

Terms of Reference

MS16/1

Retirement Outcomes Review



July 2016

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If you wish to respond to the questions set out in these Terms of Reference, please do so by 31 August 2016.

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Abbreviations used in this document

| | |
|-----------------|---|
| CP | Consultation Paper |
| CMU | Capital Markets Union |
| DB | Defined Benefit |
| DC | Defined Contribution |
| EU | European Union |
| FAMR | Financial Advice Market Review |
| FCA | Financial Conduct Authority |
| FSMA | Financial Services and Markets Act 2000 |
| IORP | Institutions for Occupational Retirement Provision |
| ISA | Individual Savings Account |
| LISA | Lifetime Individual Savings Account |
| MiFID II | Markets in Financial Instruments Directive II |
| PS | Policy Statement |
| PRIIPs | Packaged Retail and Insurance-based Investment Products |
| SIPP | Self-Invested Personal Pension |
| UFPLS | Uncrystallised fund pension lump sum |

1.

Executive summary

Introduction

- 1.1** Pensions are a priority area of focus for the Financial Conduct Authority (FCA) given their economic and social importance, as well as the fundamental changes this market has experienced. Deciding how to use pension savings is one of the most important financial decisions people will make. Government policies have started to increase the levels of pension saving as well as the options available to consumers when they decide to access those savings. The latter reforms that came into effect in April 2015 have provided consumers with the benefit of accessing their pension flexibly from the age of 55, but also increase the range of financial planning decisions individual consumers may need to make in decumulation. This brings both opportunities and risks.
- 1.2** Since the introduction of the pension reforms in April 2015, there have been a number of key market developments. The market is more fragmented, in the sense that consumers are accessing their savings through a wider range of products and options, with annuity sales at lower levels than prior to the reforms. In response to these changes, firm business models are adapting in different ways, and new policy and regulatory issues have come to light, such as barriers to accessing the pension freedoms. Alongside this, the sustained period of low interest rates has had an impact on investment returns. We are also aware of a number of concerns that have been raised by stakeholders in relation to annuity rates, product charges, non-advised sales and sustainability of income. Further market changes will follow in 2017 with the introduction of the secondary annuity market and the Lifetime Individual Savings Account (LISA).
- 1.3** In our Retirement Income Market Study¹ in March 2015 we identified a number of issues relating to consumer decision-making following the introduction of the pension reforms. Now these reforms have come into effect, we want to assess their impact on competition in the decumulation market by using this Retirement Outcomes Review to look at how firms and consumers have responded to the new freedoms.
- 1.4** This review focuses on the role of competition in the decumulation market, but needs to be seen as part of a wider package of FCA activities that we are undertaking against the backdrop of the changes described above. Broadly speaking, these consist of the following:
- **Supervision**, including the thematic reviews of annuity sales practices and the fair treatment of long-standing life insurance customers, designed to identify and tackle past misconduct.
 - **Policy work** to implement and support the Government's reforms and our regulatory approach, including changes to our pension rules and guidance, the implementation of a cap on pension early exit fees, and preparation for the introduction of the secondary annuity market.

¹ www.fca.org.uk/news/market-studies/retirement-income-market-study

- **Markets-based analysis** of how the market is operating and evolving with the reforms, including our earlier Retirement Income Market Study, and the subsequent remedy proposals and monitoring of market developments. This work is designed to help put the market on the best footing for the future.
- 1.5 In parallel, we have been working with the Government on the Financial Advice Market Review (FAMR), and the Government is also consulting on the public provision of financial guidance and advice.
- 1.6 We want to engage with industry and consumers during the course of this review to help inform the future direction of the decumulation market. Therefore, we encourage firms and other stakeholders to respond to the questions we have set out in Chapter 4 of this document.

Topics we will be covering

- 1.7 The starting point of this review will be the potential issues that we identified in the Retirement Income Market Study in March 2015. However, since the introduction of the pension reforms, we have been monitoring market developments through quarterly market data collection exercises and repeating the quantitative consumer research we conducted as part of the Retirement Income Market Study. The scope of this review has therefore also been influenced by what we have observed through our monitoring activities.
- 1.8 In October 2015 we also set out some issues that we had identified for potential inclusion in the scope of this review. We engaged with stakeholders during October 2015 on the scope and shape of the review, and have continued to develop our thinking in light of the feedback we received. We have also further refined the scope of this review in light of the wider FCA activities related to the pensions and retirement income markets, in particular FAMR.
- 1.9 In light of these factors, we have identified the following topics that we will explore in more detail in this review:
- **Shopping around and switching.** Given what we already know about the difficulties in shopping around for annuities, we want to understand to what extent consumers can compare the larger range of products/options now available to them. We want to understand whether they can compare products, shop around, switch providers where they are not receiving what they want and make good, informed, decisions.
 - **Non-advised consumer journeys.** Now that consumers are accessing more complex products without advice, we want to understand whether non-advised consumer journeys have become more complex for consumers to navigate. We will explore whether there is complexity that causes consumers not to engage, or leads them to being drawn towards certain products, choices and decisions.
 - **Business models and barriers to entry.** As firms adapt with the changes we are seeing in this market, we want to explore what business models and products are emerging and what risks they might pose to competition in this market. For example, how might firms' business models impact on consumer engagement and switching, and are there barriers to entry for challenger firms?
 - **Impact of regulation on retirement outcomes.** Although proportionate regulation intends to bring about positive outcomes, are there examples of FCA regulation that are

overly burdensome and may be inadvertently contributing to barriers to entry or preventing useful product innovation by firms?

Next steps

- 1.10** In Chapter 4 of this Terms of Reference document we have set out some specific questions relating to the issues we have included within the scope of this review. We would welcome responses to these specific questions from stakeholders by 31 August 2016. You can provide us with your responses by post or email, and our contact details can be found on page 2. We will consider these responses as part of the evidence base for our review.
- 1.11** As set out in our recent Policy Statement (PS) 16/12 on our pension rules and guidance, as part of this review we will gather market-wide data to explore potential issues and detriment relating to commission payments on non-advised sales of retirement income products. We have been piloting this data request with a sample of firms and will shortly be issuing that data request to a broader range of firms. Once we have issued the data request we will invite all firms asked to respond to a session at the FCA to discuss any questions or concerns they may have. Separately, we will also be providing guidance to firms on how to complete the data request, as well as responses to questions received during the piloting phase with firms.
- 1.12** We will continue to engage with stakeholders and monitor market developments as we progress our review. We intend to publish our final report in Summer 2017.

2. Introduction

Pensions and retirement income are a priority area of focus for the FCA, given their economic and social importance as well as the fundamental changes there have been to this sector.

Government policies are increasing the number of people saving into a pension, and have also broadened the options available to consumers when they decide to access those savings. The latter reforms that came into effect in April 2015 have brought benefits to consumers but also increased the range of financial planning decisions they may need to make. In our Retirement Income Market Study² in March 2015, we identified a number of issues relating to consumer decision-making following the introduction of the pension reforms in April 2015. We want to assess the impact of the reforms on competition in the decumulation market through this Retirement Outcomes Review.

Since the introduction of the pension reforms, there have been a number of key market developments. We are also aware of a number of concerns that have been raised by stakeholders in relation to annuity rates, product charges, non-advised sales and sustainability of income.

This review should be seen in the context of the wider package of FCA activities we are undertaking against the backdrop of change in the retirement income market. Our work is a mixture of Supervision, policy work, and markets-based analysis.

Background

- 2.1** Pensions are of fundamental economic and social importance in ensuring that people have an adequate income in retirement. At an individual level, deciding what to do with pension savings is one of the most important financial decisions people have to make.
- 2.2** In the UK, people are also living longer lives on an unprecedented scale. In the next five years the number of consumers aged over 65 in the UK is expected to increase by 1.1 million, and the proportion of people aged over 100 will rise by 40%. Older consumers represent a growing proportion of the UK population, and it is important that we deepen our understanding of how markets work for these consumers.³

² www.fca.org.uk/news/market-studies/retirement-income-market-study

³ www.fca.org.uk/news/dp16-01-ageing-population

- 2.3** There have also been increasing challenges with people not saving enough for retirement. In recognition of this, in 2012 the Government introduced automatic enrolment of employees into workplace pension schemes. By the time it is fully rolled out, it is estimated that automatic enrolment will lead to nine million more people saving, or saving more, in a workplace pension scheme.⁴
- 2.4** In the Budget 2014, the Government announced reforms giving people more freedom around how they access their pension savings from the age of 55. These reforms came into effect in April 2015 and mean that people will have a greater spectrum of decisions to take in relation to how and when to use their pension savings. Individual consumers can access their pensions in more flexible ways but will have a broader range of choices to make. This brings both opportunities and risks, such as the adequacy of consumers' long-term financial planning. In making more decisions consumers will increasingly need to consider several factors, such as how long they will live, investment risks, exposure to charges, and sustainability of income to a greater extent than has previously been the case.
- 2.5** Since the introduction of the pension reforms, there have been a number of key market developments. The market is more fragmented, in the sense that consumers are accessing their savings through a wider range of products and options, with annuity sales at lower levels than prior to the reforms. In response to these changes, firm business models are adapting in different ways, and new policy and regulatory issues have come to light, such as barriers to accessing the pension freedoms. Alongside this, the sustained period of low interest rates has had an impact on investment returns. We are also aware of a number of concerns that have been raised by stakeholders in relation to annuity rates, product charges, non-advised sales and sustainability of income. Further market changes will follow in 2017 with the introduction of the secondary annuity market and the LISA.

Why we are conducting the Retirement Outcomes Review

- 2.6** In our Retirement Income Market Study⁵ in March 2015, we identified a number of issues relating to consumer decision-making following the introduction of the pension reforms in April 2015. In particular, we were concerned that increased flexibility, product complexity and opaque charges could make it harder for consumers to compare products and shop around, weakening competitive pressure on firms. We also made it clear that we expected firms seeking to meet mass market consumer demands to ensure that they develop appropriate distribution and guidance arrangements, commensurate with the increased availability of more complex and higher-risk products.
- 2.7** Since the pension freedoms were announced in the Budget 2014 and their introduction in April 2015, much of the FCA's work has been in support of successful implementation of the reforms. Now that these reforms have come into effect, we want to assess their impact on the market by looking at how firms and consumers have responded to the pension freedoms. We are keen to understand whether the issues we identified in the Retirement Income Market Study have become more or less acute, and will do that through this Retirement Outcomes Review.

⁴ www.gov.uk/government/news/pensions-savings-9-million-newly-saving-or-saving-more-says-pensions-minister

⁵ www.fca.org.uk/news/market-studies/retirement-income-market-study

- 2.8** This review focuses on the role of competition in the decumulation market, but needs to be seen as part of a wider package of FCA activities that we are undertaking against the backdrop of the changes described above. Broadly speaking, these consist of:
- **Supervision**, designed to identify and tackle misconduct. This includes our ongoing thematic work on annuity sales practices and on the fair treatment of long-standing customers in the life insurance sector. The fair treatment of long-standing customers review also aims to improve customer outcomes going forward, as we will issue in due course non-Handbook guidance which will provide firms with extra detail on the actions they should be taking in order to treat their closed-book customers fairly in the future.
 - **Policy work** to implement and support the Government reforms. In this area, we have recently published PS16/12, which sets out the changes we have made to a range of our pension rules. We have also published Consultation Paper (CP) 16/15 setting out our proposals on the application and level of a cap on pension early exit fees, and CP16/12, setting out our proposals for the rules to support the Government's introduction of the secondary annuity market.
 - **Markets-based analysis** of how the market is working and evolving with the reforms. This includes our earlier Retirement Income Market Study and the subsequent remedy proposals, which we have been behaviourally testing with a view to updating our rules and requirements as necessary later this year. Alongside these Terms of Reference, we have also published the results of our behavioural testing of our proposed annuity comparison remedy, and set out our proposed next steps. As part of the commitment we made to monitor the market and track consumer outcomes following the Retirement Income Market Study, we have also undertaken ad-hoc data collections, and will continue to do so, in order to understand particular issues. This work is designed to help put the market on the best footing for the future, and the Retirement Outcomes Review forms part of this.
- 2.9** In parallel, we have been working with the Government on FAMR, and the Government is also consulting on the public provision of financial advice and guidance.
- 2.10** More broadly, but also relevant to the pensions and retirement income markets, we have also published Discussion Paper DP16/1 on the Ageing Population and Financial Services. This will ultimately lead to the development of an FCA Strategy on the Ageing Population, which we will launch in 2017.

Interaction with other initiatives

- 2.11** The pension reforms and our current activities on pensions and retirement income cannot be viewed in isolation. Throughout this review we will keep abreast of other initiatives and legislative changes that may lead to further change and influence the pensions and retirement income markets.
- 2.12** At the UK level, relevant current and expected developments include:
- The Government's introduction of the secondary annuity market⁶ and the LISA⁷ in April 2017.

⁶ We are currently considering responses to our Consultation Paper CP16/12, which sought views on our proposed new rules and guidance for the secondary annuity market, due to start in April 2017.

⁷ The Government's intention is that the LISA will help young people to save flexibly for the long term. It will let them save for a first home and for their retirement, without having to choose one over the other.

- The Government's review of public financial guidance, with the final response to the review to be published in autumn 2016.
- The Government's consideration of disclosure of transaction costs as part of its review of the default fund charge cap, and our planned review of Independent Governance Committees, both scheduled for 2017.
- The ongoing behavioural testing of a pension passport and the work being undertaken to consider the development of a pension dashboard in the longer term.

2.13 On 23 June 2016, the UK voted to leave the European Union (EU). The longer term impacts of the decision to leave the EU will depend, in part, on the relationship that the UK seeks with the EU in the future. Current EU initiatives relevant to pensions and retirement income include, in the context of the EU Commission's aim to build a Capital Markets Union (CMU), exploring how to create a single market in personal pensions. Separately, its review of the Institutions for Occupational Retirement Provision Directive (IORP) continues. More broadly, the European Commission is mandated, in 2018, to review whether pension products should be brought into the scope of the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation. The approach taken to the planned implementation of the Markets in Financial Instruments Directive II (MiFID II) may also impact on the pensions and retirement income market in the future.

Promoting effective competition in the interests of consumers

- 2.14** The FCA has an objective to promote competition that is effective in the interests of consumers. Our competition objective supports and is supported by our market integrity and consumer protection objectives.
- 2.15** The potential issues we identified in the Retirement Income Market Study could impact on effective competition in the interests of consumers in this market. In assessing whether competition is working well in this review, we are interested in factors such as choice, price, product offerings and innovation. We want the retirement income market to develop in a way that allows consumers to engage with their options, shop around, and switch providers where appropriate. We also want the market to encourage new and existing firms to compete hard for business by offering good outcomes for consumers in terms of lower prices, new products and services that meet customer needs, better customer service and wider choice.

The powers and procedures we will use to conduct the review

- 2.16** We will conduct this review using our powers under the Financial Services and Markets Act 2000 (FSMA). As set out earlier in this chapter, the purpose of this review is a follow-up to the Retirement Income Market Study. It will explore how firms and consumers have responded to the pension freedoms and assess whether the issues we identified in the Retirement Income Market Study have become more or less acute.
- 2.17** As we explained in CP15/30 in October 2015, to inform this review we have been gathering post-reform market data as part of the commitment we made in the Retirement Income Market Study to monitor this market following the introduction of the pension reforms. We also stated at that time that we may need to collect further data from firms to complement our data

collection activities to date. In PS16/12, we stated that we would gather market-wide evidence to explore potential issues and detriment relating to commission payments on non-advised sales of retirement income products. Following piloting with sample firms, we will shortly be issuing this data request to a broader range of firms and providing additional guidance on how to respond. We are not using formal powers under the FSMA to request this information; however, we would hope that firms comply with the data request to the best of their abilities within the timescales we set.

- 2.18** In Chapter 4 of this Terms of Reference document we have set out some specific questions relating to the issues we have included within the scope of this review. We would welcome responses to these questions from stakeholders by 31 August 2016. You can provide us with your responses by post or email, and our contact details can be found on page 2.
- 2.19** We will consider the responses we receive and continue to engage with stakeholders as we progress our review, hosting roundtable events and bilateral meetings as appropriate.
- 2.20** We intend to conclude the Retirement Outcomes Review and publish our final report in Summer 2017. If following the conclusion of this review we consider that it is necessary to consider further remedies or recommendations for this market, we will consult in line with our obligations. Further details can be found in our guidance on market studies and market investigation references.⁸

⁸ See www.fca.org.uk/news/fg15-09-market-studies-and-market-investigation-references

3.

Scope of the Retirement Outcomes Review

Traditionally, there have been two broad areas of the pensions and retirement income sector: the accumulation (saving) and decumulation (withdrawing) phases. Since the introduction of the pension reforms, the overlap between these two phases has increased, as people can now withdraw money from their pension while continuing to save.

The focus of our review will be on competition in the decumulation phase. However, areas of the accumulation phase may also need to be considered, given the overlap with the decumulation phase.

We intend to focus on the following categories of products in this review: annuities, income drawdown, hybrid products, and options available to make full or partial withdrawals of cash from pension savings. We recognise that there are a range of related products that may need to be considered as relevant wider context when we explore consumer decision-making. The geographic scope of our review is the UK, but as we conduct our review we will take into account any relevant initiatives and changes that will influence the market at UK and EU levels.

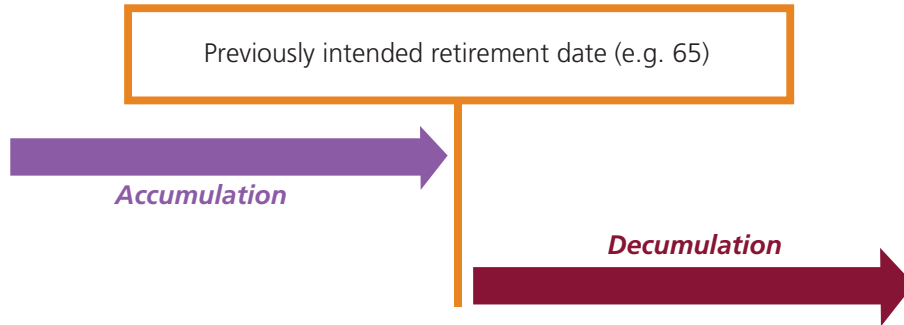
Following the conclusion of FAMR, there is a wide-ranging programme of work relating to issues of access, value and quality of financial advice. Advice is also one of the FCA's priority themes for the coming business year. These issues are **not** within the scope of this review.

Overview of the pensions and retirement income sector

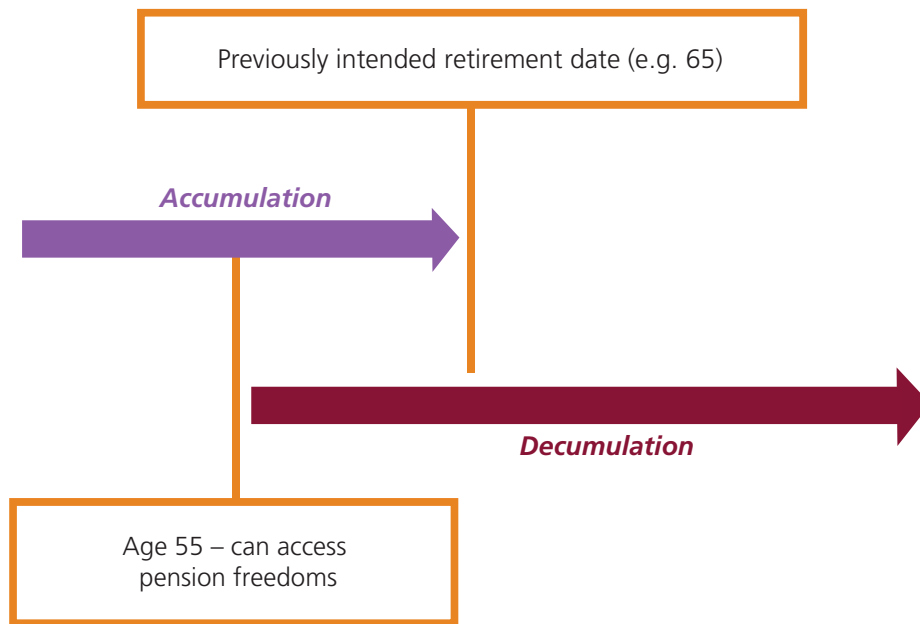
- 3.1** Traditionally there have been two broad areas of the pensions and retirement income sector: the accumulation phase and the decumulation phase. The accumulation phase involves saving and growing sufficient financial assets for use in retirement. The decumulation phase involves converting those assets to fund a desired lifestyle. Some firms operate across accumulation and decumulation, while others have a narrower focus, operating on only one or the other. Distribution and advice are also relevant related activities for these firms. Since the introduction of the pension reforms the overlap between these two phases has increased, and firms' activities may also be changing. Consumers can now also withdraw money from their pension flexibly while continuing to save, as illustrated in Figure 1 below.

Figure 1: Relationship between accumulation and decumulation

Relationship pre-pension reforms



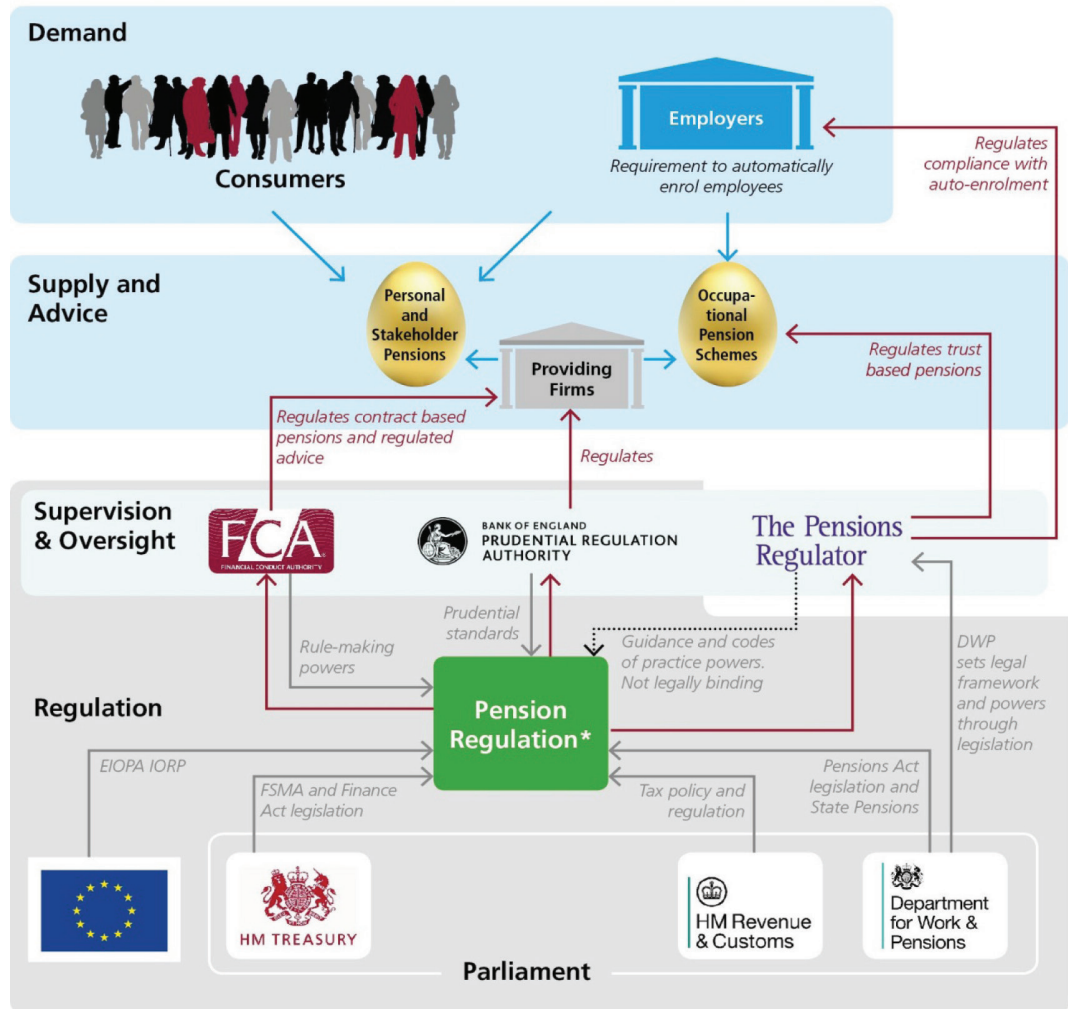
Relationship post-pension reforms



Regulatory scope

3.2 In the pensions and retirement income sector we regulate firms operating personal pension schemes, including stakeholder pensions and Self-Invested Personal Pensions (SIPPs) and, alongside The Pensions Regulator, the conduct of those operating workplace pension schemes. We also regulate insurers, financial advisers, SIPP operators, brokers and others who play an important role in both the accumulation and decumulation markets. The Government, through the Treasury and the Department for Work and Pensions, sets the overall framework for pensions, because pensions are inextricably linked to social policy and taxation. Figure 2 below illustrates the regulatory environment for this sector.

Figure 2: Pensions and retirement income regulatory environment



Our focus on the retirement income market

- 3.3 The focus of our review will be the decumulation phase of the pension and retirement income sector. In doing so, we will be able to review how firms and consumers have responded to the pension freedoms, and understand whether the issues we identified in the Retirement Income Market Study have become more or less acute.
- 3.4 However, aspects of the accumulation phase may also need to be considered, given the increased overlap with decumulation, to understand whether there is an impact on competition in the decumulation phase. For example, we want to understand how different customer journeys and firm business models affect competition. As some firms have both accumulation and decumulation activities, we may need to consider aspects of the accumulation phase.

Product and geographic scope

- 3.5** We will focus on the following categories of products and options in this review, as set out in Table 1 below. We will also consider these products and options from the perspective of availability to consumers through their existing providers and the open market:

Table 1: Key products/options within scope of the Retirement Outcomes Review

| Product/option | Description |
|--|---|
| Annuities | <ul style="list-style-type: none"> A form of insurance policy that consumers can purchase with their pension pot. There are a number of different types of annuity, but they will typically provide the consumer with a guaranteed income for life, or for a fixed number of years. |
| Income drawdown | <ul style="list-style-type: none"> Flexi-access income drawdown products involve investing a pension pot into a fund or funds, allowing the consumer to access flexibly. Income drawdown providers offer a range of different investment funds, with different investment objectives, risks, and levels of charges. |
| 'Hybrid' products | <ul style="list-style-type: none"> This is a term used to cover a number of products that offer some form of guarantee to the consumer. It encompasses newer structured products and variable annuities that offer guaranteed death benefit, guaranteed withdrawal benefits and guaranteed income benefits, as well as more traditionally offered products such as with-profits and unit-linked annuities. |
| Uncrystallised pension fund lump sum (UFPLS) cash withdrawals | <ul style="list-style-type: none"> UFPLS is not strictly a product, but an option through which consumers can access their pension savings. UFPLS features allow consumers to take partial or full withdrawals of cash from their accumulation pension savings. When making partial withdrawals, 25% of each withdrawal is tax-free, with the remaining 75% of each withdrawal subject to tax. |

- 3.6** We recognise that there are currently a number of other related products and options available to consumers to generate funds when they retire or otherwise access their pension savings. Examples of this include Defined Benefit (DB) pensions, equity release products and Individual Savings Accounts (ISAs). Although these products are not the focus of our review, we recognise that we may need to consider them as relevant context when we explore how consumers make decisions on how to access their Defined Contribution (DC) pension savings. Looking ahead, we are also aware that the LISA may become a vehicle that consumers use to save for their retirement.
- 3.7** The geographic scope of this review is the retirement income market in the UK.

Relationship with developments on advice and public guidance

- 3.8** As noted in Chapter 2 of these Terms of Reference, in parallel with our programme of work on pensions and retirement income, we have been working with the Government on FAMR. That review has detailed a series of recommendations aimed at stimulating the development of a market that provides affordable and accessible advice and guidance, as well as further proposals to increase consumer engagement with financial advice. Alongside this, the Government's

review of public financial guidance continues, with the final response to the review to be published in autumn 2016.

3.9 FAMR noted that the pension freedoms may have increased consumers' need for advice. A number of its policy recommendations could impact on some consumer journeys and firm activities in the pensions and retirement income sector. For example, relevant FAMR recommendations include the following:

- The recommendation for the FCA to consult on new guidance to support firms offering services that help consumers who are making their own investment decisions without a personal recommendation, as part of addressing uncertainty among firms as to what constitutes advice and what does not.
- The recommendation for the Treasury to challenge the industry to make a pension dashboard available to consumers by 2019.
- The recommendation for the Treasury to explore options to allow consumers to access a small part of their pension pot before the normal minimum pension age, to redeem against the cost of pre-retirement advice.
- The recommendation for the FCA and the Treasury to develop an appropriate baseline and indicators to monitor the development of the advice market.

3.10 In our 2016-17 Business Plan we have also identified financial advice as one of our priority areas. As part of our planned work for the coming year we have stated that our supervisory focus will include continuing to assess the suitability of financial advice that is being provided.

3.11 In light of the wide-ranging programme of work focused on financial advice summarised above, the scope of the Retirement Outcomes Review will **not** consider issues relating to access to financial advice, or the value and quality of financial advice. As we consider the role of the consumer journey as part of this review, our focus will be on consumers who are making decisions without financial advice (see Chapter 4 for more detail).⁹

⁹ We recognise that there may be circumstances in which the non-advised consumer journeys within the scope of our review are preceded by a mandatory requirement for a consumer to take financial advice, for example in relation to accessing pensions with certain safeguarded benefits. We will not consider this advice in our review.

4. Topics to be explored

This review will consider the potential issues that we identified in the Retirement Income Market Study in March 2015. The key topics that we will explore in this review are as follows:

- **Shopping around and switching.** Given what we know already about the difficulties in shopping around for annuities, we want to understand the extent to which consumers can compare the larger range of products/options available to them. We want to understand whether they can compare products, shop around, switch providers where they are not receiving what they want and make good, informed, decisions.
- **Non-advised consumer journeys.** Now consumers are accessing more complex products without advice, we want to understand whether non-advised consumer journeys have become more complex for consumers to navigate. We will explore whether there is complexity that causes consumers not to engage, or leads them to being drawn towards certain products, choices and decisions.
- **Business models and barriers to entry.** As firms adapt with the changes we are seeing in this market, we want to explore what business models and products are emerging and what risks they might pose to competition in this market. For example, how might firms' business models impact on consumer engagement and switching, and are there barriers to entry for challenger firms?
- **Impact of regulation on retirement outcomes.** Although proportionate regulation intends to bring positive outcomes, are there examples of FCA regulation that are overly burdensome and may be inadvertently contributing to barriers to entry or preventing useful product innovation by firms?

For each topic that we will be exploring, we have also set out a list of specific questions, and we would welcome responses from stakeholders on these to inform our review.

Introduction

- 4.1** The starting point of this review is the potential issues that we identified in the Retirement Income Market Study in March 2015 (see paragraph 2.6). However, since the introduction of the pension reforms we have continued to monitor market developments through quarterly market data collection exercises and repeating the quantitative consumer research we conducted as part of the Retirement Income Market Study. The scope of this review has also been influenced

by the market trends and developments we have observed through our monitoring activities, which we intend to continue as the market develops.

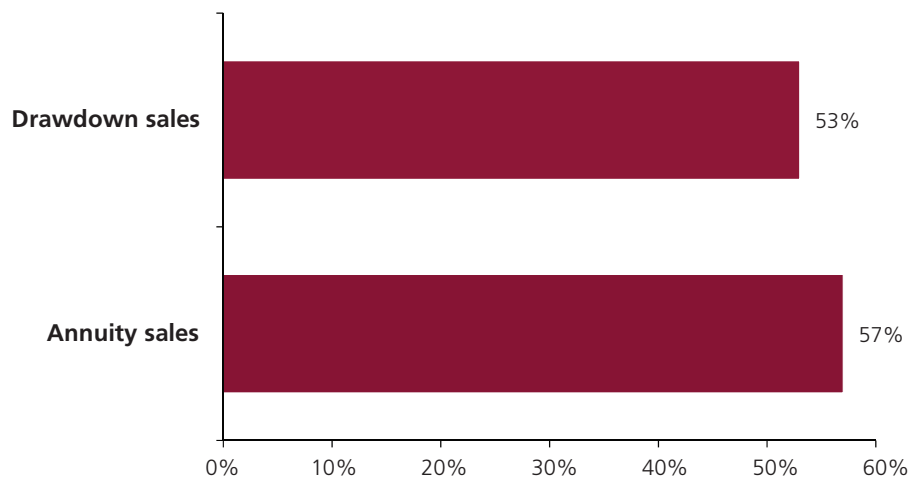
- 4.2** In October 2015, we published our CP15/30 on our pension rules and guidance, which also set out some issues that we had identified for potential inclusion in the scope of this review. We engaged with stakeholders during October 2015 on the scope and shape of the review, and have continued to develop our thinking in light of the feedback we received. We have also further refined the scope of this review in light of the wider FCA activities related to the pensions and retirement income markets (see Chapter 2 for details), in particular FAMR.
- 4.3** In this chapter we have provided a summary of the key findings of our Retirement Income Market data collection exercises, to provide an indication of how the market has developed since the introduction of the pension freedoms. We have then set out in more detail the topics we will be exploring in this review. For each topic, we have also set out a list of specific questions, and we encourage responses from stakeholders on these.

Market developments

- 4.4** In the Retirement Income Market Study we committed to monitor and assess market developments following the introduction of the pension reforms. To do this we have collected data on a quarterly basis from a representative sample of pension and retirement income providers, and we have been publishing these data since January 2016. Our most recent data set was published in April 2016 and covered the period October to December 2015. Further information on our data collection is available on the FCA website.¹⁰
- 4.5** The data we have collected from firms have highlighted some market developments that are particularly relevant for our assessment of competition in the retirement income market. The key developments are set out below.
- 4.6** The data shows that **more than half of customers are staying with their existing pension provider** when accessing their pension savings. Figure 3 shows that in the October to December 2015, firms reported that 53% of income drawdown entrants and 57% of annuity sales were to existing customers. Although not directly comparable data, in the Retirement Income Market Study, our quantitative consumer research highlighted that 40% of consumers purchasing annuities did so from their existing provider.

¹⁰ www.fca.org.uk/your-fca/documents/data-bulletin/data-bulletin-supplement-april-2016

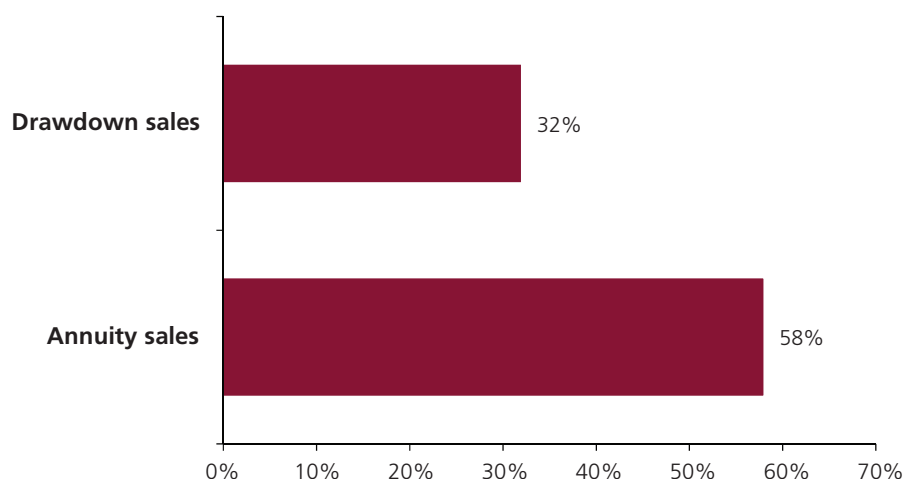
Figure 3: Proportion of sales to existing customers October to December 2015



Source: FCA Retirement Income Market Data

- 4.7** There are also now **higher numbers of consumers entering income drawdown products without use of a regulated adviser**. Figure 4 shows that for the period October to December 2015, 32% of reported drawdown sales were not associated with a regulated adviser. In the Retirement Income Market Study, we noted that in 2013, 97% of new income drawdown sales were sold through advice services. This is likely to have been influenced by the type of consumer purchasing income drawdown at that time.¹¹ Prior to pension freedoms income drawdown consumers typically had significant pension pots to invest and were more able to afford independent financial advice.

Figure 4: Proportion of annuity sales and income drawdown entrants not associated with a regulated adviser October – December 2015



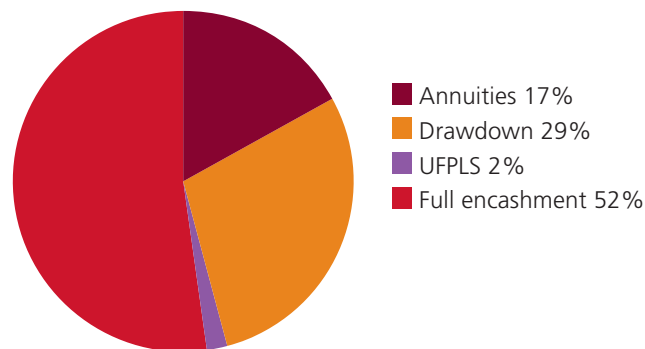
Source: FCA Retirement Income Market Data

- 4.8** There have also been a **significant number of consumers taking full encashment or making high rates of cash withdrawals from their pension savings**. Figure 5 shows that,

¹¹ Based on Mintel data: ABI/MINTEL – MINTEL Annuities-UK, August 2014, p. 31. See also Retirement Income Market Study: Interim Report (December 2014), p. 54.

of all pensions accessed in the period October to December 2015, just over half of pots were fully cashed out via UFPLS, flexi-access drawdown or small pot lump sum payments, though this trend is more prevalent among smaller pots. Our data also show that 11% of consumers aged 55-59 withdrew 10% or more of their pension pot (after the deduction of tax-free cash for drawdown and/or pre-UFPLS payments) in the quarterly period October to December 2015.

Figure 5: Consumer choices October – December 2015



Source: FCA Retirement Income Market Data

4.9 In the Retirement Income Market Study we highlighted concerns regarding the ability of consumers to make informed decisions and place competitive pressure on firms in light of increased choice and complexity and increased mass market access to higher-risk products. The developments outlined above suggest that these concerns are being borne out in practice. The purpose of this review is to understand these developments in more detail and assess whether there are steps we can take to mitigate the associated risks.

4.10 In that market study final report we also stated that we expected the development of hybrid products in this market, which offer flexibility alongside some form of guarantee to the consumer. We noted that there may be particular risks around the comparability of these products and their value relative to the individual products that make the components of the bundled product. Since 2015, we have seen some limited innovation in this area through our supervisory activity. Feedback from stakeholders in October 2015 suggested that this was due to the challenges of simplifying existing products and catching up operationally post-pension reforms. However, we will continue to assess the risks we have previously highlighted as part of this review.

Topics to be explored

4.11 We will explore the following four topics in more detail in the Retirement Outcomes Review:

- Consumer shopping around and switching.
- The non-advised consumer journeys.
- Firm business models and barriers to entry.
- The impact of FCA regulation on retirement outcomes.

- 4.12** The scope of these topics, the potential issues and an overview of how we will explore these issues are set out in more detail below.

Topic 1 – Shopping around and switching

- 4.13** In our Retirement Income Market Study we found that consumers have been missing out on a higher income by not shopping around for an annuity. We also found that some did not buy the best annuity for their circumstances. We concluded that consumers' tendency to buy annuities from their existing provider weakened competitive discipline, since incumbent providers felt less pressure to offer competitive vesting rates and challenger firms found it difficult to attract a critical mass of customers. Since the introduction of the pension freedoms, consumers have a larger range of products and options available to them. We want to explore whether there is a more acute issue post-pension freedoms in relation to consumers' ability to compare their options, shop around, and switch providers to achieve good outcomes and drive effective competition. This could particularly be the case for income drawdown aimed at mass market consumers and other emerging, more complex options such as hybrid products.

- 4.14** In exploring these issues, we want to understand the following:

- Whether consumers find it difficult to obtain information relevant to assessing products and options, such as charges, likely income and returns, and risks/assumptions; and how comparable this information is across the choices they face.
- Whether a lack of information and comparability of products leads to consumers disengaging, choosing decision-making shortcuts, or making poor decisions. We are also interested in how firms may be able to contribute to or alleviate this complexity (for example, through the design and operation of their customer journeys or product information communications).
- Whether consumers' difficulty in accessing, assessing and acting on information weakens competitive pressure on firms to compete hard for their business (for example, by improving prices or other outcomes for consumers).

- 4.15** In order to help us explore these issues, we would welcome responses to the following questions:

Q1: *How difficult is it for consumers to access and assess product information, such as prices and product features, and why? What are the effects of this on consumer decision-making?*

Q2: *How do firms enhance or alleviate any complexity and comparison difficulties that consumers may face?*

Q3: *Why has the level of consumer switching decreased since the introduction of the pension reforms?*

Topic 2 – The non-advised customer journeys

- 4.16** The pension freedoms have introduced much greater flexibility for consumers in terms of how and when they can access their pension savings, as they no longer need to buy an annuity and can access their savings from the age of 55. However this also means that there is no longer necessarily a one-off decision point. The lack of a clear decision point in time could:
- Contribute to consumers disengaging and selecting the easiest option (for example, withdrawing their pension savings as cash without considering the tax implications, or defaulting to a decumulation product with their current provider without properly considering the alternatives).
 - Allow firms to steer consumers to certain choices or products without consideration of all the options available to them, due to the way customer journeys are designed by firms and how consumers interact with them. In the Retirement Income Market Study we highlighted that consumers are sensitive to the way options are presented to them. We made it very clear that we wanted to see firms framing options in a way that helps consumers to make good decisions, rather than to drive sales of higher margin products.
- 4.17** Therefore we will explore the non-advised consumer journey and assess whether consumers are inhibited or discouraged from making informed and impartial decisions. We will also explore how this may affect how effectively they access their pension savings, the value they obtain from their retirement income, and the quality and strength of competition among firms (see Topic 1).
- 4.18** In exploring these issues, we want to understand the following:
- Now that consumers can access a broader range of options, does this lead to consumers engaging with their options more, or increase difficulties in engaging? From our previous work, we know that some consumers already found it difficult to engage with the retirement income market when faced with, effectively, a choice to buy an annuity at a defined point in time. Prior to the pension reforms, most non-advised consumers were faced with this choice.
 - How well consumers understand their retirement income options when they engage on a non-advised basis, and whether they make informed choices.
 - How firms engage with their customers as part of this more complex non-advised journey, and what impact this has on consumer decision-making. We want to understand the impact of the way in which firms structure and present decumulation options and products and their incentives for doing so. For example, firms supplying both accumulation and decumulation products and options may engage with the consumer journey differently to firms that do not, and this could impact on consumer understanding and behaviour in different ways.

- 4.19** In order to help us explore these issues and the extent to which they exist, we would welcome responses to the following questions:

Q4: *What do the different non-advised customer journeys look like following the introduction of increased flexibility and choice?*

Q5: *How do firms engage with these different customer journeys, and what is the impact on consumer decision-making?*

Q6: *How does product presentation and distribution influence the customer journey? For example, what impact does combining accumulation and decumulation products and options have on consumer decision-making?*

Q7: *To what extent do the changing customer journeys promote good informed decisions, or create barriers to doing so?*

Topic 3 – Business models and barriers to entry

- 4.20** The introduction of the pension freedoms has presented firms with the opportunity to develop their business models, for example through being able to offer a wider choice to consumers, or to focus on operating in specific segments of the market. As well as providing consumers with the ability to access their pension savings more flexibly, the reforms also opened up possibilities for firms to enter or expand in the retirement income market, for example, by offering drawdown products or by developing innovative decumulation products that address consumer needs and desires. This has the potential to have a positive impact on competition in the market and consumer outcomes.
- 4.21** However, there are also potential risks and impediments to improved competition and consumer outcomes. In light of falling annuities sales, some firms may experience pressures to maintain margins through consolidation or through adapting their business models in other ways. A noteworthy development in this context has been the merger between two significant ‘challenger’ annuity providers, Just Retirement and Partnership.¹² Some firms may also decide to develop business models that allow them to access and use customer relationships in ways that may also have the effect of reducing shopping around and the levels of switching by consumers.
- 4.22** Further, low rates of customer switching can act as a barrier to new firms that want to enter the market; in the Retirement Income Market Study we concluded that access to a critical mass of customers was the most significant barrier to entry in the annuities sector. We want to understand the extent to which having a critical mass of customers and/or customer acquisition continues to be a barrier to entry or expansion in the broader retirement income market.

¹² See the CMA merger decision of 28 October 2015, ME/6544-15 Anticipated merger between Just Retirement Group plc and Partnership Assurance Group plc, published 27 November 2015, available at: www.gov.uk/cma-cases/just-retirement-group-partnership-assurance-group-merger-inquiry

4.23 In exploring these issues, we want to understand the following:

- How the market structure and business models have changed since the pension freedoms.
- The nature of business models used by existing firms and new entrants, and their impact on the market and consumer outcomes, such as consumer engagement and switching. Examples of relevant business models could include: supply of both accumulation and decumulation, referral arrangements between firms, and vertically integrated businesses.
- The extent to which having a critical mass of customers and/or customer acquisition is a barrier to entry or expansion in this market and weakens competition between incumbent and challenger firms.

4.24 In order to help us explore these issues and the extent to which they exist, we would welcome responses to the following questions:

Q8: *How have the market structure and business models evolved since the pension reforms?*

Q9: *How might developing business models lead to efficiencies or detriment for consumers?*

Q10: *To what extent do the developing market structure and business models affect barriers to entry or expansion for challenger firms?*

Q11: *To what extent is obtaining a critical mass of customers a barrier to entry or expansion since the introduction of the pension reforms?*

Q12: *Are there any other relevant barriers to entry or expansion that prevent the retirement income market from working well?*

Topic 4 – Impact of regulation on retirement outcomes

4.25 While proportionate regulation intends to bring about positive outcomes such as consumer protection, market integrity or effective competition in the interests of consumers, where it is overly burdensome it may inadvertently contribute to poor outcomes. Some examples of where regulation can be overly burdensome are:

- where it acts as a barrier to entry or expansion,
- where it raises firms' costs of doing business disproportionately to the market failure it seeks to address, and
- where it stops firms innovating or developing advancements to benefit consumers.

- 4.26** In order to help us explore these issues and the extent to which they exist, we would welcome responses to the following questions:

Q13: Are there examples of FCA regulation that act as barriers to entry or expansion? If so what are they?

Q14: To what extent does existing FCA regulation disproportionately increase costs for firms or deter innovation that meets consumer needs?

Q15: To what extent is further regulation needed to promote the FCA's objectives in this market?

Glossary of terms used in this document

| | |
|---|---|
| Accumulation | The phase during which a consumer saves into a pension pot during his/her working career in order to build up a pension pot for their retirement. |
| Annuity | A form of insurance policy that consumers can purchase with their pension pot. They will typically provide the consumer with a guaranteed income for life, or for a fixed number of years. |
| Automatic enrolment | A legal requirement that every employer must automatically enrol its workers into a qualifying pension scheme subject to certain criteria. Employers will have gradually enrolled all eligible workers into qualifying pension schemes between 2012 and 2018. |
| Decumulation | The process of converting pension savings into a retirement income. |
| Default fund charge cap | FCA rules require firms that operate workplace personal pension schemes used for automatic enrolment to implement a charge cap within the default funds of those schemes. Similar measures have been implemented in regulations for occupational schemes for which The Pensions Regulator is responsible. |
| Defined Benefit | A scheme in which the benefits are defined in the scheme rules and accrue independently of the contributions payable and investment returns. Most commonly, the benefits are related to members' earnings when leaving the scheme or retiring, and the length of pensionable service. Also known as 'final salary' or 'salary-related' scheme. |
| Defined Contribution | A scheme in which a member's benefits are determined by the value of the pension fund at retirement. The fund, in turn, is determined by the contributions paid into it in respect of that member, and any investment returns. Also known as a 'money purchase' scheme. |
| Equity release products | Products that enable a consumer to access the equity acquired in his/her property. Typically equity release products will either be lifetime mortgages, which allow an individual to borrow a proportion of their home value, or home reversion, where an individual sells a share of their property, but retains a right to continue living in the property. |
| Financial Services and Markets Act 2000 (FSMA) | The primary source of legislation governing financial services and markets in the UK. |
| 'Non-advised' | Sales made by firms that do not involve any personal recommendation and leave the customer to decide how they wish to proceed. |

| | |
|---|---|
| Income drawdown | Flexi-access income drawdown products involve investing a pension pot into a fund or funds, allowing the consumer to access flexibly. Income drawdown providers offer a range of different investment funds, with different investment objectives, risks, and levels of charges. |
| Independent Governance Committees | FCA rules require providers of workplace personal pension schemes to set up and maintain independent governance committees. They have a duty to act solely in the interests of scheme members, assessing and, where necessary, challenging providers on the value for money of workplace personal pension schemes. |
| Hybrid products | This is a term used to cover a number of products that offer some form of guarantee to the consumer. It encompasses newer structured products and variable annuities that offer guaranteed death benefit, guaranteed withdrawal benefits and guaranteed income benefits, as well as more traditionally offered products such as with-profits and unit-linked annuities. |
| Pension dashboard | A pension dashboard provides the consumer with an overview of the key information on all the pension funds that they have. |
| Pension passport | A document that provides the consumer with key information on a specific pension fund that they have with a specific firm. Examples of the information that it could include are: policy number; pension fund size; maximum tax free cash available; and whether any guarantees or reductions apply to that policy. |
| Secondary annuity market | From April 2017, individuals will be able to sell their annuity income, as long as their annuity provider agreed, without the tax restrictions that currently apply. |
| Self-Invested Personal Pension (SIPP) | A pension 'wrapper' that holds investments until an individual retires and draws a retirement income. It allows individuals to make their own investment decisions from a range of investments approved by HM Revenue and Customs (HMRC). |
| Uncrystallised fund pension lump sum (UFPLS) | UFPLS is not strictly a product, but an option through which consumers can access their pension savings. UFPLS features allow consumers to take partial or full withdrawals of cash from their accumulation pension savings. When making partial withdrawals, 25% of each withdrawal is tax-free, with the remaining 75% of each withdrawal subject to tax. |



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