Consultation Response

Retirement Outcome Review – Terms of Reference (Financial Conduct Authority)

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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

About this consultation

This consultation by the Financial Conduct Authority explores the terms of reference for a forthcoming review of the retirement income market, in particular on the role that competition should play in improving outcomes for consumers. The review will consider four broad areas: shopping around and switching, non-advised customer journeys, business models and barriers to entry, and the impact of regulation on retirement outcomes.

Key points and recommendations

- While we continue to support the pension flexibilities and believe they are an opportunity for many people to improve their retirement outcomes, we are concerned that many consumers are not well-placed to make good decisions about how to maximise value from their pension savings. The new customer journeys are increasing the barriers to informed decision-making.
- It is concerning that shopping around has declined. Although this review should generate some good-quality empirical evidence as to why this has happened, policy-making should not be premised on the assumption that rates of shopping around can be increased.
- The take-up of Pension Wise remains stubbornly low – an immediate priority should be to dramatically increase the numbers of people using the service, so only a small minority are going without guidance or advice.
- Fees and charges, in particular for drawdown products, are difficult to understand, and the majority of consumers find it difficult or impossible to navigate their way through the product maze. The FCA will need to maintain a focus on the terms and conditions of products as they develop.
- Online guidance/advice journeys are increasingly being offered and the review should include special consideration of this area of the market.
- There is still a lack of information about the impact the reforms have had on individual consumers, which urgently needs to be rectified by the FCA, the Treasury and the Department for Work and Pensions.
- This includes the impact the different sources of guidance/advice have on at-retirement behaviour and on longer-term outcomes.
- When conducting the review, it is important to consider the difference between short, medium and long-term outcomes. FCA will need to bear in mind that the market could be changed considerably by the introduction of a secondary annuity market and (perhaps to a lesser extent) LISAs. It should seek to develop a benchmark of consumer behaviour against which the impact of these policy changes can be evaluated.

- The priority should be ensuring good outcomes for consumers who are either disengaged and/or have lower value pension savings, especially where they rely on Defined Contribution saving for their retirement income.
- This review should also investigate the impact of scams and fraud on peoples' pensions and decision-making, as well as evaluating the best regulatory methods for preventing fraudsters operating.

1. Introduction

Age UK continues to support the pension freedoms and we believe that the policy opens up new possibilities for improving retirement outcomes for individuals who might not have been best served by buying an annuity. However, it does not come without risks, and the FCA and the Treasury need in particular to ensure that the marketplace adequately serves consumers with lower levels of saving and those who are disengaged.

We are concerned that levels of take-up for the Pension Wise guidance service remain stubbornly low. The most recent FCA figures suggest that while many people are purchasing regulated advice, only 20 per cent of consumers are using Pension Wise, which in all likelihood (we cannot tell for sure because the data doesn't tell us) leaving many more disengaged consumers to their own devices. Also, it's worth noting that the Pension Wise figures could include using the website, which tells us little about the nature of the guidance people are actually receiving.

We are pleased the FCA will be reviewing retirement outcomes. There is a clear need for a wider study into decision-making processes, the longer-term effects of different choices, and the actual impact of Pension Wise and other guidance/advice.

2. Consultation 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?

The available information strongly suggests that many people find it difficult to compare and contrast different products. The FCA's own consumer insight research published in December 2014 concludes that consumers are not "particularly well equipped to make decisions on how to access and manage their money at retirement, without additional support and information".[i]

Accessing this additional support and information is therefore crucial. The FCA data states that 58 per cent of drawdown and 37 per cent of annuity customers use a regulated adviser, with 20 per cent seeking help from Pension Wise (although there are likely to be some people using both, as well as others who only use the online support and do not derive sufficient help). Given the expense of using a regulated adviser, it is likely that those paying for regulated advice have a higher value pension pot or a higher household income than those either using Pension Wise or going it alone.

The Pensions and Lifetime Saving Association reported that the early users of the pension flexibilities tended to be wealthier than average and were often likely to already have pensions in payment.[ii] From this finding we can infer that the consequences of 'getting it wrong' for many people would likely be less severe than for people with lower value pension savings in future (although this would certainly not apply to a great many people), and it might even indicate that use of a regulated adviser has been artificially high in the early stages of the freedoms.

Pension Wise will be increasingly important in helping people access and assess product information, and it is incumbent upon the government and the FCA to take urgent action to increase take-up.

Furthermore, the array of charges for different products – in particular income drawdown – is confusing for many consumers. Citizens Advice recently estimated that 160,000 people have paid to access their pension since April 2015, with an average total cost of £1,577. This particularly affects consumers with smaller pots, with an average fee of £2,000 applied to pots below £20,000. This high level of charges – which are poorly understood – can only be detrimental to consumer confidence in pensions.

In our 'Dashboards and Jam Jars' discussion paper, we identified five main types of charges applied to income drawdown:

1) Administration charges specific to drawdown, including set-up fees for entering income drawdown; annual management fees; charges for altering the level of drawdown payments; charges for altering the frequency of payments or making one-off withdrawals; and charges for depleting the fund or reducing it below a certain size.

2) Investment charges, including direct fund management costs and charges paid to the fund manager; legal and audit fees which would be included in the Total Expense Ratio; costs incurred by any stock lending undertaken by the fund; commission payments made to the financial adviser who sold the consumer the

investment (these have been banned for new business from 1st January 2013, but existing legacy arrangements can continue).

3) Platform charges: The costs of holding the pension funds and investments through a platform such as a SIPP.

4) Transaction costs within and between funds

5) Advice costs: If the consumer receives advice about whether to enter income drawdown, how their investments should be managed and how much they should withdraw each year then they would need to pay initial and/or on-going charges to a financial adviser.

These can be deeply confusing to consumers who may have little experience of dealing with such matters and in some cases only low levels of financial capability. This can lead to sub-optimal decision making, encourage people to take the ‘path of least resistance’ and actually create the opposite intended effect to the pension flexibilities, namely deterring people from taking engaged and responsible decisions.

There is a real risk that as the early cohorts of automatically-enrolled savers begin to use their pension savings, high and difficult-to-compare charges could undermine trust in pensions and damage the automatic enrolment project.

The FCA should work with the Treasury and other stakeholders to conduct a full review into the impact of the pension flexibilities on consumer outcomes, including to what extent Pension Wise changes behaviour, in order discern a well-evidenced answer to this question.

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

It is well known in behavioural studies that proliferation of choice frequently leads to consumer paralysis or inaction. With the range of retirement income (and other) products now available, this partly explains why savers fail to switch providers once they access their pension.

However, it is only part of the explanation and there is no definitive answer to this question. It is likely to be a highly complex interplay between financial capability, provider/industry behaviour and behavioural psychology.

Following years of (largely) failed attempts to increase annuity switching rates, a pattern that appears to have become more intractable under the pension freedoms, a more radical solution is needed that the current process that relies on individual responsibility for shopping around. Instead the government and the FCA should explore ideas such as a clearing house for annuities, a single and understandable charge under a low cap for drawdown products, and developing default product pathways that build in competition for the best available rates.

In the meantime, the immediate focus should be on radically expanding access to Pension Wise so that no-one is left to access their pension without guidance, unless they actively choose not to take it.

It also should be noted that for many consumers remaining with their existing provider may represent the ‘least worst’ option. While it all-too-often fails to provide the optimal outcome, given the risk of scams and the pitfalls of full encashment purchasing an annuity at a less-than-market-leading rate may avoid the worst case scenarios and generate a long-term outcome that surpasses other possible options – without a full evaluation of individuals’ decision-making and outcomes it is near impossible to know.

This is not to suggest that consumers should be discouraged from shopping around, but instead to note that a lack of confidence in the system may itself be partially responsible for reducing shopping around, creating a vicious cycle of consumers staying put.

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

Age UK is particularly concerned with the outcomes of savers with small and medium sized pots. Such savers are less likely to take advice, and are likely to turn either to their existing provider for information, or to other sources such as their employer or family and friends.

We note that the Department for Work and Pensions is currently consulting on the future of NEST. This is particularly relevant as over the coming years (potentially) millions of NEST savers, who are likely to have smaller than average pension savings, could access their pension without having a provider offering decumulation products to turn to – this is actually a very promising opportunity for engaging lower value pot-holders, regardless of the outcome of the consultation. It is an opportunity to promote a genuinely open product information or guidance service to NEST savers that replicates the offer of other providers.

The FCA should consider this as part of this review, notwithstanding that NEST is a trust-based scheme.

We also note that the number of online guidance services is growing. While we welcome the greater availability of guidance, we think FCA will need to carefully monitor their quality and transparency, as well as how to prevent the use of websites as fronts for fraud.

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

The disparity between what people say they want from a retirement income product (e.g. a secure index-linked income for the rest of their lives) and those that are actually purchased, suggests that there are potentially many consumers who are not making well-informed decisions.

For example, common misconceptions about income drawdown – the PLSA research showed 70 per cent of people close to retirement want to use income drawdown but 53 per cent thought that it would provide a guaranteed income and 23 per cent thought it had no risk – suggest that many people are fundamentally misunderstanding how to get the best value from their pension pot.

These different, often non-advised, customer journeys therefore give rise to significant concerns about the longer-term financial prospects for people who rely on Defined Contribution savings. There is a significant risk that without the appropriate level of support people will make sub-optimal decisions about using their savings.

That said the freedom and choice agenda is also an opportunity to improve outcomes for most people. To make this a reality the FCA needs to investigate default product pathways, and significantly increasing take-up of guidance, as part of this review.

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

The FCA should consider whether further regulation is necessary to promote and protect the specific interests of consumers who are less commercially appealing to the major providers.

We are particularly concerned that lowering regulatory standards and consumer safeguards may help businesses achieve lower costs, but may be disproportionately detrimental to consumers – in particular those who do not use advice or guidance. The interests of the consumer must be paramount if any such changes are made.

The FCA could consider using the regulatory sandbox approach specifically to test for beneficial and innovative solutions for this group of consumers.

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[i] Ignition House (Dec 2014), Exploring consumer decision making and behaviour in the at-retirement landscape, Financial Conduct Authority

[ii] Pension and Lifetime Savings Association (2016), Pension freedoms: no more normal