Consultation Response

Financial Conduct Authority: Retirement Outcomes Review: interim report

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About this consultation

The Financial Conduct Authority (FCA) is undertaking the Retirement Outcomes Review, due to report in 2018. This consultation is also the interim report, and highlights the emerging findings from its analysis and the consumer research that was commissioned as part of the Review. It identifies a series of potential remedies to address the issues identified, and asks for feedback on these and the findings more generally.

Key points and recommendations

- Age UK welcomes the research and analysis produced in and alongside this interim report. It adds significantly to the evidence base and helps build a better understanding of consumer behaviour.
- We are pleased that the FCA has developed a robust response on non-advised drawdown. However other issues – in particular the high propensity to take cash – also warrant detailed investigation and the development of measures to improve consumer outcomes. We hope the final report will consider this in more detail.
- In addition, we suggest three other issues are considered as additional 'emerging issues' – people fully withdrawing to spend or pay off debt; the impact on the cash savings market; and closer examination of the potential longer-term impact of current decisions, for example through scenario testing.
- There is a clear market failing – providers have failed to deliver the innovation needed to deliver competitive mass-market decumulation products.
- We are unconvinced by arguments that this will improve. As long as disengagement and a predisposition to take cash remain common, there is likely to be little incentive for firms to innovate, notwithstanding the increasing value of Defined Contribution (DC) savings. There is scope for significant regulatory intervention to resolve these issues.
- The FCA should work with HM Treasury and other stakeholders to develop suitable product default pathways. These will help guide disengaged consumers through their later-life financial decisions.
- We support the proposal to develop default investment pathways for non-advised drawdown customers. We agree that this will help large numbers of people achieve better outcomes. However, it should be considered the first part of the road towards developing default product pathways.
- We are broadly in favour of decoupling accessing the tax-free lump sum from the rest of the pension pot, and agree this will help people avoid moving into higher charging drawdown accounts.
- Prior to accessing their pension, all consumers should be defaulted into Pension Wise. This would be on an opt-out basis, so people who do not require this service would not be obliged to use it, but for the majority it would prompt them to access what has proven to be a successful and helpful intervention.

- We support moves to improve customer communications designed to increase shopping around and outcomes more generally. A cost metric for drawdown would help achieve transparency, although it would need careful consideration given the plethora of charges and current lack of consumer understanding.
- The pensions dashboard is an opportunity to improve communications, but should be seen as complementary to other means of engagement, not ‘the silver bullet’ – it is far from certain that the majority of people will use it.
- It would be desirable to increase the scope of Independent Governance Committees to include decumulation products. This will be essential if the FCA presses ahead with the proposal to implement default investment pathways in non-advised drawdown.
- FCA data is produced on a pot-by-pot basis. This means there is no sustainable way of looking at individual consumers and getting a holistic picture of their retirement income. It requires in depth research to build a proper picture. The FCA, HM Treasury and Department for Work and Pensions should work together to develop a method for improving the data available for analysis.

1. Introduction

Since their introduction in 2015 the pension flexibilities have been well received by many consumers. People generally welcome the opportunity to spend their money in a way of their choosing, and only a small minority do not approve.[i] However the reforms have driven a marked change in consumer behaviour, with many people accessing their pensions without fully understanding the consequences of their decisions. The new consumer research published alongside this review raises several issues, for example the high number of people taking cash from their pension saving, often before age 60 and without consideration for their future income; and the lack of understanding of and engagement with the pensions system.

Age UK is pleased that the FCA has taken this opportunity to take stock of what impact the changes have had, and we welcome the detailed research and thought that has gone into producing the interim report. The analysis and accompanying research adds a considerable amount to the evidence base.

It is clear that there is much to be done if consumers are able to derive ‘good’ outcomes. Part of the difficulty lies in defining what ‘good’ means and then measuring it. Pensions are designed to deliver long-term income throughout later life, and it is important to remember that it is not just about delivering good value in the here-and-now, but also ensuring that people have suitable products, access to advice and guidance, awareness of their options, and (last but not least) sufficient funds to last the rest of their lives. As the FCA takes forward the Retirement Outcome Review, we would like to see more focus on the long-term impact of consumer decision-making and the lack of development in the marketplace. This cannot be delayed to ‘wait and see’; as FCA comments, social norms are changing very quickly.

It is clear that decision-making is very difficult for individuals at the point of pensions access. The array of available options, often coupled with a lack of understanding about what each means, can lead to poor choices. For example research by the Pension and Lifetime Savings Association found that 53 per cent of people thought that drawdown would secure them an income for life.[ii] The well-documented behavioural biases, such as underestimating life expectancy and valuing the present more highly than the future will also be having an impact on decision-making, even if in many cases it will not be possible to measure the detriment for a number of years.

Furthermore, the ‘decoupling’ of pensions and retirement income decision-making identified in the consumer research is also concerning. With many people, particularly those with lower and mid-sized pots accessing the 25 per cent tax free lump sum without any long-term financial plan in place – effectively making a consumption decision rather than a retirement one – there is potentially a significant shortfall in pension wealth when they come to access the money later on.

We understand the FCA’s decision to focus on the non-advised drawdown marketplace at this point in time, although the other issues also warrant serious attention. In particular, there needs to be behavioural testing to try and prevent people from cashing in their pension, especially where it is likely to be left sitting in other product wrappers that are not in the consumer’s interest – for example, just leaving it in a bank account. Improving outcomes here is also of great concern.

Our forthcoming report on ‘women and private pension decumulation’ might also be of interest. It considers the main issues affecting women at and in retirement, and how outcomes might be improved. We are happy to share this as soon as it is available.

We also note the FCA is currently running another consultation on DB transfers. The recent increase in demand for transfers is of concern to Age UK, and is largely driven by the freedom and choice reforms for DC savers. The two issues are closely intertwined, and the FCA needs to ensure the outcomes complement one another.

2. Consultation questions

Question 1: Do you agree with our interim findings as set out here and throughout the report? If not, why not? Can you provide any relevant evidence to support your views?

The findings in the report seem, to the best of our knowledge, to be an accurate reflection of the emerging issues in pensions freedom and choice. The consumer research and the FCA's analysis is thorough and corroborates existing research about consumer behaviour.

We agree with that the five emerging issues identified are all potentially serious problem. They are copied here for reference:

- many consumers have fully withdrawn pension pots to move into savings elsewhere, partly driven by lack of trust in pensions
- consumers who access their pots early without taking advice typically follow the 'path of least resistance', accepting drawdown from their pension provider without shopping around
- many consumers buy drawdown without taking advice but may struggle with the complexity of the decisions they have to make
- providers are continuing to withdraw from the open annuity market
- there is limited innovation for mass market consumers

We would, however, expand these by adding three more categories that we believe are worthy of more detailed consideration.

Full withdrawal for spending and paying off debt
In addition to those who are fully withdrawing and moving the money to non-pension products, a significant minority are also spending the money. There are two groups identified for which it is difficult to tell the level of the problem but should also be considered an emerging issue.

Firstly, for the 25 per cent of 'withdrawers' who spent all or most of their money, it is not known whether this is a sensible decision. Pensions are primarily there to provide a retirement income, and while not all savers have enough money to turn into a lasting income, it raises concerns when high number of people are withdrawing in full. It is also unclear whether many people doing this have alternative sources of retirement income. This should not be taken as a given.

Secondly, 14 per cent of the ‘full withdrawers’ are paying off mortgages and debts. This may be in their best interest, but again it is impossible to tell. People considering cashing in for this reason need to receive debt advice beforehand, probably alongside a Pension Wise session, to help them make the best decision. We refer FCA to a recent publication from the Council of Mortgage Lenders, *Later Life Borrowing: new mindsets, old silos*, which includes helpful research and recommendations on the interaction between pensions and debt.

In the longer-term, questions may arise over whether pension tax relief in accumulation is good value for taxpayers if people are making inappropriate decisions, so it is important to get it right.

Other issues also arise under the ‘full withdrawal’ banner. We are not convinced that the seeming dismissal of ‘minority behaviour’ is always appropriate – for example, just because “only 9 per cent” (para 4.28) of those encashing are giving up a Guaranteed Annuity Rate (GAR), does not make it an irrelevance. People who do give up GARs are very likely to experience worse outcomes later on in their retirement, and action on preventing this is still necessary, even if it only applies to a minority.

The impact on the cash savings market

We are concerned that many people are cashing in their pension only to leave it in a savings account – yet in the FCA’s cash savings market study in 2015 found that the savings market was not working well for many consumers. It is even more critical now that it does work well, and we recommend that the FCA reviews how well the remedies it put in place are working, and considers the interaction between pensions and savings further.

Longer-term impact on consumer outcomes

Perhaps more importantly, the longer-term impact of the freedoms is not covered by the Review. As pensions are designed to provide an income lasting for many years, the impact of consumer behaviour over 20, 30, 40 or even 50 years is important to consider. Poor decision-making now can cause a lasting detriment of people’s financial future. This needs to be given more detailed consideration.

In the future there will be fewer people with alternative sources of income, hence decisions now will assume an even greater importance. While Figure 24 in the FCA paper shows that 24 per cent of people have a DB pension as their largest source of income, higher that 21 per cent for the State Pension, this does not chime with other relevant data. According to the Department for Work and Pensions, 97 per cent of pensioners are in receipt of the State Pension with a mean income of £161, compared to all (DC, DB and personal) private pension income showing 72 per cent in receipt with a mean value of £143 per week,[iii] it seems there might be a more complicated picture to explore.

It cannot be assumed that people have other sources of income to rely on, especially as the data gathered by the FCA only reports on a ‘per pot’ basis, or that this will continue into the future.

Question 2:
Do you agree with our overall approach to intervening in this market? In particular, do you have views on whether our proposed remedies strike the appropriate balance between:
• intervening early but also giving the market time to adjust
• measures aimed at protecting consumers and promoting more effective competition

Age UK is pleased that the FCA is doing a thorough evaluation of the market failings and looks forward to the final report of the Retirement Outcomes Review and accompanying research. However, we are concerned that the market has had time to adjust but has failed to do so. The FCA’s analysis highlights the gaps in innovation alongside where this has occurred. Crucially, there is still a significant gap between solutions for the mass-market and for the higher end, while consumers make decisions without full understanding of the options available. This reduces the need to innovate.

Based on the evidence presented in the review, innovation appears to be stifled by two factors: firstly, the lack of pension savings (and hence profitability) of lower and middle income consumers; secondly the absence of effective consumer demand, driven by the poor understanding of products and the decision-making process.

These are exacerbated because the second compounds the first and are unlikely to change, and we do not agree with industry arguments that over time as assets under management in DC pensions increases this will drive innovation and competition – as past history shows, while people fail to shop around and make genuinely informed choices the status quo is likely to continue.

We believe that the DWP’s analysis of why NEST should not enter the drawdown marketplace, which the FCA agrees with, fails to take into account some important factors. To take each point in paragraph 6.22 in turn:

1) People with smaller pots (and often but not always lower incomes[iv]) do often need such products. Their absence drives them to cashing out altogether or reduces their options across the marketplace. There is also a definitional issue with what is considered a small pot – we believe that the £30,000 threshold is too high, especially as the median pot value is £25,749.[v] This leads to people with a pension pot that is sizeable relative to their income being given the impression that their pot is not large enough to significantly boost their retirement income.
2) There is, as yet, insufficient evidence about suitable product pathways through decumulation (sometimes called 'defaults' or 'soft defaults'). However, this is largely because the industry has failed to develop proposals – other than the NEST blueprint, there have been no serious attempts to do so. The FCA, along with the DWP and HM Treasury, should look to build the evidence base here, rather than accept that it does not exist.
3) Providers have had three and half years since freedom and choice was announced, and two and a half since the reforms went live, and there is still relatively little evidence of any products in development. Instead, we've seen large insurers like Standard Life and Prudential pull out of the open annuity market, leaving consumers with further reduced choice. In the drawdown and hybrid spaces there is minimal development – providers have had time but have done little, often citing 'the changing nature of decumulation' – which is frankly a weak excuse – suggesting strongly that strong action is required to drive innovation and competition.

There are remedies that could be applied to oil the wheels of the market, for example defaulting people into Pension Wise (see Question 4), although these are unlikely to be sufficient to drive innovation. If full withdrawal becomes standard, then the incentive to develop new products will never arise.

Furthermore, there needs to be an intervention to prevent people from fully cashing in their pension. While we do not know for sure whether or not this is in a consumer's best interest, there is evidence that some people choose to do so because it is the 'path of least resistance'[vi] or they have been told by a friend that they can. It is already becoming the social norm, and intervention is needed to prevent this.

At the moment, it appears freedom and choice has delivered limited benefit for consumers in the product marketplace, as highlighted by the lack of shopping around and limited innovation – the worst of both worlds.

Question 3:
Do you consider we should introduce further consumer protections for consumers who buy drawdown without taking advice to ensure consumers are not at risk of choosing particularly unsuitable investment strategies?

- **Should we explore the possibility of default investment pathways?**
- **Should a charge cap also be considered for default investment pathways?**
- **Should the role of IGCs be extended to decumulation products?**
- **Do you agree with the decision not to pursue the option of introducing an appropriateness test for non-advised drawdown at this stage?**

Age UK agrees that there should be further reform to protect consumers, and we welcome the measures proposed. Focussing on non-advised drawdown is a good starting point, although it is worth remembering this is only one part of the at-retirement landscape. There is also a risk that introducing regulation only in this part of the market distorts individuals' decision-making.

The FCA should also consider how to benchmark any changes against longer-term criteria. Para 8.21 notes that it is "too early to assess whether consumers are making poor choices about their withdrawal strategy", which we would broadly agree with, but retirement income is a long-term game and it could be decades before we have seen the full impact. Helping steer people on to the right long-term path is important – ideally this would be done through product defaults, but the proposed remedies could potentially be helpful too.

We welcome the idea of creating default investment pathways. We agree this could provide protection for the disengaged majority who are moving to this product, and the proposed requirements outlined in para 8.28 seem sensible.

A charge cap appears to go hand-in-hand with default investment pathways. Given the range and number of charges in drawdown it might be difficult to implement without some prior simplification of charging structures, otherwise if it just applies to investments it could be easy to game (for example by adding compensatory additional charges to withdrawals). This does not need to be a barrier, although it might require more consideration of how it would work in practice and subsequently be enforced.

Extending the remit of Independent Governance Committees (IGCs) could serve as a fall back option. The IGC could oversee the charges and ensure they are value for money. The FCA should also consider whether to give the IGCs more teeth, or take a more proactive approach to enforcement of poor value themselves, if this option were to be pursued. Generally, we believe that IGCs should be given a fiduciary duty to act in the interest of the provider's customers – extending their remit into decumulation products would represent a big change and would necessitate a review of their operation.

Question 4:
Do you believe the market can deliver 'decoupling' without regulatory intervention?

While we are broadly in favour of decoupling, we believe it must be accompanied by regulatory intervention. We agree with the FCA that it would allow people to access their tax-free lump sum without moving to a drawdown account, which could result in lower charges for the consumer. The consumer research found that many people are determined to get their "windfall" money as soon as possible, and so this move would be beneficial to this group. However 'decoupling' could reinforce a new social norm that the tax-free lump sum is there to be taken at 55, which may not be in people's best interests.

Defaulting people into guidance
It is important that before accessing their pension, people are able to understand their options and the consequences of decisions. We support the proposal to 'default' people into Pension Wise, on an opt-out basis, before they access their pension savings.

Pension Wise has proven to be an effective service, with 92 per cent of users reporting they were very or fairly satisfied.[vii] However this success has been tempered by low take-up rates – even though the service is free. Over the six month period between October 2016 and March 2017, 35,701 people had a Pension Wise appointment.[viii] A total of 276,761 pension pots were accessed for the first time in this period.[ix] This suggests that only about one in six people who accessed their pension had used the guidance service. While more will have used the Pension Wise website, it is difficult to ascertain the nature of the online interaction. Notwithstanding, this is a worryingly low proportion.

The FCA consumer research shows that the norms of decision-making have evolved towards early access to their savings, with many people simply wanting to access cash (either the tax-free lump sum or the whole pot) without due consideration of the consequences (short or long term). We therefore believe that defaulting people into Pension Wise on an opt-out basis provides a sensible and feasible resolution.

This system would encourage consumers to seek guidance before they take the initial decision, thereby providing them with the opportunity to better understand issues like tax, product choices, and alternative sources of income. As people would be able to opt-out in the same way they can from automatic enrolment, we believe it would help boost engagement with saving and continuity between the accumulation and decumulation phases.

Question 5:
Do you consider it proportionate for us to pursue remedies to make it easier for consumers to shop around for drawdown? In particular: Do you consider that the introduction of drawdown comparison tools should be left to the market or is more proactive intervention needed?

- **What are your views on the benefits and costs of mandating the use of a summary cost metric in customer's communications?**
- **Do you agree with the decision not to pursue the alternative measures at this stage?**

We support moves to improve shopping around and transparency, and believe a cost metric would benefit consumers. There would be challenges in assimilating the different charges and costs of drawdown schemes, and it might require some simplification of such charging structures before a tool could be effective, but we urge the FCA to pursue it.

The presentation of this information would be important, and we are hopeful the FCA would be able to draw on both behavioural research and its previous experiences to deliver a tool that encourages consumers to shop around.

One warning we would provide at the outset is that such a tool is *not* a substitute for other forms of consumer protection, such as charge caps or default investment pathways. It should not be pursued to the detriment of other solutions.

Question 6:
Do you agree we should act to make existing information more impactful and effective rather than introducing new disclosure? In particular what are your views and suggestions on our proposals to:

- **Improve the effectiveness of communications sent to consumers before and when they access their pension pots?**
- **Explore the feasibility of introducing tools that compare different products and options?**
- **Raise consumer awareness of potential eligibility to purchase an enhanced annuity earlier in the consumer journey? Is there a better way of ensuring consumers are made aware?**

We agree there is scope to improve pension communications. Wake up packs have only limited impact, and there is no doubt scope for more impactful communications delivered at more appropriate times. Given the evolving nature of decumulation decision making, the FCA should consider whether more than one wake up pack (or wake up letter) is required, for example at 55 as well as the scheme's normal retirement age.
There is also scope for the FCA to promote the need for an 'MOT at 50'. We are shortly to publish a discussion paper looking at how to combine careers advice (with a higher State Pension age people will need to keep working for longer) with a nudge on pension savings. It represents an opportunity for the industry to engage earlier with consumers and persuade people to increase their contributions, and are happy to discuss with the FCA.

The pensions dashboard also represents an opportunity to improve communications. We are supportive of the development of the dashboard, but it is unlikely to present a catch-all solution. Other forms of communication will continue to be important.

Other issues that are often overlooked by consumers include safeguarded benefits and enhanced annuities. Ensuring people take up these options where appropriate should be considered a priority.

Question 7: Do you agree that we should not be intervening in these areas at this stage? If not:

- **Why do you consider we should be intervening?**
- **What interventions should we be pursuing?**

We are very concerned by the limited innovation for mass-market consumers, and believe there is scope for FCA intervention in order to improve outcomes. The demand side of the market is highly dysfunctional, as demonstrated by the number of people fully encashing before the age of 60 we well as people taking their tax-free lump sum at around age 55 and then leaving the remainder of their pot sitting in drawdown accounts that are likely to have higher charges. We explained in our answer to Question 2 why we disagreed with the DWP's rationale for not allowing NEST to enter the drawdown market, and the same principles apply here.

The most realistic ways to solve this are through legislative and/or regulatory intervention, and we believe it is in the interests of consumers and the industry to improve innovation and competition among products directed at lower to middle income consumers.

In para 1.34 the FCA identifies that “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 pots are currently relatively small.”

To discuss these in turn:

1) Policy changes – while there have clearly been developments in legislative and regulatory policy, the fundamental aspects of freedom and choice have not changed since its inception. Providers are aware of the ground rules, have an idea about the types of products that are likely to be appropriate, and have the expertise to develop and test them. The FCA needs to take a firm decision about future changes to the investment charge cap so that firms understand what they are working to – the onus is on the FCA to make its intentions clear.
2) Uncertainty about the market – this suggests a vicious cycle where a lack of innovation leads to a lack of innovation. This requires intervention to break.
3) Small pots – providers are aware of projections for future savings levels[x], and may well consider even these to be unprofitable. We are concerned that in future the industry will simply find another excuse not to innovate. This can be tackled with regulatory intervention now, for example a charge cap on drawdown products may drive product development that is more appropriate for smaller pot holders.

If taking the tax-free lump sum or full encashment becomes the established norm, the scope for innovation will be even more limited. As demographics, DC savings and alternative sources of income will be forever changing, the above issues risk becoming a paradigm mindset that becomes difficult to break free from – the market is always likely to be developing, with solutions for smaller pot holders always to be delivered ‘in the near future’ but never ‘in the here and now’.

Regulatory intervention has a key role to play in improving outcomes for low and mid-value pot holders.

[i] Citizens Advice (2016), Life after pension choices: consumer reflections on pension choices and thoughts on the future
[ii] Pension and Lifetime Savings Association (2016), Pension freedoms: no more normal, Understanding Retirement Wave II
[iii] DWP Pensioners' Incomes Series, 2014/15, published June 2016
[iv] See Pensions Policy Institute (2014), How complex are the decisions that pension savers need to make at retirement?
[v] Pensions Policy Institute, The Future Book: Unravelling workplace pensions second edition, 2016
[vi] People's Pension/State Street Global Advisers (2016), New choices big decisions
[vii] Department for Work and Pensions / Government Social Research (2016), Pension Wise service evaluation, wave 1 interim findings
[viii] Face-to-face and telephone appointments combined, data from 'Pension Wise usage: transactions by channel' available at https://www.gov.uk/performance/pension-wise/appointments-delivered-by-channel
[ix] FCA (Sep 2017), Data Bulletin 10 underlying data
[x] Pensions Policy Institute, The Future Book: Unravelling workplace pensions second edition, 2016