on delivering the changes from the pension freedoms. However, we acknowledge that this market is still developing and providers and consumers are continuing to adjust to the reforms. Innovation may develop as DC pots grow in size and industry is given more time to develop propositions.
- This market is still developing and providers and consumers are continuing to adjust to the reforms.

Potential remedies we considered in the interim report

11. Our interim report proposed a number of potential remedies to address the issues we found, and asked stakeholders for feedback and comments on them.

⁵ FCA analysis of FCA retirement income market data collected from 56 providers, October 2015 – September 2016.

⁶ Of pots that were fully withdrawn October 2015 - September 2016. See Figure 19 in the interim report.

⁷ Our research was with consumers who had withdrawn a pension pot worth at least £10,000 without taking regulated financial advice.

⁸ Based on consumer research summaries in the interim report.

⁹ October 2015 and September 2016. This has remained stable in the period between October 2016 and September 2017, at 31%.

¹⁰ www.moneymarketing.co.uk/issues/26-january-2017/annuities-down-but-not-out

12. **Additional protections for consumers who access drawdown without advice**

- Default or off-the-shelf investment pathways. Many consumers do not engage with or struggle to make pension decisions. Requiring providers to offer a default or off-the-shelf investment pathways could help ensure they select an appropriate product. This could be particularly beneficial for non-advised consumers who do not or cannot engage with their pension decisions, who are also likely to be some of the most vulnerable.
- Charge control measures for default or off-the-shelf products, to ensure they provide value for money. For the final report we conducted additional research to assess the potential harm to consumers.
- Oversight arrangements – we considered extending the role of Independent Governance Committees (IGCs) to decumulation products offering drawdown options. IGCs currently scrutinise value for money in workplace accumulation products, and could potentially also do so for default or off-the shelf pathways.

13. **Measures to promote competition for consumers who access drawdown without taking advice**

- 'Decoupling' - enabling consumers to access some of their savings early without having to take pension benefits with the rest of their pot. This will allow consumers to take the 25% tax-free cash while delaying the important decision about the rest of the pot until a time when they are ready to focus on it. We acknowledged that decoupling requires making changes to tax rules through primary legislation, and will require providers to make administrative and systems changes.
- Make it easier for consumers to compare and shop around for drawdown
 - facilitate the introduction of drawdown comparison tools
 - promote the use of summary cost metrics

14. **Tools and services to help consumers make good choices.**

- improve the effectiveness of communications (e.g. wake-up pack and risk warnings)
- encourage the use the free guidance services (e.g., from Pension Wise)
- increase awareness of enhanced annuities

Consultation process

15. We sought views on our interim findings following their publication. This was intended to give all interested parties an opportunity to comment on our emerging thinking and analysis. This helped assure the robustness of our findings and promote continued constructive engagement between the FCA, providers, trade associations, consumer bodies and other interested parties.
16. As part of our consultation process, we held various stakeholder events including roundtable discussions with industry and consumer groups. These well attended events were considered as part of our consultation.

17. We received 56 formal written responses to the interim report from a cross-section of stakeholders including providers, consumer bodies, trade associations, individuals and academics.
18. A summary of views from stakeholders on the interim findings and early thinking on remedies can be found in annex 3.

