Retirement Outcomes Review

At a glance

2017

Retirement Outcomes Review
Introduction

Our review looked at how the retirement income market is evolving since the pension freedoms were introduced in April 2015. We focused particularly on consumers who do not take advice.

Our findings

We found that consumers have welcomed the pension freedoms. Over one million defined contribution (DC) pension pots have been accessed since the reforms. The pension freedoms have changed the way consumers access their pots:

- **Accessing pots early has become 'the new norm':** 72% of pots have been accessed by consumers under 65, most of whom have taken lump sums.[1]
- **Over half (53%) of pots accessed have been fully withdrawn:** 90% of these pots were smaller than £30,000.[2] Over half of fully withdrawn pots were transferred into savings or investments.[3] Overall, we did not find evidence of people 'squandering' their pension savings.
- **Most consumers (94%) who fully withdrew their DC savings had other sources of income in addition to the state pension.**[4] Consumers were mostly likely to state that a defined benefit (DB) pension would be their most significant source of income in retirement (24%), followed by the state pension (21%) and other DC schemes (10%). Only 3% of consumers identified their withdrawn pension pot as their most significant source of retirement income.[5]
- **Drawdown has become much more popular:** twice as many pots are moving into drawdown than annuities.[6] Before the pension freedoms, over 90% of pots were used to buy annuities.[7]

Since April 2015, providers have developed tools to help consumers understand the changes. They have also introduced simpler flexi-access drawdown products that consumers can buy without taking financial advice.

Emerging issues

This market is still developing and firms and consumers are continuing to adjust to the reforms. However, we identified five emerging issues:

- **Consumers who fully withdrew their pots did so partly because they do not trust pensions.**[8]
- **Most consumers choose the path of least resistance.** They accept the drawdown option offered by their pension provider without shopping around. Our research shows very low levels of shopping around and data from the Association of British Insurers (ABI) shows that 94% of non-advised drawdown sales were made to existing customers.[9]
- **Many consumers buy drawdown without advice but may need further protection to manage their drawdown effectively.** The proportion of drawdown bought without advice has risen from 5% before the freedoms[10] to 30% now.[11] Making this decision is complex, so there is a question about whether further support and protection is needed.

1. FCA analysis of FCA retirement income market data collected from 56 providers, April – September 2016. This figure does not include October 2015 – March 2016 as during this period our data did not segment full withdrawals by consumers' age.
2. FCA analysis of FCA retirement income market data collected from 56 providers, October 2015 – September 2016.
3. IFF consumer research commissioned by the FCA. Consumers who fully withdrew a pot worth at least £10,000 without taking regulated financial advice.
4. IFF consumer research commissioned by the FCA. Consumers who fully withdrew a pot worth at least £10,000 without taking regulated financial advice.
5. IFF consumer research commissioned by the FCA. Consumers who fully withdrew a pot worth at least £10,000 without taking regulated financial advice.
6. FCA analysis of FCA retirement income market data collected from 56 providers, October 2015 - September 2016.
7. www.moneymarketing.co.uk/issues/26-january-2017/annuities-down-but-not-out/
8. IFF consumer research commissioned by the FCA. Consumers who fully withdrew a pot worth at least £10,000 without taking regulated financial advice. Our consumer research found that mistrust was typically based on negative media coverage of the broader pensions sector, including DB schemes, rather than personal experience.
9. FCA analysis of ABI data, April 2015 – March 2017.
10. Retirement income market study: Interim Report, 2014: www.fca.org.uk/publication/market-studies/ms14-03-2.pdf.
11. FCA analysis of FCA retirement income market data collected from 56 providers, October 2015 - September 2016.

- **Annuity providers are leaving the open annuity market**, reducing choice for consumers shopping around in the open market. This may weaken the effectiveness of competition over time. We will continue monitoring the market to ensure that it remains open and competitive.
- **So far, product innovation has been limited.**

If competition is not working effectively and consumers make uninformed retirement income decisions this could lead to different types of harm, such as:

- paying more in charges and/or tax
- choosing unsuitable investment strategies
- missing out on valuable benefits (eg employer pension contributions) or investment growth
- running out of pensions savings sooner than expected

We will carry out further work to assess the harm these emerging issues may cause.

Potential remedies we are considering

To support pension freedoms and get this market on a good footing for the future it is important that:

- there are appropriate protections for those least able to engage
- the market drives value and innovation
- consumers can get the right support when they take important and difficult decisions about their pension savings

We have identified some potential remedies to help tackle all three areas, and would like views on both how urgent and appropriate they are:

- additional protections for consumers who buy drawdown without advice
- measures to promote competition for consumers who buy drawdown without taking advice, including proposals to:
  - allow consumers to take some of their savings early without having to put the rest into a drawdown product
  - make it easier for consumers to compare and shop around for drawdown products
- tools and services to help consumers make good choices

Next steps

Getting this right will require cooperation across the Government, regulators, industry and consumer bodies.

We invite stakeholders to respond to our report by 15 September 2017. We will also hold events to get stakeholders' views in autumn 2017. We will think further on whether we should intervene at this stage and how we can do this most effectively. We intend to publish our final report in the first half of 2018.

Contents

This summary provides a brief overview of the key points from the interim report and may be enough detail for some readers. For a more in-depth description of our findings and proposed remedies you can read the full interim report. We have signposted relevant chapters that may be of interest throughout the summary.

In this summary we cover the following:

- an overview of the retirement income market
- why we looked at the market
- what we did
- what we found
- emerging issues
- potential remedies
- next steps

If you want to find out more, the full interim report is available at: www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report.pdf

Overview of the retirement income market

Pension and retirement income products allow consumers to save over their working life to fund their spending in retirement or later life. This typically involves two phases:

- **The saving for retirement (accumulation) phase** involves saving and growing assets for use in later life.[12] Individuals and their employers can contribute to different types of pension schemes, including defined benefit (DB) schemes, defined contribution (DC) schemes and hybrid schemes, which are a mix of the two.
- **The accessing your savings (decumulation) phase** involves converting pension assets into income, either before or at retirement. Members of DC schemes have a range of ways to do this. However, DB scheme members in contrast, automatically get an income from their pension scheme, unless they transfer to a DC scheme.[13]

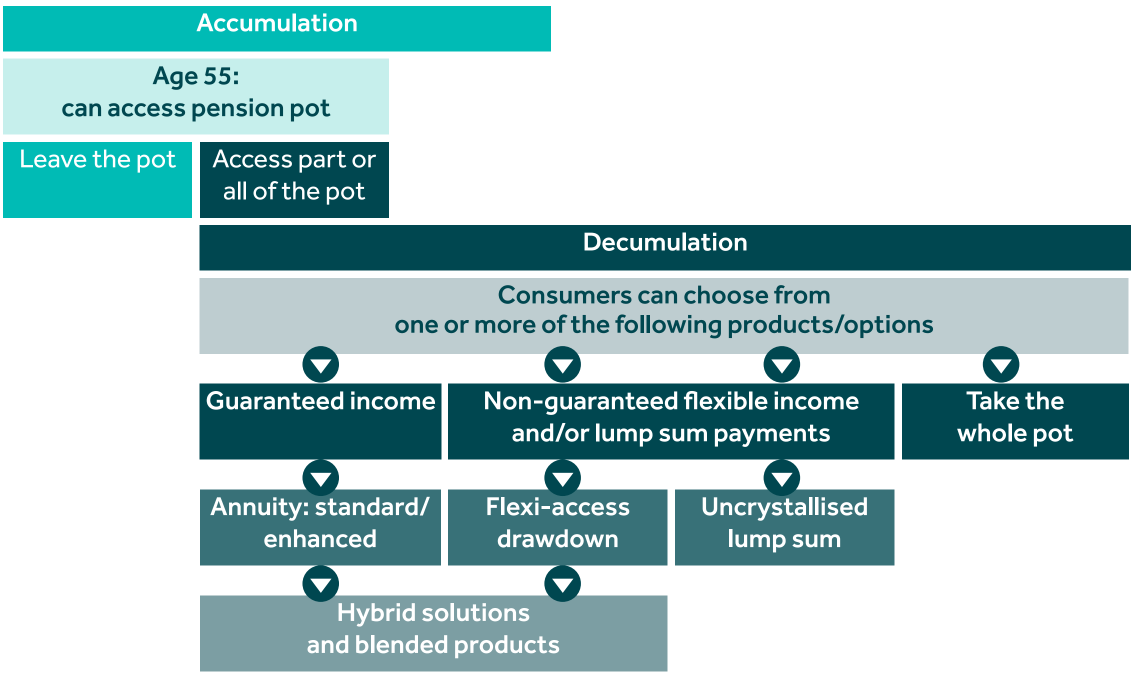
Our review focuses on the decumulation phase. Before the pension freedoms, consumers faced several restrictions and most had to buy an annuity at retirement. The pension freedoms introduced more flexibility. Consumers can now access their savings from the age of 55 while continuing to work and can choose from a wider range of retirement income products and options.

This market is still developing. Most of the DC pots accessed so far were small: 64% of them have been under £30,000. By comparison, the value of the state pension is currently estimated at £200,000. However, DC pension savings will be an increasingly important source of income for later life for future generations. By 2030 it is estimated that workplace DC schemes will hold £1.7 trillion, five times the £340 billion held in 2015.

More than 50 providers sell retirement income products. These differ by target market and the products offered. Seven large insurers have made over 50% of sales since the pension freedoms.

To find out more, see Chapter 3 in the main report.

Figure 1: Retirement income consumer options



12. Consumers may also save for retirement in other ways - for example, through saving into an individual savings account or investing in property. Our review did not look at these alternatives.
13. Some employers providing DB schemes buy an annuity for their members, so these consumers indirectly enter the decumulation market.

Why we looked at the market

Deciding how to use pension savings is one of the most important financial decisions people will make in their lives. Since April 2015, consumers have much more choice in how they can use and access savings in their DC pension pots. We carried out this review because our previous work identified several issues that may arise.

In July 2016 we launched the Retirement Outcomes Review to assess how competition is evolving after the pension freedoms. We focused on outcomes for consumers who do not take regulated financial advice.

To find out more, see Chapters 1 and 2 in the main report.

What we did

We explored:

- how consumers decide when and how to access their DC pension savings, including whether they can shop around and choose from the wider range of options now available
- what business models and products have emerged and their effect on competition
- whether FCA regulation is too burdensome and creates barriers to firms entering the market, expanding or developing innovative new products

We gathered a wide range of evidence and data to assess how the market was working.

To find out more, see Chapter 2 in the main report.

Figure 2: What we did

Consumer research

Survey of
1,000
consumers who had fully withdrawn a pension pot worth at least £10,000 and not sought advice

Focus groups and in-depth interviews
171
in-depth interviews with consumers who accessed their pension pots after pensions freedoms without advice

Data collection

56 firms
collected retirement income data and bespoke data on distribution channels and charges paid by advised and non-advised consumers through various distribution channels from 56 firms

ABI
data collected on sales since pensions freedoms

Behavioural research and stakeholder engagement

Behavioural research, including randomised controlled trials and experiments

Interview and meetings with a range of stakeholders, international governments and regulators

Our findings

Here we outline our main findings on how consumers and providers have responded to pension freedoms:

- The pension freedoms have significantly changed the way consumers access their pots. Drawdown is now twice as popular as annuities. Most pots are fully withdrawn and consumers withdraw their savings partly because they have limited trust in pensions.
- So far, pension providers have focused on meeting the basic requirements of pension freedoms, rather than innovating. Many insurers have moved away from selling annuities in favour of drawdown. Providers have introduced simpler flexi-access drawdown that consumers can buy without taking financial advice.

How consumers have responded to pension freedoms

Consumers have welcomed the pension freedoms. With over one million DC pension pots accessed since April 2015, the freedoms have clearly changed the way consumers access their pots:

- many consumers are taking their pots early, mostly taking lump sums
- over half of pots accessed have been fully withdrawn
- drawdown has become much more popular than annuities
- many consumers buy drawdown without advice

Over 1 million

pension pots accessed since pension freedoms

Most pots were less than £30,000 and the majority were accessed by 55-64 year olds

Source: FCA data

72%

of pots have been accessed by consumers under 65

Accessing pots early has become the 'new norm'

53%

of pots accessed were fully withdrawn

90%

of fully withdrawn pots were smaller than £30,000

Drawdown has become more popular

Twice as many pots move into drawdown than annuities, 90% of pots moved into annuities before pension freedoms

30%

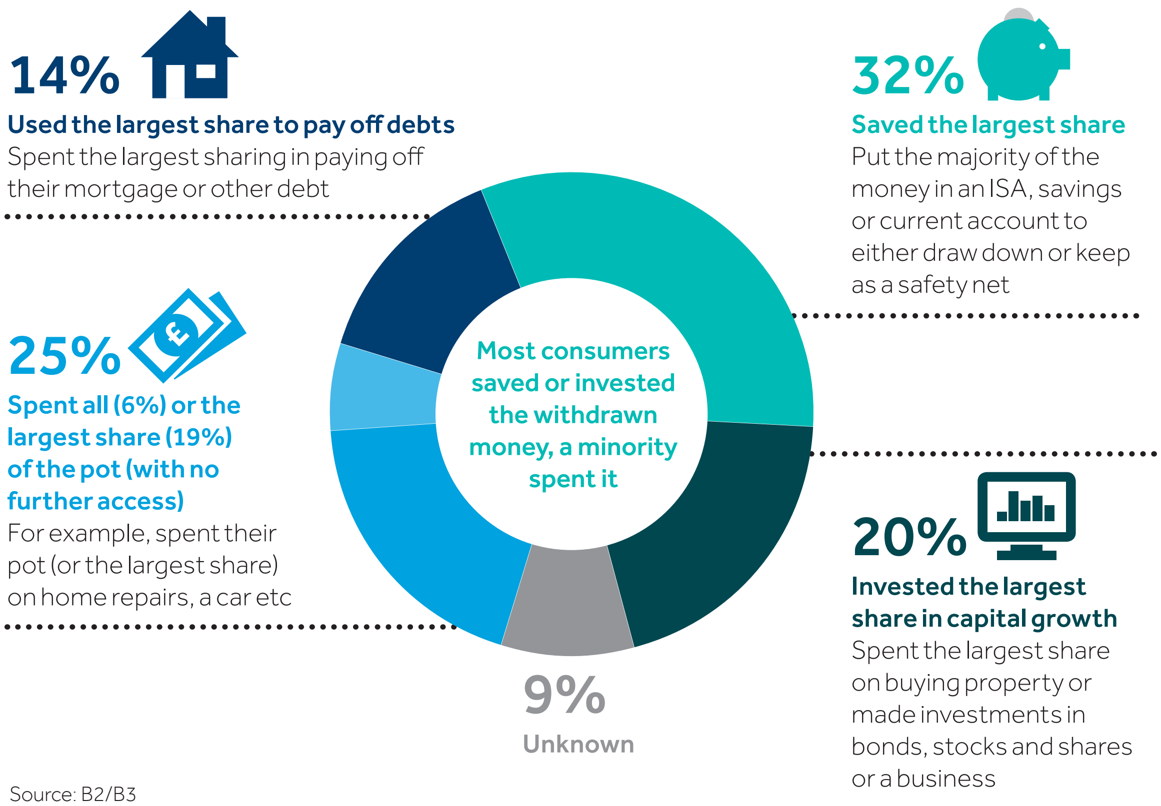
of drawdown plans were purchased without advice compared to 5% before pension freedoms

More consumers are purchasing drawdown without advice

For those who fully withdrew their pots:

- **Most had other sources of retirement income**. Our consumer research found that 94% of consumers who made full withdrawal had other sources of retirement income as well as the state pension.[14] Consumers were most likely to state that a DB pension would be their most significant source of income in retirement (24%), followed by the state pension (21%) and other DC schemes (10%). Only 3% of consumers identified their withdrawn pension pot as their most significant source of retirement income.
- **Most are not spending the money they withdrew.** Only a quarter of fully withdrawn pots were spent.[15] As shown below, over half (52%) of consumers who withdrew their whole pot invested most of it in capital growth or saved it, for example by transferring into an ISA or current account.
- **General lack of trust in pensions is the main reason consumers fully withdraw their pots.** We found this was typically based on negative media coverage of the broader pensions sector, including DB schemes, rather than personal experience. Consumers' mistrust was also driven by the perception that pension money was 'doing nothing sitting there' and that the pension rules were constantly changing, to their detriment.

Figure 3: What consumers did with their withdrawn pots



Source: B2/B3
Base: All respondents (1,000)

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

Motivations for fully withdrawing pension pots

"I knew I didn't want to leave it in the pension pot because my view is that there won't be anything left by the time I pull it out… I've never believed in pensions"

Female (69-70), £10,000-£30,000 pot, full withdrawal

"I went with an open mind, but the payments coming back to me monthly, with £14,000, would have been a pittance"

Female (60-65), £10,000-£15,000 pot, full withdrawal

"You just don't know what the government will do, because they can change the rules at any time"

Male (55-59), £75,000-£250,000 pot, full withdrawal

How providers have responded to pensions freedoms

So far, providers have focused on meeting the basic requirements of pension freedoms, such as introducing new products so customers can access their pots, developing tools and calculators and improving their online systems to help consumers make better decisions.

Many insurers are re-focusing their business models from selling annuities to drawdown. At September 2016, 11 (22%) providers offered the full range of retirement income products, 33 (67%) only offered drawdown and a small number of providers only offered annuities. Providers offering the full range of products tend to be life insurers, while those offering only drawdown tend to be SIPP providers.

Many insurers have developed simplified drawdown for their mass market of consumer who do not take advice. This allows consumers to take their tax-free cash early, if they wish to do so. These products generally only offer a limited range of funds.

Most insurers restrict non-advised drawdown to their existing pension customers or steer those customers seeking drawdown towards advice. As a result, few providers offer non-advised drawdown to new customers but we know of at least three insurers and four SIPPs and asset managers who do.

Several providers, mainly the large insurers, have withdrawn from the open annuity market. In July 2017, seven firms still offered annuities on the open market, compared to fourteen in July 2014.

To find out more, see Chapters 3 to 7 in the main report.

Emerging issues

We found a number of emerging issues. Competition is not working well for consumers who do not seek advice, and we have concerns about whether a competitive market can develop in the future. We also have concerns that consumers who move into drawdown may struggle with the complexity of the decisions they have to make, particularly where they have not taken advice. We will carry out further work to assess the harm this may cause. To find out more, see Chapter 1 in the main report.

In summary our review identified five emerging issues:

01

Many consumers have fully withdrawn pots to move savings elsewhere. This is partly because they don't trust pensions, when it would have been better for them to keep pots invested for longer

- over half of pots accessed after the pension freedoms have been fully withdrawn, although pot sizes were relatively small
- we found no evidence of consumers 'squandering' their savings
- consumers motivated by mistrust in pensions may be making uninformed decisions that mean they pay more tax than they otherwise would or miss out on the benefits of staying invested for longer
- consumers do not take up the available help and guidance

02

Consumers who access their pots early without taking advice typically follow the 'path of least resistance'. They buy drawdown from their pension provider without shopping around so they may get poorer deals

- consumers who did not take financial advice considered withdrawing the tax-free proportion of the pot early as the new norm
- few consumers considered what to do with the rest of their pot and most followed 'the path of least resistance' by buying drawdown from their current pension provider
- because consumers who don't take advice also don't tend to engage or shop around there is limited incentive for providers to compete

03 Many consumers buy drawdown without advice but may need further support and protection to manage their drawdown effectively

- drawdown charges can be complex, opaque and hard to compare - and there are no market wide comparison tools
- decisions about how to manage a drawdown product are complex: consumers have to manage their own investment and withdrawal strategy and also consider how long their pension savings will have to last
- poor choices can lead to consumers missing out on investment growth, being exposed to investments that are too risky for them or running out of their pension savings sooner than expected

04 Providers are leaving the open annuity market

- several providers, mainly the large insurers, have left the open annuity market and the number of open annuity market providers is at an all-time low
- in July 2017, seven providers offered annuities on the open market - half the number of July 2014
- it was likely some providers would merge or leave because of lower demand for annuities; many of the providers that have left still offer annuities to their existing customers

05 There has been limited innovation for mass market consumers

- there has been some progress, such as tools to help consumer decision-making and simplified drawdown, but we haven't seen new products which combine flexibility and guarantees for mass market consumers who do not take advice
- we have not seen much technological innovation, such as 'robo advice'
- the main barriers to innovation are the pace of policy change, uncertainty about how the market may develop in the future, consumer inertia and the fact that most DC pots are currently relatively small
- we think incentives for innovating will increase over time as consumer DC pots grow in size - we want to give the market further time to develop before we taken any action

Our potential remedies

We have identified a range of possible remedies to address these issues. We summarise them below and give more details in Chapter 8 of the main report. Our proposals are part of our broader pensions and retirement income strategy. Later this year we will publish a strategy for the pensions sector which will set out our regulatory approach.

This market has undergone significant change. We want to help consumers use the pension freedoms and encourage the industry to develop innovative solutions to help meet consumer needs. We want to strike the appropriate balance between intervening early and giving the market time to adjust.

Ensuring this market works well and rebuilding trust in pensions will require cooperation across the Government, regulators, the industry and consumer bodies. The potential remedies we are proposing do not fall within our remit alone and some of these issues sit outside our immediate powers.

We will develop the package of remedies, considering whether we need to intervene at this stage, how effective these remedies are likely to be and how we can design them to manage the risks we have identified. We will do further work to assess harm that may come from consumers buying drawdown without advice.

To find out more, see Chapter 8 in the main report.

Potential remedies to protect consumers less well placed to make their retirement income decision

01 Extra protection for consumers who buy drawdown without advice

These consumers need to make difficult decisions about investment strategy and withdrawal rates. Poor choices can mean they take on too much investment risk or miss out on investment growth. This can reduce their future retirement income or mean they run out of money altogether. Some consumers cannot or will not engage with these decisions and we are considering the merits of additional protections to support them.

Default investment pathways
Once a consumer decides to buy a drawdown product, or moves into drawdown to access their tax-free cash, providers could be required to offer them default investment pathways based on retirement outcomes chosen by the consumer. Consumers would be free to choose an alternative investment strategy if they wish.

A potential charge cap for the default investment pathways
This could help ensure that those consumers who do not engage with their investment decisions do not pay excessive charges.

Extending the role of Independent Governance Committees (IGCs) to decumulation products
IGCs have been put in place to scrutinise value for money provided by workplace accumulation products. Their role could be extended to scrutinise decumulation products – including drawdown default investment pathways – to help ensure they are appropriate and provide value for money.

Remedies to help consumers engage with their retirement income decision

02 Giving consumers early access to their savings without having to buy a new drawdown product

We also want to enable consumers to take some of their savings early without having to buy a drawdown product. Many consumers have to transfer into drawdown to access their tax-free cash, even if they are not planning to retire at this point. This means they are not engaged in this drawdown decision and do not consider shopping around and whether the product is suitable or good value for money. We are concerned that this may result in a lack of competitive pressure on providers and consumers may be paying higher charges as a result.

We will work with stakeholders to explore how to separate the decision to take tax-free cash early from the decision about what to do with the rest of the pot.

03 Making it easier to shop around for drawdown

We want to make it easier for customers to shop around for drawdown. Our evidence indicates that there are low levels of shopping around and switching. Also, drawdown charges can be complex, opaque and hard to compare - and there are no market wide comparison tools. In the longer term, this may result in higher charges, lower product quality and less innovation. We are looking at two options to make it easier to shop around for drawdown:

- drawdown comparison tools to make it easier for consumers to access, understand and compare available drawdown products
- requiring providers to include a summary cost metric in their consumer communications

04 Helping consumers understand their options

We want to help consumers engage with their retirement decision. However, we recognise the limitations of disclosures and we do not propose to introduce more disclosures. Instead, we will look at improving the effectiveness of:

- current communications sent to consumers before and when they take their pension pot (such as the 'wake-up pack' and the risk warnings)
- ways to encourage consumers to use the free guidance
- ways to increase consumer awareness of enhanced annuities

We are also concerned that it is difficult for consumers to assess which option, such as annuities or drawdown, best meets their needs. The available tools only make general comparisons. So we think it is valuable to look at how better comparison tools could be developed, and would like stakeholder views on this.

Next steps

Getting the remedy package right will require cooperation across the Government, regulators, industry and consumer bodies.

We are not currently proposing action on providers leaving the open annuity market and innovation, but we will keep the market under review.

We will be engaging with stakeholders over the coming months. We invite stakeholders to send their views to RetirementOutcomes@fca.org.uk by 15 September 2017.

We invite comments particularly on:

- our interim findings on how competition works
- the potential remedies, and, specifically, the questions set out in Chapter 8 of the main report

Want to know more?
Further information can be found in the main report: www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report.pdf

25 The North Colonnade Canary Wharf London E14 5HS
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk