MS16/1.2: Annex 1

Retirement Outcomes Review

Interim Report: Annex 1 – Feedback on Terms of Reference

July 2017

We received 35 written responses to the Retirement Outcomes Review (ROR) Terms of reference. This included responses from 21 firms, seven trade bodies, two NGOs, two charities and a government department. The main points respondents raised are highlighted here:

- Many claimed that a general level of mistrust exists in holding money in a pension. Also, when consumers initially access their pension, they are increasingly looking to access their tax free cash pre-retirement.
- Consumers lack an understanding of their product options, the associated tax implications, and the importance of charges. Charging structures for income drawdown and hybrid products are complex.
- Many firms and trade bodies believe that limited change has taken place to business models in response to the pension freedoms. Firms are primarily continuing to focus on retention of their accumulation consumers.
- Some respondents suggested that there is a gap between where Pension Wise guidance stops and full advice starts. Some life insurers suggest shopping around would be helped by making pension guidance mandatory before engagement with the provider.
- Respondents are divided on whether the pace of regulatory change is impacting innovation, with insurers more likely to be concerned than platforms. A few respondents suggested that some technological change has taken place, with the emergence of robo-advice as a streamlined form of advice.

1. This annex summarises the responses to questions posed in the Terms of reference. The questions covered the following areas:
   - shopping around and switching
   - non-advised customer journeys
   - business models and barriers to entry
   - impact of regulation on retirement outcomes

Shopping around and switching

2. In our Terms of reference, we asked questions on how difficult it is for consumers to access and assess products, the effect of this on consumer decisions and how firms can enhance or alleviate complexity and comparison. We also asked why the level of consumer switching has decreased since the introduction of pension freedoms.

3. We found:
   - mixed views on the ability of consumers to access product information when shopping around and switching
   - consensus that consumers struggle to understand, assess and compare product information (particularly drawdown products)
   - examples of firms alleviating complexity for consumers

- general agreement that consumers are following the 'path of least resistance' and remaining with their current pension provider and not engaging
- most respondents felt that the pension reforms have reduced switching

Mixed views on consumers' ability to access product information

3. Several firms and a trade body thought that product information is easy for consumers to access. One medium-sized provider emphasised that regulatory requirements set a minimum level of information for providers to give consumers, and that many go beyond this requirement. However, two firms and a trade body believed that product information is difficult for consumers to access. One building society emphasised that it is not clear to consumers where they can get relevant product information until their wake-up pack[1] arrives, which overwhelms people by presenting them with a large volume of complex information at once.

Consumers find it difficult to assess and compare products

4. Many respondents highlighted how market complexity is inhibiting the ability of consumers to make well informed decisions. Some considered that the increased choice and flexibility, following the pension freedoms, confuses and overwhelms consumers and leads to procrastination and poor outcomes, such as the consumer selecting the 'easiest option':
   - The majority of respondents agreed that product information is complex and difficult for consumers to assess and compare.
   - A number of respondents cited the use of technical terms and jargon as a key barrier to consumers understanding product information.
   - Three trade bodies mentioned the excessive volume of paperwork that firms issue to consumers. They note that this increases complexity and discourages consumers from engaging with their finances.
   - There was consensus across some respondents that the range of products and product features makes product comparisons difficult.
   - Some highlighted that the variety of ways in which product information is presented makes it more difficult to compare products.
5. Several firms claimed that the ease of assessing product information depends on the type of consumer and product choice. Drawdown was cited as the most difficult product to assess, because of the variety of factors to consider, such as charging structures and projection rates. Annuities were seen as easier to assess and compare as they have one price point.

6. A few respondents provided examples of how firms can make things more complicated and product comparisons difficult, for example by providing excessively long, complex, and technical information in consumer documents. One provider suggested that fear of regulatory punishment results in firms providing information in a way that protects them from legal risks, rather than in a simple and clear way that consumers can understand. Another provider claimed that firms deliberately make things more complicated so they can steer consumers towards high-margin products. However, one provider suggested that the volume of product information is the result of firms' assumptions that increased levels of information leads to increased consumer understanding.

[1] Wake-up pack: Information sent to consumers before they decide which retirement income product(s) to purchase.

There were a range of examples of firms alleviating complexity for consumers

7. Many respondents provided examples of how firms can alleviate complexity for consumers, such as:
   - Providing good quality communications to consumers. It was suggested that this was the key to alleviating complexity. One large insurer explained that providing clear, consistent language that avoids technical terms was important.
   - Having trained telephone consultants and specialist teams to support consumer understanding.
   - Providing online tools for consumers, such as drawdown and emergency tax calculators.
   - Inviting customer feedback and using this feedback to improve services.
   - Referring customers to Pension Wise or the Money Advice Service to make things more simple.
   - Ensuring options are explained to consumers in a way that supports good decision making. One large insurer used the example of making their customers think about outcomes rather than products at an early stage.

8. Respondents mentioned other initiatives that could simplify things for consumers. For example, some mentioned the development of a voluntary code of conduct by the ABI to encourage clear and standardised language. Another suggested developing an effective drawdown comparison tool to help consumers compare products in a simple way. Two firms mentioned the need to provide an alternative to the wake-up pack, making it clearer and sending it to consumers at an earlier stage.

Consumers are defaulting to their current pension provider and not engaging

9. Consumer inertia and a lack of engagement are mentioned throughout the responses as being the main causes of poor outcomes in the decumulation market. Some firms highlighted that customer engagement and willingness to invest significant time in exploring options is a prerequisite to making well-informed non-advised decisions.

10. Many respondents claimed that consumers who experience difficulty accessing and assessing product information will just choose the easiest option, or the 'path of least resistance'. This usually involves withdrawing a lump sum of cash and remaining with their current provider. One trade body emphasised that consumers are unwilling to engage with their own financial matters, irrespective of whether they find it difficult to access and assess product information. Two firms and a trade body noted that the uncertain climate and pace of policy change are big factors that stop consumers from taking decisive action.

11. One firm indicated that the way information is presented can have implications for the level of shopping around. For example, they note that the way a customer's accumulation provider presents decumulation options discourages shopping around as customers may believe provider familiarity means the options presented are fair or even best for them. Another respondent argued that although consumers tend to stay with their current provider, this is only one important element of a well-functioning market.

12. In addition to these reasons, respondents suggested that low levels of shopping around may also be driven by a limited understanding of the benefits.
    - Three respondents highlighted that shopping around for an annuity product is easier than shopping around for drawdown products, however, low annuity rates are reducing this incentive. Many respondents said that shopping around is more difficult and less important with drawdown products. These are not one-off irreversible purchases, they are much more difficult and time consuming to compare on the open market and consumers generally have poor knowledge of them, not knowing where to find a reputable provider. Respondents also highlighted how the large number of consumers that only wish to withdraw their tax free cash have no incentive to shop around.
    - Some respondents provided comparisons of consumer engagement in other markets, for example, a number suggested that consumers regard pension pots to some extent akin to bank accounts. One firm suggested that, as with current accounts, consumers may not see the additional value that could be gained from using alternative providers.

13. A firm suggested that better controls on the process of switching providers could help. They indicated that it should be similar to those made available in the retail banking market through the Current Account Switching Service (CASS).

14. Another firm suggested that consumers would make better-informed decisions if they were sent through a 'central information repository' where they could see information on all of the available options across providers. In doing so, the consumer would view different providers' product information together so it would be their responsibility to decide whether to use their accumulation provider for decumulation. The firm claimed that it should be compulsory for all providers to display information in the repository, and this should be provided in a consistent way. It also emphasised that the service should be provided by an impartial body such as Pension Wise.

Pension freedoms have reduced switching

15. Respondents suggested that the increase in choice and complexity, which has come about with the introduction of the pension freedoms, has heightened consumer confusion and resulted in a greater level of disengagement and consumer inertia. The majority of respondents said this was the primary cause of reduced consumer switching since pension freedoms were introduced.

Non-advised customer journeys

16. In our Terms of reference we asked questions on what the different non-advised customer journeys now look like, how firms engage with these journeys, and how consumer decision-making is influenced by firm engagement, distribution, and product presentation. We also asked how much these changing customer journeys promote well-informed decisions, or create barriers to doing so.

17. Respondents:
    - provided an overview of the typical non-advised customer journey
    - told us firms communicate with consumers in a variety of ways
    - told us they direct consumers to support and advice
    - highlighted their concern that non-advised consumers take on risks they don't understand

- suggested innovations that could improve the consumer journey

Overview of the typical non-advised consumer journey

18. Firms suggested that the typical non-advised existing consumer journey starts six to 12 months before retirement when the consumer starts to think about the decumulation journey. Communication from their accumulation provider such as the 'wake-up pack' is the main way that consumer engagement starts. At this point, consumers tend to telephone their provider, discuss and consider their options and decide on their preferred decumulation product. Before or after telephoning their provider, customers may engage with Pension Wise or use online tools, either on their providers' website, or available publicly.

19. In contrast, other consumers were found to engage in the process much earlier, for example, to access their cash from the age of 55. Their non-advised journey is very different, and their focus is on quickly accessing the tax free cash, without paying for regulated advice or considering what to do with the remaining pension pot.

20. One firm suggested that the majority of non-advised purchases of decumulation products would be through the consumer's existing pension provider. The firm also said that non-advised journeys do not exist on drawdown unless the customer remains with their existing provider, because firms on the open market often require the customer to take advice.

Firms communicate with consumers in a variety of ways

21. Firms generally suggested that the primary means of communicating with their customers are either by telephone or on paper. Some firms suggested that the design of their journeys allows customers to interact with them via their preferred method (telephone, paper, online) and emphasised the importance of doing so. For two firms, including one large insurer, non-advised interactions with their customers almost exclusively take place over the telephone. The large insurer emphasised the importance of continuing to offer written communication in addition to that online and via telephone, and along with a second large insurer they recognised that many consumers may be unable to make digital transactions or may simply not be comfortable doing so.

22. Many respondents noted the importance of engaging with non-advised customers in a consistent way. In particular, respondents considered it important not to emphasise one product over another in their interactions so they don't unduly influence their customers. One large insurer had looked to improve customer engagement through simplified wake-up packs focusing primarily on the options available and key points for the consumer to consider. One trade body specifically suggested that it is hard to prevent choice architecture effecting customer decision making in non-advised journeys.

23. Some respondents suggested that the providers' interaction with customers has little impact on decision making as customers have often decided in advance which option they wish to take. One trade body recognised the extent to which behavioural biases impact consumer decision making, in particular by those hesitant yet hopeful, who often use rules of thumb at the more complex stages to make cognitive short cuts.

Some firms direct consumers to support and advice

24. One large insurer highlighted that where a customer in the non-advised journey is identified as vulnerable, or struggling to understand their options, they recommend they take advice. In some instances firms highlighted how they indicated that they refer non-advised consumers towards Pension Wise, in some instances before having a telephone conversation with them.

25. Some firms and a trade body suggested that consumers receiving guidance, advice, or both receive better outcomes, as the non-advised are less likely to fully understand their options, and often default to their existing provider. The trade body suggested that comparison tools aid decision making, and help people to achieve good outcomes by not simply defaulting to their accumulation provider.

There was concern that consumers may take on risks they don't understand

26. One platform and one small drawdown provider suggested that the non-advised consumer journey does not sufficiently explain and help consumers understand longevity risk or the possibility that income is likely to run out with certain retirement income solutions, such as income drawdown. The platform also suggested that scams should receive greater prominence in communications to reduce the risk of them happening to non-advised consumers.

Innovation could improve the consumer journey

27. Some respondents highlighted how innovation in the market could support and promote informed consumer decisions. For example, one large insurer suggested that new digital journeys are supporting consumers' decisions in this sector, particularly non-advised consumers. Another large insurer suggested that in the future technology will allow for communication channels (online, telephony, face-to-face) to be increasingly linked together. A medium-sized insurer highlighted how their online tool allows consumers to produce a report that helps them better understand their options – the report, while not classified as regulated advice, helps consumers understand the potential risks and impacts of each option. They think this information can help non-advised consumer journeys while not influencing their final decision.

28. Many respondents highlighted the Pensions Dashboard[2] as an innovative way to increase engagement over the accumulation phase, better prepare consumers for decisions on decumulation, and in turn promote well-informed decisions that generate positive customer outcomes. One trade body considered that such well-informed decisions rely on clear information about existing pension pots and any associated guarantees, charges or conditions likely to impact that decision.

29. Firms highlighted the many tools that are already available to consumers, for example there are a range of tools designed to educate customers, give product and provider comparisons, help choose the most suitable products and model cash flows generated from different products or combinations of products.

Business models and barriers to entry

30. In our Terms of reference we asked questions on how the market structure and business models have evolved since the pension reforms, and how this evolution

[2] The Pension Dashboard is a platform designed to let savers see all their pension savings in one place. The Association of British Insurers (ABI) is managing a prototype build expected in spring 2017 that will show an individual's funds help with eleven pension providers.

may lead to efficiencies or detriment for consumers. We also asked what barriers to entry or expansion prevent the retirement income market from working well and specifically whether the developing market structure and business models or gaining a critical mass of customers does so.

31. Respondents:

- suggested there has been limited business model change in response to pension freedoms
- provided mixed views on the extent pension freedoms have changed barriers to entry
- raised concerns about consolidation of annuity providers, particularly the enhanced annuity sector
- viewed vertical integration as positive for consumers

Limited business model changes in response to pension freedoms

32. Many respondents thought that there has been limited change to the market structure in response to the pension freedoms and firms have not significantly changed their business models. However, some respondents expected that business models will evolve for some time in the future, which could bring efficiencies. For example, through employing technology-based digital solutions and automated advice which could make advice more affordable, convenient and accessible to the consumer. Some respondents highlighted how these changes to business models could also bring risks.

33. The limited change in business models has been a surprise to some respondents. A number of firms suggested that there has been less change and innovation than they had expected. Indeed, one firm suggested that, at the time of responding, no providers had made any major changes to address the pension reforms directly. The most significant change to business models identified by respondents was the emergence of hybrid ('third way') products.

34. A number of firms highlighted opportunities for business models to evolve in the sector. Two respondents argued more could be done in the advice space, identifying that an advice gap exists between the two ends of the market and that good outcomes may be achieved both for those receiving full advice and non-advised customers for whom Pension Wise is adequate. These respondents suggested that poor consumer outcomes may be occurring in a gap in the middle.

35. One small drawdown provider also said that the lack of a facility to identify and aggregate assets influences customers' decision making since they see each small pot as separate and therefore less valuable. The provider also suggested that relaxing pension rules to allow couples and family members to pool assets would help the market work better.

The extent that pension freedoms have changed barriers to entry

36. Several firms and a trade body thought that the pension freedoms and resulting changes to market structure and business models have not affected barriers to entry or expansion.

37. Some respondents suggested that wider factors such as regulatory requirements and ongoing macro-economic and political uncertainty were more likely to deter potential new entrants than the pension freedoms.

38. Several respondents thought the difficulty that new firms face in acquiring customers is one of the main barriers to them entering the decumulation market, and for smaller incumbent providers to expand their customer base. This creates a barrier to entry and deters new business models from emerging by making it challenging for new entrants to gain the critical mass of consumers required to operate successfully in the sector. One large insurer suggested that pension freedoms have made customer acquisition even more difficult.

39. This tended to be the result of the pensions freedoms reducing shopping around and switching further. Examples provided by respondents include:

- The emergence of flexi-access drawdown products as the 'new default'. Some firms are finding that although more consumers are choosing drawdown products, fewer of them are shopping around (compared to annuities) or switching. One challenger firm suggested that this 'new default' poses a material risk to competition and that mandating or defaulting product purchases through the open market would help and increase customers' shopping around.
- The lack of a one-off decision was cited by one firm as the reason for lower shopping around and switching on drawdown.
- Decreased engagement of consumers, which was partly attributed to the increased choice which has reduced consumer confidence in shopping around.

40. Although many firms said that the ability to obtain a critical mass of customers has increased as a barrier to entry and expansion, some suggested that the reforms themselves had not increased the extent to which it poses a barrier.

41. Many respondents identified other consumer traits that create other barriers to entry and expansion and prevent the market from working well. In particular two respondents suggested that poorly informed consumers and their lack of engagement prior to retirement lead to a "cliff edge" decision which they are unprepared for.

42. In addition to consumer behaviour in the market, other barriers were identified, although these were not necessarily increasing as a result of the pension freedoms:

- General uncertainty in the sector. The uncertain policy direction of future governments, the macro-economic impact of Brexit, and the extent of regulatory change in the market were all considered contributing factors to the level of uncertainty.
- One trade body suggested that the fall in annuity rates over 2016 reduces the potential for profit margin and may therefore deter new entrants into the annuity market.
- It was highlighted that significant resources are needed to enter the market, for example, large IT infrastructure costs.
- One firm expected that it will become increasingly difficult for providers to develop early customer relationships as auto-enrolment shifts the weighting of defined contribution pension accumulation towards employer arrangements. This might make entry more difficult.

Concern was raised about consolidation in annuity market

43. Respondents alluded to concerns about competition in the annuity sector, due to the consolidation between providers that has taken place and the withdrawal of

some firms from open market participation. One firm noted, in particular, the level of consolidation that had taken place in the enhanced annuities market.

Vertical integration is generally viewed positively

44. Respondents indicated that vertical integration provides benefits to the sector and consumers. A number of examples of this were provided:

- It can reduce the cost of advising and servicing customers and therefore enable some customers who otherwise may not have received guidance and advice to access it.
- Efficiencies can be achieved through the introduction of regulated defined uniform processes, service standards and a "central clearing" system. The firm noted that such a system should present a consumer all their options across all providers in a consistent and easy to compare form.
- One wealth manager suggested that business models designed to retain customers from accumulation into decumulation present efficiencies but noted that customer detriment could arise through any corresponding increase in inertia.

45. Firms noted that providers offering both accumulation and decumulation products can be both a good and bad thing for consumers. One firm suggested that providing both can lead to consumers having greater levels of early engagement. A challenger firm suggested that there is a natural break between the two products, which generates a pause so customers can shop around, consider appropriate solutions, and seek the best value. However, another medium-sized insurer believed that providing both can damage competition by reducing the ability of new entrants to compete for decumulation customers.

Impact of regulation on retirement outcomes

46. In our Terms of reference, we asked for examples of FCA regulation that act as barriers to entry or expansion in the decumulation market, and how much this regulation disproportionately increases firms' costs and prevents innovation that could benefit consumers. We also asked respondents if they thought any further regulation was needed to promote our objectives in the market.

47. Respondents felt that:

- the pace and volume of legislation were deterring new firms from entering the sector as well as deterring innovation
- there were specific requirements that they felt created barriers to entry, expansion and innovation
- there was more that could be done to protect consumers in this sector
- lack of clarity on advice is preventing firms from providing support to consumers

Pace and volume of regulation deters entry and innovation

48. Three respondents emphasised that the continuous policy and regulatory change since the introduction of pension freedoms puts off potential entrants into the retirement income market. One firm highlighted the need for skilled resources to consistently analyse and interpret new regulation.

49. Two respondents suggested that the volume of regulation in the FCA Handbook serves as a barrier to entry. One large insurer suggested that drawdown products are subject to a high level of regulatory focus, making this market less attractive for new entrants by increasing the risk of regulatory intervention. Two respondents said that the FCA's Conduct of Business Sourcebook (COBS) needs to be relaxed or simplified. A firm and a trade body also highlighted the expenses that result from EU disclosure requirements, particularly when these are prescriptive.

50. A number of other respondents agreed that the pace of regulatory change can have a negative impact upon firms' costs and prevent product innovation. Some firms claimed that they have changed their schedules for investment in innovation as a result of regulatory burden. One trade body specifically emphasised that the FCA needs to be clearer on its pipeline activity, as firms will be reluctant to invest if upcoming regulatory changes undermine it.

Specific requirements were identified as creating barriers to entry, expansion and innovation

51. Prudential requirements and the recently imposed early exit charge caps were identified as creating a barrier to new firms entering the sector, current firms expanding their market share and deterrence to innovation:

- The level of prudential requirements, particular those on capital reserves and risk weighted assets were identified as preventing the market from working well. One firm suggested that simplifying the impact of Solvency II would make the market work better. Another medium-sized provider drew out the impact of strict prudential requirements on smaller and specialist insurance companies as a barrier to entry and expansion.
- Charge caps were said by some respondents to have detrimental impact upon firms' product innovation. One trade body suggested that some asset classes can be too expensive for the current level of pricing in the DC market.

There was more that could be done to protect consumers in this sector

52. Although there were mixed views on whether additional regulations could improve consumer outcomes, many respondents suggested specific initiatives that could support consumer protection and competition in the market. Two respondents highlighted the need to improve the format and communication of wakeup packs, including sending them to consumers at a much earlier stage in the consumer journey. One medium-sized insurer suggested that there should be a compulsory requirement for providers to refer their customers to Pension Wise, while informing them about the option to shop around. One firm suggested that the FCA should promote the consistency of language used in the names and descriptions of products. Three respondents stressed the need for the FCA to do more to tackle scams, suggesting that these are an emerging risk for consumers in the post-freedoms decumulation market.

Lack of clarity around what is advice is preventing firms from providing support to consumers.

53. One firm suggested that the regulatory implications of the Retail Distribution Review have had an adverse impact on the advice market. They claim that there are fewer incumbents in the advice market, making it more difficult for consumers to access financial advice.

54. Both firms and trade bodies highlighted that the way in which advice is regulated can increase costs for both firms and consumers, as well as stifle product innovation. One medium-sized SIPP provider suggested that the lack of clarity between what constitutes advice and guidance limits the scope to design more innovative services to help customers through retirement. A firm and a trade body claimed that the high level of regulation on advice increases its price for both firms and consumers. Firms are reluctant to innovate out of fear of exposure to liabilities.

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