FINANCIAL CONDUCT AUTHORITY

MS16/1.3: annex 3

Retirement Outcomes Review

Final report: annex 3: Feedback on interim findings and our early thinking on remedies, and our response

June 2018

1. In this annex, we summarise the feedback we received on the interim findings and our early thinking on potential remedies. We also respond to these.

2. We received 56 formal written responses to the interim report from a cross-section of stakeholders including providers, consumer bodies, trade associations, and individuals.

3. The responses generally agreed with our findings and mostly focused on our early thinking on remedies. Their views have affected our thinking on remedies and have fed into their development.

4. The annex is divided into:

   - feedback on our interim findings and our response
   - feedback on our early thinking on remedies and our response

Feedback on our interim findings and our response

5. The vast majority of respondents said that the analysis was thorough and that the findings align with their experiences and understanding of the market. There was also general agreement that the issues we identified in the retirement outcomes market can have a significant impact on consumers.

6. A small minority of respondents challenged some aspects of our findings, and others highlighted issues they felt should have been looked at in more depth. These challenges to our findings focused on the following issues that:

   - accessing pensions early has not become the 'new norm' as stated in the interim report
   - the interim report underestimated the actual uptake of guidance

7. Alongside these, respondents also highlighted additional issues, which while outside the scope of this review, they felt were particularly important for the retirement outcomes market that:

   - greater policy and regulatory certainty is needed
   - educating consumers about the need to save more should be a priority

General agreement with our findings

8. The vast majority of respondents generally agreed to our findings, and noted that they align with their experience and understanding of the market, as well as their own research.

9. Most respondents agreed that many consumers who were going into drawdown, were doing so only for the purpose of taking their tax-free cash and were not yet taking an income. Our non-advised drawdown pension sales review corroborated this finding.

10. There was also general agreement that there are low levels of consumer understanding of pensions.

Shopping around

Feedback received

11. Respondents also largely agreed there was a lack of shopping around in the market. However, some noted that many consumers were fully encashing their pots, mostly small pots, in which case no shopping around was needed. Several respondents also noted that many consumers were not buying new products in order to access drawdown, but rather were exercising an option in a product they had already shopped around for previously. Others noted that drawdown was not a one-off decision, and therefore consumers who did not shop around may still do so in the future.

Our response

12. We agree that shopping around is not needed in all cases, including when people fully encash their pots. We believe however that there are significant potential benefits in shopping around for drawdown, even when consumers may have shopped around before.

13. Also, while we agree that accessing drawdown is not a one-off decision and that consumers are able to shop around at different stages, we believe that the point in which consumers go into drawdown for the first time is a key point for shopping around. We believe it less likely that consumers will be shopping around at later stages if they have not done so initially, and also believe it is important that they make the right choice of product at an early stage.

14. Our evidence shows that levels of shopping around in drawdown are very low. We also found that charging structures are complex and opaque, which makes shopping around and switching difficult for consumers. As we detail below, we have also found that drawdown charges vary considerably between different providers, which indicates low competitive pressures on pricing.

15. We therefore believe that competition is not working effectively in this area, and that measures are needed to remedy that.

Accessing pensions early becoming the new norm

Feedback received

16. There was challenge, particularly from one trade body, to our finding in the interim report that 'accessing pots early has become 'the new norm''. They argue that most consumers who are eligible to access their pots have not done so, and that therefore early access should not be considered 'the new norm'. They also expressed concerns that the use of this terminology may inadvertently act to drive consumer behaviour toward following similar courses of action, because it is considered the 'new norm'.

Our response

17. We agree that the majority of DC pots belonging to those aged 55 and over have not been accessed.

18. Our review focused on consumers who have accessed their pots since the reforms. We found that most of those (72%) who have accessed their pots did so early, before the age of 65. We also found that most of the people who accessed their pensions withdrew the tax-free portion of the pot early.

19. Our finding is therefore that '*of the people who accessed their pension pots*, accessing them early and withdrawing tax-free cash has become the new norm'.

20. We do not believe that accessing pension pots early should be the 'new norm' and it is definitely not our intention to incentivise early access. Our proposed changes to rules will amend the pre-retirement information sent to consumers to emphasise that consumers should consider and review their pensions savings, but do not necessarily need to take any action. We propose for consultation that the earlier 'wake-up' packs will include a statement to consumers to consider whether they are saving enough to meet their needs in retirement. The risk warnings in the packs will also warn consumers that accessing their pension early may not be the best option for them (if, for example, the consumer would forego an employer contribution as a result).

The uptake of guidance

Feedback received

21. We received challenge to the analysis on the uptake of guidance, which led us to conclude in the interim report that 'so far the take up of Pension Wise has remained low'.

22. The responses challenged the calculations we made on the uptake of guidance, argued that more prominence should have been given to the use of the Pension Wise website, and that further consideration should have been given to the fact that consumers who take advice are unlikely to also require guidance.

Our response

23. Having considered the challenge, we agree that the interim report may have underestimated the uptake of guidance.

24. We found that in the third quarter of 2016, 143,752 pension pots were accessed by consumers and 13,990 consumers had a Pensions Wise appointment. The interim report considered that this equated to about 10% of consumers who accessed their pots seeking guidance from Pension Wise. However, the same consumer may be accessing multiple pots – on average two pots for each consumer during this period. We therefore estimate that around 20% of those consumers accessing a DC pension in this period had a Pension Wise appointment either by telephone or face to face.

25. Further, consumers are also accessing the information available on the Pension Wise website and since its launch it has received over 5 million visits. This is a substantial figure even allowing for the fact that not all those visits will be by consumers looking to access their pots.

26. Our consumer survey asked consumers whether they had sought guidance in making their investment decisions, and if so from what source. We found that consumers sought guidance from a range of sources. Over half (54%) said they received guidance from their pension provider, while 46% received guidance from Pension Wise, 23% from friends and family and 16% from the Pensions Advisory Service.

27. These figures are broadly consistent with Pension Wise's own usage figures, and suggest that a higher percentage of consumers use the guidance bodies than we set out in our interim report. It should be noted that there is potential for some confusion for consumers between Pension Wise and the Pensions Advisory Service.

28. We believe that consumers can benefit greatly from the use of guidance and some of our remedies seek to further encourage consumers to use these services. The Financial Guidance and Claims Act is also making changes and brings together all guidance provision in one place to facilitate consumer access to guidance.

Policy and regulatory change

Feedback received

29. A number of respondents called for greater certainty in the treatment of pensions and retirement policy. Some of them considered that the lack of trust in pensions is partly due to the changing regulatory and legislative environment in recent years, and called for a sustained period of consistency to help restore confidence.

30. Others further argued that the trend of taking the tax-free cash early is partly driven by a public perception that future legislation changes would prevent consumers from getting access to their cash. They called for assurances to be given that no significant policy changes will occur for some time, and considered that this might reduce people's motivations for taking the tax-free cash early.

31. As we noted in the interim report, respondents also argued that the volume of regulation and regulatory uncertainty deterred potential entrants and inhibited innovation from incumbents.

Our response

32. We agree that our analysis indicates that some consumer decisions may be affected by a perception that pension rules may change. As our consumer research showed, one of the motivations for fully withdrawing pension pots was that consumers believed that the pension rules were unlikely to stay the same, and therefore wanted to access their savings before the rules changed again.

33. We also said in the interim report that ensuring this market works well will require cooperation across the Government, regulators, the industry and consumer bodies. In particular, all of these have a role to play in re-building trust in pensions, including providers working with Government and other regulators to support the embedding of previous interventions so that trust can be built within the new regulatory framework.

34. The overarching pension regime is determined by Government, not by the FCA. Changes to policy and primary legislation are therefore outside the scope of this study, and indeed outside the FCA's mandate. Our focus is on making the current regime, post the pension freedoms, work well and achieve good outcomes for consumers.

35. Nonetheless, we believe that stability and certainty in the pensions market are likely to positively impact trust in the sector. In Australia, where the pension regime has been largely static for over 20 years, consumers on average are more engaged with their pension funds (mostly MySupers)[1] than UK consumers are with theirs (see further details in the case study in chapter 5).

36. We call on Government to consider the potential benefits of a stable and more certain pensions system and rules.

[1] There are multiple types of funds, but Australians typically save through their workplace into MySupers. These are simple and cost-effective default accumulation products, with a single investment option or a lifecycle investment option.

Educating consumers about the need to save more

Feedback received

37. Several stakeholders noted the complete lack of consumer understanding, particularly in relation to longevity and the risk of running out of funds.

38. Some called for Government, guidance bodies, the FCA and the industry to educate consumers about the need to save more and invest for the long term to meet their future retirement needs. They also called for a change of message to make clear that accessing a pension early might have a significant negative effect on retirement income. They warned against normalising access to pensions as soon as a consumer reaches the age of 55.

39. Other respondents highlighted longevity risk as the single most important issue in the pension market. One respondent argued that if assets perform as expected, on average, and longevity is on average as expected, around half the pensioner population will use all their DC funds by simply surviving beyond the average life expectancy. They too called for action from Government and the regulator to educate the public about the need to save more.

Our response

40. Although the direct issue of longevity risk is largely outside the scope of this review, we agree that consumer education is crucial, and that one of the biggest potential harms in the sector is the prospect of people not having adequate income, or the level of income they expected, in retirement. We also recognise that this harm is affected by several factors that we cannot tackle alone and this is an area of focus in our joint strategy with tPR.[2] We will continue working with other regulators and the Government to protect consumers.

41. In addition, changes that the Government has introduced, including auto-enrolment and the Fuller Working Lives project, will help people save more for their retirement and be able to work for longer. Also, several of our proposed remedies are targeted at improving the engagement of consumers with their pension decisions and associated risks, and at providing them with further support. We also believe that the introduction of pathways will help consumers manage their pensions more effectively. This includes them considering longevity risk and how to secure an income for life.

Feedback on our early thinking on remedies and our response

42. In this section we summarise the feedback we received on our early thinking on remedies and respond to it.

43. The section is divided into:

- general feedback on our approach for developing remedies
- specific feedback on the following considered measures:
  - additional protections for consumers who access drawdown without advice

[2] Regulating the pensions and retirement income sector: Our strategic approach, Joint call for input, www.fca.org.uk/publication/call-for-input/call-for-input-regulating-pensions-retirement-income-sector.pdf

- measures to promote competition for consumers who access drawdown without taking advice
- tools and services to help consumers make good choices

Work and Pensions Committee

44. In April 2018, the Work and Pensions Committee published its final report of its inquiry into pension freedom and choice. The Committee's reports are highly relevant to much of the work we are currently undertaking, and plan to undertake in future. It has formed an important part of our considerations and we set out throughout this report how our remedies relate to the inquiry's findings.

General feedback on our approach for developing remedies

45. We set out our approach to developing remedies in detail in chapter 8 of the interim report. As we described there and in our guidance on market studies,[3] we want to ensure that our regulation evolves with the financial services market rather than holding it back. We are keen to understand how and when regulation can provide unnecessary barriers to new providers entering the market.

46. We therefore want to identify proportionate and effective measures to address our concerns without having a negative impact on the pensions market, and use our four-step decision-making framework[4] to do so.

47. Getting this right will require cooperation across the Government, regulators, industry and consumer bodies as the measures we are proposing do not fall within the FCA's remit alone and some of these issues sit outside our immediate powers.

48. When we consider introducing remedies, we first assess the range of our available regulatory tools and make a judgement about whether these tools can remedy or mitigate the harm cost-effectively. Choosing the best remedy will often mean carefully combining tools. Indeed, our proposed package of remedies, as detailed in chapter 5, uses a number of different tools, targeted at different issues, to achieve the best outcomes.

49. When we set out our early thinking on proposed remedies in the interim report, we considered:

- the tools we can use, including our powers and our ability to make further rules, as well as constraints from relevant legislation
- how each remedy would address our findings and resulting consumer detriment
- how effective and proportionate the remedy (or package of remedies) would be
- how the different remedies would interact and work as a package to make the market work better for those consumers for whom it is not working well
- how the remedy (or package of remedies) fits in with the FCA's other policies and actions relevant to pensions

50. In our interim report we asked for views on our early thinking on the overall approach for intervening in this market, including on whether our proposed remedies

[3] www.fca.org.uk/publication/finalised-guidance/fg15-09.pdf

[4] See 'Our Mission', page 10 onwards, www.fca.org.uk/publication/corporate/our-mission-2017.pdf

strike the appropriate balance between intervening early while also giving the market time to adjust.

51. The respondents to the interim report largely supported our approach to developing remedies, and raised a number of general issues which we set out below. As expected, there were different views about which measures were most appropriate and will be most effective as well as about the right mix and combination of measures.

52. In developing our remedies we also considered other relevant work we conducted in the meantime. This includes the findings from the Thematic Review on non-advised drawdown sales, the review of annuity sales practices (TR16/7) and additional information which suggested that changes were needed to our rules on the annuity information prompt (see chapter 5 for further details).

Intervening early vs giving the market more time to adjust

53. The respondents largely supported our approach with some mixed views as to whether we should intervene early or give the market more time to adjust to the reforms.

54. Some respondents argued that intervening at this early stage might dampen the pace that providers can continue to adapt and innovate. Other respondents said that further intervention and change might also exacerbate feelings of consumer mistrust in pensions.

55. Conversely, other respondents raised concerns that we should intervene at this stage to prevent harm from crystallising, and maintained that we should intervene to ensure that the market evolves in the right way. One respondent also argued that intervening at this stage is not in fact early as many of these issues already existed in the retirement income market before the freedoms were introduced.

56. On balance, there was greater support for intervening now to address the emerging issues we have identified, than giving the market more time to adjust.

Risk of disparity between types of pensions and products

57. A number of respondents expressed concerns that the considered remedies create a disparity between the experience of, as well as the rules that apply to, those in occupational pensions and those in contract-based arrangements. Some of them argued that interventions that are applied to contract-based pensions should therefore also be applied to occupational pensions, while others argued that this was a reason for not introducing these measures at all.

58. Similarly, others were concerned that the measures might create a discrepancy between different options for using the pension pot, with the interventions focusing largely on the drawdown option and not on full encashment and UFPLS.

Enhancing consumer engagement vs a non-engaged approach

59. Some respondents also argued that the interim report did not present a vision of the market, to base the remedies on. They argued that a vision for the market could either be one in which consumers are engaged and empowered to make good choices, or one which assumes a lack of engagement from consumers and therefore focuses on different remedies, such as introducing defaults.

60. Some respondents argued that the latter might be counter-productive as it might exacerbate the issue of consumers not engaging.

Our response

Intervening early vs giving the market more time to adjust

61. We recognise that the market is still evolving and adjusting to the pension freedoms, and acknowledge the need to strike the appropriate balance between intervening early and giving the market time to adjust.

62. In developing our final suite of measures we considered the responses to our general approach to developing remedies, as well as the responses to the specific considered remedies. While some respondents felt that some issues may resolve themselves over time if the market were given time to adjust, there was also general consensus that at least some of the issues we identified will not be resolved without some intervention from the regulator.

63. As expected, some remedies received more support than others. In considering our final approach we took this feedback on board. Accordingly, we intend to progress some of these measures now, seek further feedback on others, and have decided not to progress other remedies at this stage. We set out how we will take these remedies forward in chapter 5.

64. Our proposed package of remedies addresses immediate issues we identified as causing consumers harm, and also aims to put the pensions market on a good footing for the future. We believe it is a comprehensive package of remedies, which balances between consumer protection measures and remedies to promote effective competition, and that it will not hinder innovation.

Risk of disparity between types of pensions and products

65. We agree that this review focused mostly on consumers using drawdown and those who made full withdrawals, and much less on consumers who used UFPLS. The reason for that is that only a very small percentage of those who accessed their pots have made use of the UFPLS option.[5]

66. We also agree that our remedies focus mainly on people using a drawdown option, with limited focus on those who withdraw fully. There are a number of reasons for this:

- Firstly, pots that have been fully withdrawn have mostly been small and belonged to people who had other significant sources of retirement income.
- Secondly, those who withdraw their pot completely no longer hold a pension, and therefore interventions relating to products and providers will not impact them.
- Thirdly, drawdown grows in prevalence as the size of the pot increases, and the proportion of consumers going into drawdown on a non-advised basis has been growing too. Indeed 86% of pots over £250,000 go into drawdown compared to 2% withdrawing fully. DC pots are expected to grow and become an increasingly significant part of consumers' total pensions wealth, and therefore our focus on drawdown is intended to put the market on a good footing in the future.

[5] See for example Figure 2 on page 8 of the interim report.

67. In any case, interventions aimed at engaging consumers with their pensions and increasing competition, do apply to that population and we believe they will have a positive effect in enabling consumers to consider their options and make retirement income decisions.

Enhancing consumer engagement vs a non-engaged approach

68. We believe that the more engaged consumers are with their pension decisions, the better the market performs, and that consumers get better outcomes as a result. As a result a number of our proposed remedies are focused at increasing engagement with consumers and providing them with clearer simple information and ways to compare between products and providers, so that they can make better decisions.

69. At the same time, we also recognise that some consumers cannot or will not engage with their pensions, for example due to low financial capabilities. Often these consumers are from particularly vulnerable populations, and to avoid them suffering harm require protections. We also recognise that pension decisions are complex, and many non-advised consumers struggle to make them. For this reason, some of other proposed remedies are focused on protecting consumers from poor choices, such as holding funds in cash for extended periods of time, or being invested in assets that do not match their needs and objectives. We set out how we will take forward our remedies in chapter 5.

Feedback on measures providing additional protections for consumers who access drawdown without advice

70. As we set out in detail in the interim report, decisions about how to make the most of a drawdown option are very complex, and we are concerned that many consumers will struggle to make them. In particular, we are concerned about the potential of consumers ending up with unsuitable investment strategies, and about them paying excessive charges.

71. In the interim report, we suggested that we would consider introducing the following additional protections for consumers who access drawdown without advice:

- default investment pathways for consumers who do not or cannot engage with their investment decisions
- charge controls measures and governance arrangements –
    - a charge cap for the default investment pathways
    - extending the role of Independent Governance Committees (IGCs) to ensure that decumulation products – including default investment pathways – are appropriate and provide value for money

72. We also requested views on our decision not to pursue the option of introducing an appropriateness test for consumers moving into drawdown without taking advice.

73. The vast majority of respondents agreed that additional protections should be put into place for people who access drawdown and that we should not introduce an appropriateness test for non-advised drawdown. A few raised objections and made other suggestions. We set out these views and our response to them below.

Feedback received on default investment pathways

74. We suggested that we would consider requiring pension providers to offer consumers who decide to access drawdown, default investment pathways based on retirement outcomes chosen by the consumer. Consumers would be free to choose an alternative investment strategy if they wish to do so. The interim report also set-out an example of how investment pathways could work.

75. Most respondents, including some of the largest providers, expressed a general agreement to exploring this option further. They agreed that the choices consumers need to make are very complex and held that current provisions for guidance are not sufficient to deal with this. Therefore they agreed that default investment pathways could be valuable in protecting people. Some of the respondents who supported this measure also raised issues and had suggestions on how it should be applied and what considerations should be taken into account. A minority of respondents opposed the idea and raised arguments against it.

76. The Work and Pensions Committee subsequently recommended that Government introduces default decumulation pathways, and that the charges for these will be capped and set at 0.75%, the level of the charge cap on default arrangements in qualifying workplace pension schemes used for automatic enrolment.[6]

77. The following issues were raised during consultation:

- **Use of the term 'default'**: A number of respondents from industry who generally supported this remedy challenged the use of the term 'default' to describe it. They requested clarification on whether we meant a genuine default, i.e. a pathway that applies without the consumer having to make a choice, or rather that providers will develop off the shelf investment pathway or pathways and will give consumers an option to choose from them.

- **On-going engagement with the drawdown option:** Other respondents emphasised that managing drawdown options requires ongoing engagement, and that consumers will need to be able to update providers on their circumstances and change the pathway accordingly. The products and services will therefore need to be flexible and allow for updates and changes.

- **Pathways should only apply to some consumers:** Some providers emphasised that pathways should only be explored for consumers who don't want to or don't feel able to choose appropriate investments, and not to all consumers. Other respondents emphasised that default pathways and off-the-shelf products cannot replace advice.

- **Explore default products:** Some respondents argued that default investment pathways are important but should go beyond investment pathways and look at default products.

- **Pathways will discourage consumer engagement:** Some respondents from industry who were opposed to this measure argued that investment pathways might further discourage consumer engagement, and might therefore result in increased inertia. In the longer term, some of them argue, engagement will be more effective than defaults.

- **Difficulties in developing default product that will fit all consumers:** Other respondents, mostly from industry, who also opposed the measure said that one size does not fit all, and that consumers have different circumstances so that it will be difficult to create investment pathways that would work well for all. Some

[6] http://www.publications.parliament.uk/pa/cm201719/cmselect/cmworpen/917/91702.htm (paragraph 22)

considered it a reason not to introduce this remedy at all, while others argued that developing just one 'default' product might prove to be inappropriate for the needs of many of the consumers that go into it, and therefore argued that a number of pathways will be a better solution.

We also note that the Work and Pensions Committee has recommended that the Government takes forward our proposal in the interim report to require any provider offering drawdown to offer a default drawdown solution targeted at their core customer group.

Our response

78. We have considered this feedback and reflected it on our thinking and development of the investment pathways. Further details can be found in chapter 5 and in the discussion chapter in the Consultation Paper.

Use of the term 'default'

79. We have considered this feedback and in our final proposed remedies have moved away from using the term 'default'. Instead, we are seeking further feedback on our potential proposal that providers develop a number of investment pathways, to fit the needs of different groups of consumers.

On-going engagement with the drawdown option

80. We agree that the management of drawdown options requires ongoing engagement from consumers. We are therefore considering proposing to require providers to periodically remind consumers of their investment pathway, its objectives and the steps they should take if they need to change their pathway.

Pathways should only apply to some consumers

81. We are considering requiring that providers which provide drawdown to non-advised consumers should provide investment pathways to their customers.

82. We believe the measure would assist all consumers in getting an investment pathway that generally suits their needs and objectives. However, consumers will not be obliged to choose one of the pathways, and those who wish and are able to further engage with their pension decisions, may choose bespoke investment allocations (including cash if they wish to do so). The investment pathways will be available to all consumers, both advised and non-advised, and advisers would need to consider whether a pathway may be the best option for their client.

Explore default products

83. Having considered all the responses and conducted further work, we believe that requiring providers to 'default' consumers into one single default option would not be advisable. The needs and objectives of consumers are diverse, so that one single option cannot match them appropriately.

Pathways will discourage consumer engagement

84. We agree that consumer engagement is important and would like to see consumers engage more with their retirement decisions. Some of the remedies we are considering are targeted directly at increasing consumer engagement to drive better decisions.

85. As many consumers struggle to engage and deal with the complex decisions needed in the retirement income market, and in light of the low levels of trust and engagement in the pension market, we believe that investment pathways will support consumers in making more informed choices. For those who cannot or will not engage, it will offer them some protection from making poor choices.

86. We also believe that the pathways will in fact increase consumer engagement for non-engaged consumers, and are seeking feedback. With the pathways, consumers going into drawdown will be presented with a few options that they will need to choose from. This will require them to make an active choice, and engage in the decision of either choosing an investment pathway or making a different choice.

Difficulties in developing default product that will fit all consumers

87. Following our further work, we have moved away from that as we do not believe that a single, 'default' investment pathway is appropriate. Consumers' needs and objectives are diverse, and we believe that one single option cannot match them appropriately. We are also concerned that a single default might reinforce the lack of consumer engagement.

88. We are therefore considering proposing that providers develop a number of investment pathways, to meet these different needs and objectives of different groups.

Feedback received on charge controls measures and governance arrangements

89. We suggested that we would consider introducing charge control measures to the default investment pathways. This could help ensure that those consumers who enter drawdown via the pathways are offered value for money.

90. We also asked for views on the possibility of extending the role of Independent Governance Committees (IGCs) to help ensure that drawdown options within schemes are both appropriate and offer value for money. IGCs currently scrutinise value for money in workplace accumulation products, and could potentially also do so for drawdown investment pathways.

91. In addition, we asked for views on our decision not to pursue the option of introducing an appropriateness test for non-advised drawdown at this stage.

92. Respondents were split on whether or not cost controls were needed. There were also split opinions about the option of extending the role of IGC's to review drawdown options within schemes and the investment pathways, although overall it received more support than opposition. The vast majority of respondents agreed that we should not introduce an appropriateness test at this stage.

Feedback received on charge cap for investment pathways

93. Consumer and professional bodies, and also a small number of providers, supported the introduction of cost control measures. They considered that a charge cap goes hand in hand with the pathways, as an effective way to ensure that these offer good value for money. Others suggested that as a cap was in place for accumulation it would be 'remiss' not to do so in decumulation too. However many providers, and some of the other respondents, considered that a charge cap should not be introduced. They also noted that the costs in decumulation are higher than in

accumulation so that if a cap were to be introduced, it will need to be higher than 0.75%.

94. Some respondents who supported this measure did argue though that if cost controls are introduced they should be flexible enough to allow for variations in products, and will need to take into account of the different product characteristics and features.

95. There was general consensus among respondents that controlling for costs should only be applied to the pathways, and should not extend to other aspects of the product or other products. The Work and Pensions Committee also supported the introduction of a cap, noting that the same charge cap that applies to automatic enrolment schemes, 0.75%, should apply to decumulation pathways.

96. Those opposed to controlling costs argued that they might reduce product innovation, lead to overly simplified and generic products, and reduce product availability and quality, thereby stifling competition. Some also argued that with the introduction of pathways and effective governance, there would be no need to control charges. Others offered an alternative to a charge cap in the form of dealing with 'bad offenders' through enforcement rather than introducing market wide rules. Additional respondents also argued that there was insufficient evidence on charges to support the need for a charge cap.

Our response

97. As we outline in detail in chapter 4, we found that charges in decumulation are on average higher than in accumulation. We also found that charges vary significantly between providers.

98. This raises concerns that current charges might be higher than they should be if there was more efficient competition in the market. It also suggests that charges for some of the suppliers could be lower, closer to those of their competitors, which in turn might suggest ineffective price competition.

99. We acknowledge however that the market is still developing. We also acknowledge that we do not have sufficient data on the cost of drawdown to determine what a cap might be.

100. We are therefore not proposing to introduce a charge cap at this stage on the investment pathways. Our expectation is that as providers continue to develop their consumer offerings, they will also review and develop their pricing structures.

101. To ensure that the investment pathways offer value for money we will review the charges being applied to the pathways one year after their implementation. If the evidence we gather suggest it is necessary, we will undertake work to fully understand the cost of providing the investment pathways to determine whether the charges consumers are paying are excessive. If we find that they are, we will consider the options for charge controls on the investment pathways, including a charge cap.

102. We are also introducing other measures to improve the transparency of charges, and are promoting the introduction of a drawdown comparator, which will increase competition in this market.

Feedback received on extending the role of IGCs

103. There was a general agreement for the need for independent governance, and several respondents agreed that IGCs and scheme trustees could have a role here.

104. Those who supported this measure considered that IGCs could help provide governance and ensure value for money, and believed that they were well placed to do so.

105. Others who opposed this measure, mostly pension providers, raised a wide range of arguments including that IGCs might not have the right expertise, that doing so will increase compliance costs disproportionately, and that it might distract IGCs from their main purpose. Additional respondents also argued that many drawdown providers do not currently have IGCs in place and that requiring them to have them will increase their operational costs significantly and might push some providers out of the market, thereby reducing competition.

Our response

106. Having considered the responses, we are further exploring in our CP how a requirement for independent governance should apply. In particular, we are considering whether it should apply to all decumulation products or only investment pathways. We are also considering a carve out from the requirement for those providers which only provide decumulation products for advised consumers, or for sophisticated and/or high net worth individuals.

Feedback received on appropriateness test

107. The vast majority of respondents, particularly providers, agreed with our proposal not to introduce an appropriateness test for consumers moving into drawdown at this stage. Only a few disagreed.

108. Respondents argued that an appropriateness test for consumers going into drawdown might push people into fully encashing, that it might be seen to add another unwanted barrier that would add to consumers' mistrust, and that making an assessment of appropriateness would be difficult given very different consumer circumstances.

109. Those who thought that this should be pursued at this time believed it would add the extra protections that non-advised consumers require.

110. A small number of respondents also considered that guidance should be made mandatory, as a prerequisite for accessing the pension pot.

Our response

111. The responses confirmed our initial position of not introducing an appropriateness test at this time.

112. We remain of the view, as set out in the interim report, that we will not introduce an appropriateness test for consumers moving into drawdown at this stage. This is because it could risk removing the choice available to consumers who do not take advice, if they were unable to demonstrate sufficient knowledge and expertise in the investment field. This could risk leaving some consumers with a binary choice of buying an annuity or taking cash. As we have noted, we have also seen some encouraging development in providers' processes and propositions to better facilitate non-advised consumers in making investment choices. We want to give the market further time to continue to develop.

113. We would also note that, our existing rules require providers to signpost consumers to guidance when they look to access the freedoms. The Financial Guidance and Claims Act 2018 adds to these requirements. The Act requires us to make rules

providing that, before proceeding with an application to access or transfer a consumer's pension savings, firms must ensure that the consumer has either received appropriate pensions guidance or opted-out of receiving it. We are currently assessing what changes we need to make to our rules to implement the legislative requirements, and will consult on changes in due course. We have also reviewed the effectiveness of existing mechanisms to encourage more consumers to take guidance when they access the pensions freedoms. In particular, we are consulting on rules to introduce a headline disclosure from age 50 which will prompt consumers to seek free guidance.

Feedback on measures to promote competition

114. We found that some consumers have moved into drawdown just to access their tax-free cash before retirement. At the time, consumers did not consider shopping around and whether the product was suitable or good value because they were not focused on making a decision about the rest of the pot. This could potentially lead to poor outcomes for consumers, including paying higher charges, paying too much tax and missing out on employer benefits.

115. In the interim report, we suggested that we would consider introducing the following 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 go into drawdown
- Shopping around remedies for drawdown –
    - facilitating the introduction of drawdown comparison tools
    - promoting the use of a summary cost metrics

116. We also provided information on other measures we considered and decided not to pursue at this point.

Feedback received on decoupling

117. Some pension schemes do not have a 'drawdown' feature. Consumers invested in these funds who wish to take a tax-free lump sum need to transfer out of their accumulation product to a new product with a drawdown feature.

118. In the interim report we considered a remedy of 'decoupling' the decision to access tax-free cash early from the decision about what to do with the remainder of the pot. We considered that this will allow consumers to delay the important decision about what to do with the rest of the pot until a time when they are ready to focus on it. This in turn could lead them to shopping around and to choosing more suitable investment strategies. Decoupling requires making major changes to tax rules through primary legislation in relation to taking pension benefits. It will also require providers to make administrative and systems changes.

119. Leading consumer bodies and a few other respondents were either in favour of decoupling or considered that it was worth further exploration. They believed that decoupling had the potential to help many consumers who wanted to take the tax-free lump sum and have not engaged in the decision of what to do with the rest of their pot.

120. Supporters of the remedy also argued that it could enable consumers to remain within the product they have in accumulation, and in some cases, with the protection afforded by the regulation and governance structures for qualifying schemes under automatic enrolment (such as the 0.75% charge cap). They also argued that it could prevent individuals from withdrawing more than they need.

121. Many respondents, both those who opposed this remedy and those who supported it, mentioned the need to change tax rules in order to enable this remedy, and considered it to be a significant hurdle to overcome.

122. Respondents who opposed the remedy, including most of the pension providers, highlighted the costly changes that will be required to providers' processes and systems to enable this. They considered them to be disproportionate compared to the potential benefits, which some argued did not exist.

123. They also argued that many newer products already have a drawdown feature in them, so that the issue is limited to older legacy contracts. They also stated that some providers allow consumers to retain their existing investments when taking pension benefits. Therefore, they argued, the market is already delivering de-coupling to some extent, and no further intervention is required.

124. Respondents who opposed decoupling also argued that it might have the unintended consequence of increasing consumer inertia. They argued that not having to make this choice might increase the trend of taking tax-free cash at the age of 55. Others said that the potential impact on DB schemes, particularly on DB to DC transfers, should be considered in this respect. They argued that allowing consumers with DC pots to take the tax-free cash without going into decumulation, might incentivise consumers with DB pots to transfer into DC, as tax-free cash is not available in a DB pot.

125. A few respondents also argued that decoupling will add further complexity for consumers, as it will become yet another option for them to consider.

Our response

126. We remain of the view that decoupling has the potential to benefit many consumers. In particular, consumers who focus solely on taking the tax-free cash and do not engage with the decision about what to do with the rest of the pot, could benefit significantly from delaying that decision. Decoupling will allow their pension funds to remain in their existing accumulation scheme, and to make a genuine drawdown decision when it is more relevant to them and they are more likely to engage in it and make a better decision.

127. As our analysis in chapter 3 shows, in many cases consumers who have not engaged in the decision of what to do with the rest of their pot have been 'defaulted' into cash or cash-like funds, or other investments that are unlikely to suit their needs and objectives. While our package is designed to increase engagement and reduce poor outcomes that may arise from this, decoupling has the potential to further improve these poor outcomes for consumers.

128. We acknowledge however the challenges of implementing the remedy, particularly the need to make major changes to the pension tax regime to do so. We recognise that there are detailed policy and practical issues which the Government would want to consider. We would still encourage Government to consider the merits of decoupling tax-free cash from other pension decisions as one option to address the harm we have identified. We will provide HMT with the information we gathered and

our analysis of why we believe 'coupling' might lead to consumer harm to aid their consideration.

Feedback received on shopping around remedies for drawdown

129. Effective competition relies on consumers shopping around across products and across suppliers to choose products that suit their needs and provide value for money. To do so, consumers need to be able to find, understand and compare the relevant information easily. This competitive discipline leads to providers needing to offer good value products that meet needs of their customers to retain existing and attract new customers.

130. We found that there are currently no fully functional drawdown comparison tools available that are like those available for annuities. We also found that drawdown can have complex charging structures, a wide range of charges and limited transparency, so that consumers might struggle to assess the total charges they are likely to pay.

131. We suggested that we would consider intervening to make it easier to shop around for drawdown, by introducing two complementary options:

- facilitating the introduction of drawdown comparison tools
- mandating the use of a summary cost metric in consumer communications

132. We invited stakeholders to consider whether it was proportionate for us to pursue remedies to make it easier for consumers to shop around for drawdown. In particular:

- the prospect of the market introducing a fully functional comparison service
- what information such a comparison tool should provide
- whether the Government should explore the possibility of a non-market provider providing this service, such as the new Single Financial Guidance Body
- the benefits and costs of mandating the use of a summary cost metric in consumer's communications

<u>Feedback on facilitating the introduction of drawdown comparison tools</u>

133. In the interim report we asked stakeholders to consider whether the introduction of drawdown comparison tools should be left to the market or whether more proactive intervention is needed.

134. Most respondents considered that the introduction of comparison tools could be beneficial for consumers. Just over half of the respondents who addressed our question directly, thought that regulatory intervention would be required to help facilitate the introduction of comparison tools. The rest considered that it should be left to the market to develop. They argued that regulatory intervention at this early stage might reduce innovation in the future. For example, they reasoned that doing so would compel providers to develop products that would compare favourably in the tool rather than achieve the best outcomes for consumers.

135. Some of the respondents questioned the need for a comparator, and considered that its introduction is unlikely to have any effect on competition. Some of them argued that a comparison tool will not work, and cited several reasons for this. These include: that consumers are currently non-engaged and need to be engaged to shop

around and use comparison tools; that drawdown options are too complex to be compared in a tool and devising one would be very difficult if not impossible; and that even when comparison tools are working they have a limited impact on switching.

136. Most respondents considered that the new Single Finance Guidance Body (SFGB) should have a role in this, due to their impartial status and the issues associated with mandating signposting to a commercial provider. They also considered that it could counter provider's conflicts of interest in designing the tool.

137. Respondents considered that an effective comparison tool should: focus on additional features other than price for comparison, including service, online capabilities, risk and investment options, product features and options, fund performance and ongoing management. It should also include all providers in market in the comparison; be impartial so that consumers would trust them; and explain the limitations of simplified comparisons.

138. There was also some challenge as to whether we had enough robust evidence to show excessive charges or that consumers could get better outcomes by switching. Some respondents considered that more analysis is needed to identify whether any detriment is being suffered by consumers and whether product switching will address that.

Our response

139. These responses largely confirm our view that the introduction of drawdown comparison tools could help consumers in choosing the right product and will have a positive impact on competition.

140. In line with the responses we received, we are working with the ABI and the guidance bodies, which will be merged into the SFGB in the future, to develop this tool. The other issues raised in the responses have fed into our thinking about the tool.

Mandating the use of a summary cost metric in consumer communications

141. There was general agreement that cost summary metrics should be pursued, and that they could prove beneficial for consumers in assessing the total cost of drawdown.

142. Some respondents raised concerns about overly focussing on charges to the detriment of other factors.

143. Some respondents who opposed this measure also argued that already too much information is given to consumers, which causes them to disengage, and that we should therefore refrain from providing additional information.

Our response

144. These responses confirm our initial view that summary cost metrics could help consumers assess the overall cost of drawdown, so that they can more easily compare between different products to find the best deal. This in turn will increase the competitive pressure on providers and improve the effectiveness of competition in this market.

145. While we recognise that cost is one of a range of factors that determine value for money, we believe it to be a very important component so it is important that charges are easy to assess and compare across products. At the same time, we are also working with the ABI and the guidance bodies to consider what other relevant criteria should be included in the comparison tool.

146. We provide details on our next steps in introducing summary cost metrics in chapter 5.

Feedback on measures to help consumers understand their options after the pension freedoms

147. Effective communications can help improve consumer choices and decision-making. First, by providing information about products and services in a way that is both engaging and comprehensible; and second, by providing information at the appropriate time and through appropriate channels.

148. We invited stakeholders to consider whether they agree that we should act to make existing information more impactful and effective rather than introducing new disclosure.

149. We have considered and sought feedback on the following proposals:

- improving the effectiveness of communications sent to consumers before and when they access their pension pots
- exploring the feasibility of introducing tools to help consumers compare different products and options
- increasing consumer awareness of enhanced annuities

150. There was a near consensus among respondents that communications to consumers should be improved, and that the existing communications should be made more impactful. They agreed that the wake-up packs require changes, primarily to make them simpler and shorter and to send them earlier and more frequently. They also argued that the risk warnings are ineffective and need to be reviewed.

151. Some respondents considered that introducing tools to compare different types of options (e.g. drawdown or annuities) could help consumers understand their choices and make better decisions. Others considered that it would be too complicated to do so and that the potential benefits were limited.

152. Respondents agreed that steps should be taken to raise consumer awareness of enhanced annuities earlier in the consumer journey.

Feedback received on improving the effectiveness of communications

153. Although most respondents were positive about our proposals to improve the effectiveness of consumer communications, some respondents considered that the communications can only ever have limited effects on consumers. Providers and trade bodies were generally more positive about the likely effects (some providers even consider it to be the most effective remedy), than consumer bodies and other respondents.

154. There was wide support for our proposal to make wake-up packs simpler and shorter, with support from many of the large providers. Respondents argued that the length of the current 'wake up' pack deters consumers from reading it and leads them to disengage from the process. Some advocated the use of a 'Pension

Passport', a one page pre-retirement statement, a recommendation which was also supported by the Work and Pensions Committee.

155. Respondents also agreed that wake-up packs need to be sent to consumers much earlier in the process. They agreed that the concept of a fixed retirement date is no longer the norm, and therefore earlier engagement is needed. They also agreed that communications should be sent before the consumers have made up their minds, as it is very difficult to influence them after they have.

156. Many respondents therefore proposed that communications are sent from the age of 50 or before. A number of them proposed a series of wake-up packs are sent at different ages. Others highlighted that some providers already communicate with their customers years ahead of a selected retirement date and proposed that we build upon this.

157. A number of providers stressed the importance of continuing to communicate with consumers after entering drawdown, since retirement is no longer a one-off decision for many consumers and on-going management is needed.

Our response

158. There was overwhelming support for the need to improve the effectiveness of communications, in particular in making changes to the wake-up packs. We have also paid close attention to the work being carried out by the Behavioural Insights Team on the Pensions Passport, as well as carrying out our own research. We are looking to take forward the lessons learned from the pensions passport through our work on the wake-up pack.

159. We received useful suggestions from respondents on how communications can be made more impactful. We have embedded these suggestions into our thinking and they are reflected in our proposals for changes, as detailed in chapter 5 and the CP.

Feedback on introducing tools to help consumers compare different products and options

160. We sought view on whether we should explore the development of tools to help consumers assess which types of option(s) best suit their needs, such as annuities and drawdown. We recognised that different types of products are not directly comparable and that building such tools can be very complex.

161. Respondents' views on this issue were split. Some respondents were supportive of doing so. Others were generally supportive of this notionally but considered that the challenges in doing so were great, and therefore doubted whether this was feasible and worthwhile doing.

Our response

162. We remain of the view that tools to help consumers compare between different options could be useful. We believe however, that the complexities of doing so are significant and might overweigh the potential benefits.

163. We are currently developing a drawdown comparison tool together with the ABI and MAS. This tool which aims to compare between different drawdown options only is complicated in itself. We believe that it would be better to focus on the development of this, and consider whether additional tools may be useful once we can assess its use and impact.

Feedback on increasing consumer awareness of enhanced annuities

164. The vast majority of respondents were supportive of increasing awareness of enhanced annuities at an earlier stage in the consumer journey.

165. Some respondents, mostly providers, argued that many providers already ask their customers relevant questions about their health and lifestyle to assess eligibility, and alert their customers to the option of enhanced annuities where relevant. Some respondents proposed that the practices already in place in some of the providers be used as a basis for a remedy.

Our response

166. There is clear support to our proposal to increase awareness of enhanced annuities, and we are progressing with this measure accordingly. Details of our proposals can be found in chapter 5 and the CP.

Feedback on areas where we are not proposing specific remedies at this stage

167. In the interim report we highlighted that we are not proposing to pursue specific interventions to deal with two of the areas where we identified emerging issues:

- provider withdrawal from the annuity market
- limited innovation for mass market consumers

168. Most respondents generally agreed with this view.

Feedback on provider withdrawal from the annuity market

169. Most respondents agreed with our stance of not intervening to prevent withdrawal from the open annuity market at this stage.

170. Respondents, mostly providers, cited a number of reasons for providers withdrawing from the market, including a lack of consumer demand for annuity products, Solvency II requirements, political uncertainty and low interest rates. They further argued that some of these factors may change in the future and that the market is likely to pick up when they do.

171. Other respondents, particularly trade bodies and consumer groups, encouraged us to continue to monitor the market to consider if future interventions may be needed. A handful of respondents called for immediate intervention.

Our response

172. We agree with the ongoing importance of monitoring of the market. As noted, the number of providers offering annuities in the open market has further declined since the publication of our interim report. While this has to be viewed in the context of an overall decline in demand for annuities, and the fact many of the providers that have withdrawn from the open market are still offering annuities to their existing customers, we want to ensure that the open market remains competitive.

173. Therefore, we are taking steps to improve shopping around for annuities. See chapter 5 for further details.

Feedback on innovation in the market

174. Respondents largely agreed that there was little product innovation in the market so far. However, the prevalent view was that the market needs time to develop and

several respondents were confident that as the market continues to grow innovation would emerge. Other respondents further argued that limited innovation so far was a result of uncertainty in demand for new products.

175. Some respondents, mostly providers, also argued that there were already a sufficient number of products available to consumers in the market to meet their needs. They also considered that a greater number of products and options would only add to consumer confusion and disengagement.

176. Other respondents also argued that hybrid products which try to blend flexibility with guaranteed income, might not be suitable for consumers, and that charges for them are likely to be high.

177. There was a view, predominantly from consumer groups, that the FCA has a role to play in the market to help stimulate innovation for consumers.

Our response

178. There was general agreement to our finding that product innovation in the market has been limited so far. While we note that that has been some product and process innovation, we remain at the view that product development would be valuable and beneficial to consumers in this market.

179. We believe that the market is still developing and that as pots continue to grow in size it is more likely that innovation will emerge. With this in mind, we want to give the market time to develop, and are not proposing to take any action on product innovation at this stage.

180. We will continue to monitor the market to see if material innovation emerges and will consider whether intervention is needed accordingly. We are also taking steps to encourage innovation and collaboration between pension providers and technology providers, and will be organising a Pensions TechSprint later in the year.

181. We also encourage innovation in financial services in the interest of consumers through 'FCA Innovate', [7] by supporting innovator businesses with a range of services.

[7] www.fca.org.uk/firms/fca-innovate

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