Consultation Response

Retirement Outcomes Review: Investment pathways and other proposed changes to our rules and guidance

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christopher.brooks@ageuk.org.uk

Age UK
Tavis House
1-6 Tavistock Square
London WC1H 9NA
T 0800 169 80 80 **F** 020 3033 1000
E policy@ageuk.org.uk
www.ageuk.org.uk

Age UK is a charitable company limited by guarantee and registered in England (registered charity number 1128267 and registered company number 6825798). The registered address is Tavis House 1-6 Tavistock Square, London WC1H 9NA.

About this consultation

In its Retirement Outcomes Review published in 2018, examining the impact of the 2015 reforms to how people access their private pension savings, the Financial Conduct Authority identified particular challenges around investment decision-making for customers who had moved into a non-advised drawdown product. Many of these consumers were not engaged, and so the FCA proposed developing ‘investment pathways’ to help. The pathways include providers develop investment strategies that meet their customers’ future pension income objectives – as chosen from four options by the customer – and will work to prevent people being placed in inappropriate investments. This consultation is to develop the detail on how these pathways will work.

Key points and recommendations

- Age UK continues to support the development of investment pathways, and believes they will be a significant step towards helping non-advised drawdown customers.
- Investment pathways are not, however, sufficient on their own. While they will provide welcome protection from the least suitable investment choices for a high-risk group of consumers, more is needed if we are to create a suitable retirement journey.
- They will work best if they sit alongside other solutions:
    - savers should be defaulting into impartial, independent pensions guidance on an opt-out basis prior to accessing their pension;
    - the FCA should work with government and industry to develop product pathways that are designed to smooth people’s choices and to help them get the most from the pension freedoms.
- There is also a risk that they could further reduce shopping around. If the provider presents the pathways in a particular way, it may act as a barrier towards switching. The FCA should be aware of this and ensure that communications are addressed in a way that minimises this risk, and encourages people to look elsewhere.
- Age UK supports the four pathway options. However, if firms are allowed to choose to provide as few as two out of the four available, there is a risk that less commercially attractive options will be neglected by the industry. For example, if the firm does not sell annuities – the decline in annuity providers has been identified by the FCA as an issue – then they will be less likely to offer this pathway, leading to reduced competition.
- A duty should be placed on providers to proactively help customers where they exhibit behaviours that contradict the option the consumer have selected.
- The FCA must be prepared to intervene in a timely manner where there evidence suggests that a provider’s customers may not be getting a good deal, for example where there is an above average number of complaints.
- Clearly displaying costs and charges is an important part of the competitive process and we support the FCA’s proposal, although it will not be a quick win.

1. Introduction

Four years on since the introduction of the ‘freedom and choice’ pension reforms, it is clear that many non-advised consumers are still failing to use their pension savings in the best way possible. Behavioural biases, coupled with a lack of understanding and disengagement from pension saving, have meant that too many people are making decisions that may well turn out to be sub-optimal. Consumers with lower or medium value DC savings, who rarely have a financial adviser to guide them through the complexities of the retirement income product marketplace, are particularly at risk of losing out on a significant portion of their retirement income.

Age UK continues to support the FCA’s proposed ‘Investment pathways’ and believe they will help a large number of non-advised customers, making a real difference to people’s income throughout their later life.

The FCA’s research conducted as part of the Retirement Outcomes Review identified that a new ‘norm’ was emerging. People were accessing their DC pension savings in their 50s to get their tax-free lump sum, and as a result moving the rest of their money into drawdown. This leaves it exposed to higher charges and potentially inappropriate investment strategies, and a significant minority of consumers were left invested in cash when this was unlikely to be appropriate. All of these are likely to lower a consumer’s long-term retirement income.

Investment pathways should be presented as part of the retirement journey rather than as a stand-alone choice. They could also work as an alternative to immediate or early access of pension funds, if they can be presented as a way of putting people in control of their long-term income.

We also see investment pathways as being part of a trio of similar pathways. Firstly, consumers wanting to access their DC pension savings should be defaulted into Pension Wise to improve understanding of their options. Secondly, for those moving into drawdown the investment pathways should help manage their pension savings and longer-term strategies. Thirdly, product pathways are needed to help consumers navigate the complexities of the retirement income marketplace and achieve a decent financial outcome.

The three ‘pathways’ are needed to create a consumer journey that maximises the chance of attaining a decent retirement income.

We are also concerned that investment pathways could fail to improve the chances of consumers shopping around the marketplace, reducing its competitiveness. Informing customers about the pathways will create an extra opportunity for a ‘sticky’ transition to drawdown – where the default position is for people to stay with their existing provider. The communications and regulatory rules must be set and used in the correct way. As this could conflict with the FCA’s statutory objective to promote competition, we expect careful scrutiny of how this develops.

2. Consultation questions

Chapters 3 to 8: Investment pathways

Q1: Do you agree with our proposed rules on when a consumer must be offered investment pathways, including how consumers who enter drawdown in stages should be treated, and that those who take an UFPLS are not included?

We agree with the proposed rules – it is important that non-advised consumers are offered the investment pathways both when moving into drawdown and when they transfer funds to a new drawdown arrangements. We also support the additional definition of a consumer being 'non-advised' if it is more than 12 months since their initial transaction. This could protect people who may no longer have an adviser, perhaps because their employer provided financial advice and since stopping work this relationship is no longer active.

One situation that is not flagged up in the consultation paper and could potentially be problematic, is when people initially choose an objective and the related investment pathway, but then begin to use their pension savings in a different way. For example, someone might state they 'have no wish to touch my money in the next five years' (i.e. Investment Pathways Objective 1) but a few months later start withdrawing significant amounts of cash. There seems to be some expectation that consumers will notify their provider and select a different investment pathway, but given the FCA's findings in its qualitative research about lack of consumer engagement, this does not seem workable. Instead, providers need to take action and proactively identify, check whether the consumer is aware of the contradiction, and put right if necessary.

We believe an additional duty will be required for firms whose customers are taking such actions, so they can engage with and respond to changing circumstances more effectively.

Consideration must also be given to the full customer journey, from the time when they receive their wake-up pack. If the investment pathways are positioned as a stand-alone decision or event, consumers will be unprepared and will likely find it more difficult to understand the choice they need to make. We look forward to hearing more from the FCA about the development of wake-up packs and the customer journey.

Q2: Do you agree with our proposal that all providers of drawdown to non-advised consumers should be covered by our requirements on investment pathways, including SIPP operators?

We agree that all providers should be covered by the requirements on investment pathways, including SIPPs.

We retain the concern that we raised in our response to the Retirement Outcomes Review consultation in 2018 that investment pathways might exacerbate the lack of shopping around in the retirement income marketplace. Unless the provider fails to offer the appropriate pathway, the solutions offered by the FCA appear predicated on consumers staying with their provider. While it is, of course, perfectly possible to shop around under this proposal, the nature of the communications for moving into an investment pathway may ultimately provide an additional barrier for consumers to do so. The language used and the style, method, and timing of presentation should all be designed with this in mind, and appropriate messages about shopping around delivered alongside them.

Q3: Do you agree with our proposed 4 objectives, and mandating all providers to use our prescribed wording when presenting these objectives?

The four objectives, copied here for reference, seem sensible. There is clearly no perfect answer for all consumers, and we recommend that a review of the objectives is conducted in due course to ensure they are working as intended.

Option 1: I have no plans to touch my money in the next five years.
Option 2: I plan to set up a guaranteed income (annuity) within the next five years.
Option 3: I plan to start taking a long-term income within the next five years.
Option 4: I plan to take my money within the next five years.

Our only concern at this point is the issue raised in our response to question one – what happens if a consumer chooses an objective and then exhibits contradictory behaviour, and what can/should the providers do to rectify this?

Q4: Do you agree that providers should only be able to offer 1 pathways solution for each investment pathway objective?

Yes, we agree.

Q5: Do you agree with our proposed rule requirements for the choice architecture, and do you agree that providers can offer investment pathways without giving the consumer a personal recommendation?

We broadly agree, although the FCA should take a proactive role in monitoring providers' choice architectures. If there are any difficulties emerging, for example evidence of customers taking sub-optimal decisions or above average numbers of customer complaints, the FCA must intervene in a timely fashion and work with the providers to help them improve.

The choice architecture needs to be designed to ensure that customers are still able and incentivised to shop around and move to a different provider. There is a risk with a non-centralised system that providers will use behavioural techniques to game the system, and the FCA should be ready and willing to intervene.

Q6: Do you agree with our proposed rule to prevent providers from offering the same pathways solution for all the objectives?

Q7: Do you agree with our proposed rules on labelling of pathways solutions?

Clear labelling is essential, and we support the FCA's proposals here.

Q8: Do you agree with our proposed rules requiring larger providers to provide pathways solutions for at least 2 of the 4 objectives and to refer consumers to another provider's pathways solutions for any objectives where they don't provide a pathways solution?

If providers of all sizes are allowed to pick and choose a limited number of options, there is a danger that that customers wishing to take a certain path may have a greatly reduced range of options. For example, the number of firms providing annuities has significantly declined over the past few years. It therefore may only be in the interests of firms to offer the Option 3 if they are one of the existing providers of annuities. This could lead to few providers offering a pathway suitable for Option 3, and an anti-competitive outcome that is detrimental to a large number of consumers.

Larger providers should be able to develop investment pathways covering all four options without incurring significant cost – this will be essential if the marketplace for drawdown products is to become competitive under the new investment pathways regime.

Q9: Do you agree with our proposed easement for smaller providers, including our proposals for the operation and level of the threshold for qualifying for this easement?

Providers of all sizes should be encouraged to serve the needs of their customers. The FCA will need to work continuously to ensure that consumer needs are being met especially for those of smaller firms, which are exempted from the full requirements.

Q10: Do you agree with our proposed approach to product governance for firms manufacturing pathways solutions used to provide investment pathways? Do you agree with our proposed approach for distributors?

Q11: Do you agree with our proposed approach for ongoing information to consumers using investment pathways? Do we go far enough, or is there anything further that providers could do to ensure that consumers carefully consider their investment choice on a periodic basis?

The proposals seem broadly fine, although how these affect consumers will need to be reviewed.

The issue we raised in Question 1 is again pertinent here – will these new measures restrict shopping around and how can a competitive marketplace that works in the interests of consumers be created?

Just because someone selected a provider five years earlier does not mean this will remain the best choice.

There is a risk that at each point of intervention the choice architecture serves to exacerbate existing consumer biases, which could mean missed opportunities to improve outcomes.

Q13: Do you agree with our implementation timeline?

The sooner the better – we recommend that the 12 month period starts from the launch of this consultation (January) which was when providers received notice of the FCA's intentions.

Chapter 9: Ensuring investment in cash is an active decision

Q14: Do you agree with our proposals to ensure cash investment is an active choice?

Age UK supports the proposal and is pleased the FCA is taking firm action to ensure that consumers are avoiding this pit-fall.

Q15: Do you agree with our proposals on the warning about investment in cash that the non‑advised consumer will get when they enter drawdown or transfer‑in funds in drawdown to a new provider?

Q16: Do you agree with our proposals on the ongoing warning around investment in cash?

Warning consumers is a sensible approach. However there is a possibility it could back-fire if they are determined to get their hands on their money. It could lead to people withdrawing their pension and moving the money into a cash savings account or ISA, thereby paying too much tax and still ending up in cash. The FCA should seek to emphasise the other investment pathway options and to give people the right level of information – e.g. the loss they are likely to experience expressed as an easy-to-understand diagram.

Chapter 10: Actual charges information

Q19: Do you agree that, in relation to their decumulation pensions, unless charges are built into the disclosed price of the product, consumers should receive information at least annually on all the actual charges they have paid, aggregated and expressed as a cash amount?

Q20: Do you agree that our rules should require disclosure of transaction costs, but not specify how transaction costs should be calculated?

Q21: Do you agree that firms should disclose the adviser charges paid out of the product, or clarify that adviser charges are not included in the annual pension charges figure they disclose?

Costs and charges are essential information for consumers, and we agree with the FCA proposals. It will, however, not be a quick win as many disengaged consumers or those who lack numeracy skills will still find it difficult to understand the relevant information.

It also relates to the need for greater use of consumer pathways (which are sometimes referred to as defaults). Investment pathways are just one part of the solution, and need to be supported by an opt-out infrastructure for guidance, i.e. defaulting people into Pension Wise; and for product choices, where the industry, Government and the FCA need to work to create suitable pathways to help consumers get the most out of freedom and choice.