Better Pensions

March 2015

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Section 1: Summary

People who save into a pension during their working life deserve to get the most from their pension savings in retirement: it is right that consumers have the freedom to decide how and when they access their money. By allowing savers to exercise choice, the pension reforms coming into effect in April 2015 have the potential to improve outcomes for many retirees. However, people remain worried about whether they will have enough to live on in retirement, and while it is good that those who want it will have access to high quality information and guidance, more adequate consumer protections need to be in place to ensure retirees are supported to get the best outcomes from the reforms.

Decisions at retirement are some of the most complex financial choices a consumer can make that people literally cannot afford to get wrong: this can mean the difference between a comfortable retirement and one just scraping by, overshadowed by constant financial worry. Poor decisions may leave a retiree without the resources to finance the lifestyle they want in later life, or could deny their spouse retirement income should they die.

In order to make this decision, people will need to weigh up many factors including how long they may live, how much they will need to live on, the risk of investments going down in value during retirement, how much they will be charged by pension providers, how they want to access their money and how much tax they will have to pay. With these challenges in mind, it is no surprise that consumers show significant levels of uncertainty and anxiety about retirement. More than half (55%) of people are worried about the value of their pension[1]. Half (51%) say they don't know how much they will need as a weekly income to live comfortably in retirement.

In the past, these worries have been compounded by the fact that the retirement income market has not met consumers' needs effectively. Poor value annuities were common, often as a result of poor sales practices. In 2014, the Financial Conduct Authority (FCA) concluded that '…competition in the retirement income market is not working well for consumers'[2].
The positive pension reforms coming into effect in April 2015 are some of the most radical in decades and have the potential to address some of these issues. They could also expose individuals to new risks. There will be more options available to individuals when they retire but considerable uncertainty and anxiety surrounding retirement decisions is also likely to remain. As such it is vital that consumers are supported and protected when deciding how to access their pensions.

The Government's Pension Wise service will have a key role to play. However, it is important to recognise that, in a market characterised by relatively low levels of consumer engagement, some consumers will not take up the offer of free guidance. This means that safeguards are needed to ensure consumers are adequately protected from poor sales practices, poor value products, scams and wider causes of significant detriment. Although the Government and FCA have outlined proposals to ensure that consumers are supported and protected, we believe that more will need to be done. This report outlines recommendations for both the short and long-term to help consumers make the most of the new pension freedoms and get the most value from their pension savings.

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[1] The Which? Consumer Insight Tracker: Populus, on behalf of Which?, interviewed a representative sample of 2,126 UK adults online between 12th and 14th December 2014. Data were weighted to be demographically representative of all UK adults

[2] FCA, Retirement income market study: interim report, December 2014, p.5

Summary of recommendations

1. Products that meet consumer needs

To ensure that consumers are protected from high-charging default options, Which? recommends:

- **Introducing a charge cap.** The Government should work with the FCA to introduce a charge cap for default (internally sold) drawdown products where the consumer does not exercise an active choice. This should provide appropriate protection for disengaged consumers whilst also giving industry the flexibility to create a range of products to cater to customers' needs.

To ensure that people retiring have access to simple, good value products, Which? recommends:

- **Establishing a Government-backed backstop provider.** In the same way as it created NEST to enable all consumers to save into a pension, the Government should lay foundations for a low-cost, high value government-backed scheme for consumers to take money out of their pension. Once appointed, that provider should develop product defaults that match consumers' needs (e.g. by managing risk and volatility, offering low charges, and providing some flexibility so that members can adjust to changes in personal circumstances).
- **Defaulting disengaged consumers into that provider.** Should consumers not engage with their retirement decision, or should the market fail to provide real choice and good value, the Government should assess whether it should default consumers who don't make an active choice to this provider.

To ensure consumers are protected from scams, poor practice and scheme failure, Which? recommends:

- **Extending the Financial Services Compensation Scheme's (FSCS) coverage of drawdown products.** To avoid damage to consumer confidence in the event of a product provider going out of business, the Government should work with the FSCS to ensure greater protection is afforded to users of drawdown products as soon as possible.
- **Introducing a cooling-off period.** The FCA should explore how providers can be required to give customers looking to withdraw significant portions of their accumulated DC pot a cooling-off period. This would allow further signposting to available support, guidance and advice and the chance for the consumer to reconsider their decision in an unpressured environment.
- **Increasing awareness and prevention of scams and poor practice in the promotion of Unregulated Collective Investment Schemes (UCIS).** During 2015, the Government should focus its scams awareness outreach work on pension scams. The FCA should also step up its monitoring and enforcement activity against scams and the distribution of UCIS and take action with industry to support consumer awareness.

To support retirees who make an active choice, ensure the industry focuses on meeting consumer needs, and to learn from past failures, Which? recommends:

- **Making comparison easier.** To ease product comparison and drive effective competition, the FCA should work with industry and consumer groups to develop a requirement for standardised, simplified presentation of charges for drawdown and hybrid products.

- **Ensuring annuities still play an appropriate role.** The Government should monitor the take-up of annuities and, in particular, work with the FCA to review how behavioural barriers to the development of a mass market in deferred annuities might be overcome.
- **Preventing poor practice in the future.** The FCA must make clearer definitions of what constitutes an enhanced annuity and act on its stated intention to incorporate the ABI Code of Conduct on Retirement Choices into the Conduct of Business Sourcebook (COBS) quickly.
- **Monitoring compliance progress.** The FCA should repeat its independent survey of retirement income sales practices within 12 months to review whether progress has been made. If that review finds insufficient progress, the FCA must consider further action.
- **Holding providers to account for past behaviour.** The FCA should act urgently to clarify exactly which standards it believes apply to annuity sales at which periods in the past. It should enforce these standards robustly and ensure that customers who have lost out as a result of poor practice receive compensation.

2. Pension Wise – making guidance work

To ensure that Pension Wise serves consumers effectively, Which? recommends:

- **Easing the Pension Wise customer journey.** The Government should work with industry to introduce the infrastructure that would allow pension providers to book an appointment directly with Pension Wise for customers, or put them through (if communication is by phone) to the Pension Wise appointment booking service.
- **Introducing a pensions passport.** The Government should work with industry to introduce a single Pensions Passport so consumers have the information they need before guidance. In the long-term, the Government should create a comprehensive pensions and savings dashboard that enables consumers to see all their pensions and savings in one place.

3. Defining success – a market that works for consumers

To understand the impact of the reforms and take action where further change is needed, Which? recommends:

- **Monitoring progress of the new reforms.** It will be important to assess whether the new pension reforms are leading to greater choice and better value pension products, whether people can access their money without high charges and whether pensions guidance is fit for purpose. The Government should monitor the market closely, using the five key tests, to see whether the system is delivering for consumers:
    1. Do people have the information they need before using Pension Wise?
    2. Are people able to access good quality guidance via Pension Wise?
    3. Are active choices taking place, or are consumers being passively defaulted?
    4. Are drawdown and new products accessible to the mass market?
    5. Do drawdown and new products offer good low cost options?

Section 2: Products that meet consumer needs

To make the most of the freedoms introduced from April 2015, consumers will need access to good value, well designed and appropriate retirement products. However, with one or two welcome exceptions[3], there has so far been relatively little innovation in his area.

In the past, most consumers with defined contribution (DC) pensions were effectively required to purchase an annuity[4]. This meant that flexibility was reserved for people who could generally afford to absorb the impact of adverse investment outcomes and higher charges better. As a result the main alternative to annuities, income drawdown, has been tailored to meet the needs of a relatively small part of the market.

If applied to the mass market, there is a concern that the investment options, and sometimes high charges of existing drawdown products[5], may not be suited to many retirees. This is a particular worry if these options are used as default options for consumers who do not make an active choice.

Overall, without positive change on the supply-side, and better regulation, there is a risk that extending these existing products to the mass market could be as damaging to consumers' interests as inappropriate annuities have been in the past. This section outlines proposals to ensure that this is not the case.

Capping charges in default products

Costs of drawdown and hybrid products

To provide a snapshot of the market before the reforms take effect, Which? researched the costs of a sample of drawdown products currently available. To enable a realistic comparison, we created a scenario based on the following assumptions:

- A consumer with a pension pot of £36,000 (roughly the average DC pot used to buy an annuity in Q3 2014)[6] has decided they want an income drawdown product but does not wish to make a complex or active decision about investments.
- They enter income drawdown with their current pension provider[7]. We assume that this consumer uses a simple drawdown platform. Their pot is invested using a reasonable asset allocation (roughly 50% equities, 40% bonds and 10% cash)[8].

The variation in charges between different options offered by the same provider is significant

Using these simple assumptions, we found a wide variation in the amount the consumer could end up paying for drawdown, even with the same provider. With Aviva, for example, there are now no set-up costs for income drawdown. Its simplest Core platform has an Annual

[3] One large insurer has told us that it plans to reduce costs on its drawdown proposition, another has removed set-up fees. There has also been some welcome movement from fund supermarkets seeking to appeal to the mass market.

[4] In 2012, for example drawdown products accounted for just 8% of the total sales of UK retirement income products (ABI New Business Market Data, 2012).

[5] For example, they subject them to investment risk beyond their personal capacity.

[6] This figure was £36,600. Source: ABI, retirement income statistics Q3 2014,

[7] … and decides not to take her 25% tax-free entitlement as an upfront lump sum, instead investing the whole of her pot into income drawdown.

[8] This is seen as a reasonable asset allocation for drawdown. Equities are likely to enable some investment growth over retirement. Cash allows access to funds if needed, and bonds are likely to offer steady returns at relatively lower risk.

Management Charge of 0.34%. Under this option, Aviva offers a passive tracker fund which broadly mirrors our assumed asset allocation. The total annual charge for this fund is 0.1%.
If our consumer was effectively 'defaulted' into this option, they would pay a total of 0.44% in charges each year (0.1% for the investment fund, and 0.34% for the platform they use to access it). This shows that the asset allocation described can be met at relatively low cost[9].
In contrast, the same consumer with the same pot, using the same company, the same platform, and assuming broadly the same asset allocation could pay considerably more. We found an actively managed fund with a similar asset allocation[10] offered through this platform with total charges of 0.9%. With the Aviva platform charge of 0.34%, this brings the total of the charge up to 1.24%, almost three times as much as the option described above.

Of course, it is possible that a more expensive actively managed fund might produce higher investment returns. We believe that consumers should be able choose a more expensive fund if they wish to[11]. However, the consumer in our scenario is disengaged, so it would not make sense to assume that they make an active fund choice. We did not find evidence of providers planning to move disengaged consumers into expensive actively managed funds. We are, nonetheless, concerned that it may be possible to do so.

There is significant variation between different providers
We also found notable differences in costs between different drawdown providers. Whilst Aviva now does not charge for starting income drawdown, LV= charges a £295 'activation' flat fee for people with less than £50,000 to invest.

While Standard Life's Active Money SiPP does not include a platform charge for its simple drawdown option, the majority of the funds offered for drawdown which include passive trackers have charges of 1% or more[12]. In contrast, providers L&G, Aviva and LV= offer passive trackers for as little as 0.1% to 0.3% per year. This means that a relatively disengaged consumer could pay ten times as much (1% instead of 0.1%) for a passive tracker fund in retirement.

The table below illustrates this point. It shows investment into exactly the same fund with two large providers to demonstrate the potential difference in costs. We chose the Henderson Cautious Managed Fund, because the asset allocation is broadly similar to the one we assume above.

[9] For the purposes of our scenario, we have assumed the consumer does not take advice and so does not pay advice costs. Aviva's current drawdown proposition is only accessible through advice.
[10] Henderson Cautious Managed.
[11] There is a lot of evidence that many consumers do not wish to research and compare a large number of available investment options. In America, for example, figures suggest that, on average, participation in pension saving "declines by 2% for every 10 [investment] options added" to a plan. (Source: Mottola & Utkus, Can there be too much choice in a retirement savings plan?, 2003)
[12] Of the 331 funds on Standard Life's website, just nine had a charge of less than 1% and none lower than 0.5%. https://www.standardlife.co.uk/c1/accounts-and-services/drawdown.page

Table 1: The variation in costs between two providers

Insurance Company	Simple income drawdown platform and charge	Total Fund Cost for Henderson Cautious Managed Fund	Total income drawdown cost*
AXA Wealth[13]	Elevate Platform**, 0.34%	0.8%[14]	1.14%
Standard Life	Active Money SiPP, no charge for level 1 investment***	1.74%	1.74%

**excluding advice costs*
***income drawdown available through Pension Investment Account (integrated accumulation/decumulation product)*
****investment in one of 190 insured funds*

More work is needed to define good default drawdown options

Recent research by the Pensions Policy Institute (PPI) identified a '…lack of any understanding around the underlying investments in default funds, and what the funds are seeking to achieve' among retirees[15]. With this in mind, we asked providers to tell us about their popular drawdown options, and found significant variations.

When asked to provide information on their income drawdown propositions, one major provider sent us an illustration of one of their customers investing all their money in a mixed fund investment option (labelled 'balanced'). Although low cost, this invested almost 80% of funds in equities[16]. When we probed further, they confirmed this was a popular option among their current drawdown customers, and that a customer could switch to a different fund if they wished to.

In contrast, other providers suggested more balanced investment options. These variations might be justified by differences in the circumstances of different companies' customers, but that was not made clear by providers in their response to our questions. Variations of this kind raise concerns that sufficient protections are not yet in place to ensure that disengaged consumers are provided with products that match their needs, in terms of investment approach, as well as cost.

A cap on default drawdown sales

These findings suggest consumers who do not actively engage with their retirement product decisions can experience significant variations in the products they use in retirement.
Consumers who choose to actively engage should, if they wish to, be helped to compare product features and costs to find an option that provides them value for money and meets their needs. Some will choose higher-charging options that offer more actively managed investment. However, consumers who do not make an active choice may be effectively 'defaulted' by their pension provider. For these consumers the differences in costs we have noted are concerning. Analysis below demonstrates the potential size of the impact on the consumer in our scenario. It shows that, with 0.5% in annual charges, they would be able to supplement their state pension with £2000 every year for 20 years. In contrast, the same

[13] AXA Wealth offers advice-led platforms, so the consumer would have to take advice to access their income drawdown proposition. This means an adviser would have to agree with the suitability of the investment and the consumer would also have to pay advice costs.
[14] When asked for confirmation of this price level, AXA confirmed that this particular fund is now not open to new customers. It is, however, an illustration of charges that some consumers have paid for drawdown.
[15] PPI, Supporting DC members with defaults and choices, p.5, January 2015
[16] The same company also highlighted with-profits options - these are omitted for simplicity.

consumer would run out of money and could have only the state pension to live on after just 16 years, if they paid higher charges of 2.75%[17].

We believe that action must be taken to protect these consumers. Auto-enrolled workers are already protected by a 0.75% cap on charges when they put money into their pension pot for default funds. However, there is no equivalent protection for consumers when they take money out.

> ***Recommendation:*** **Introduce a charge cap.** The Government should work with the FCA to introduce a charge cap for default (internally sold) drawdown products. This should include both investment and platform fees[18].

We propose that a charge cap should apply to products which meet two conditions. First, they should be distributed through internal sale[19], which occurs directly between provider and consumer[20], because this is the distribution channel that has caused most significant consumer detriment in the past, and presents the greatest danger of inappropriate sales to consumers who are relatively disengaged[21]. Second, the cap should apply only where a consumer has also not made an active choice of product and has a clear understanding of the alternatives available, for example through active fund selection.

This measured intervention will serve to protect consumers, particularly those who do not engage with the freedoms and choices presented to them, from being defaulted through inertia or misunderstanding into high charging drawdown products that do not meet their needs.

The potential impact of capping charges

To explore the potential financial impact of current drawdown charge levels and a charge cap, we modelled the difference in income provided by an average sized DC pot used to buy an annuity (£36,000) under different charges. As well as the assumptions laid out in our scenario above, we further assumed that:

- The consumer withdraws £2,000 per year and that without the impact of charges factored in, there is an average of 2% annual investment growth in funds focusing on bonds, an average of 5% annual investment growth in equities funds and average annual inflation rise of 2% over the investment period[22]. We also assume a platform charge of 0.3%, with the remainder of the overall charge being taken off investment returns on relevant assets.

Overall, compared with a charge cap set at 0.5%, 0.75%, or 1%, higher charges mean that their pension pot lasts for a shorter period of time (see Table 2). For instance, rather than lasting for 20 years under a 0.5% cap, if they pay 2.75% charges, their money runs out in year 16. The same saver could face four years with nothing to supplement their income from the state

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[17] A large provider is currently offering an actively managed fund at this charge level.

[18] The OFT's 2013, market study (p.102) found that the majority of firms were able to offer investment during the accumulation phase at this level or below. Since platform fees are not charged separately during accumulation, a cap level of 1% for decumulation is broadly equivalent to the 0.75% level created for auto-enrolment.

[19] i.e. by the provider that the consumer in question used to accumulate their pension pot.

[20] i.e. not through an annuity brokerage or other comparison vehicle like the Money Advice Service.

[21] For an overview of recent problems resulting from internal sales see: FCA, Retirement income market study: Interim Report, December 2014

[22] These assumptions are based on PwC reporting on rates of return for FSA prescribed projections; http://www.fsa.gov.uk/static/pubs/other/projection-rates12.pdf we have taken the mid-point of the average range of investment return for these fund types.

pension, simply as a result of higher drawdown charges. In total, they would have received around **£10,300 less from their £36,000 pot,** under the higher charging, 2.75%, option.

Table 2: Loss of pension value with higher charges compared to lower charges

	Charge level							
	0.5%	0.75%	1%	1.5%	1.75%	2%	2.5%	2.75%
Year	Yearly drawdown							
17	£2746	£2746	£2746	£2746	£2746	£2746	£1874	£1170
18	£2800	£2800	£2800	£2800	£2300	£1200	£ -	£ -
19	£2857	£2957	£2857	£607	£ -	£ -	£ -	£ -
20	£2914	£1602	£221	£ -	£ -	£ -	£ -	£ -
21	£160	£ -	£ -	£ -	£ -	£ -	£ -	£ -
Difference in total drawdown compared to a 0.5% cap (to nearest £100)	£ -	£1500	£2900	£5300	£6400	£7500	£9600	£10300
Difference in total drawdown compared to a 0.75% cap (to nearest £100)	£ -	£ -	£1400	£3900	£5000	£6000	£8100	£8800
Difference in total drawdown compared to a 1% cap (to nearest £100)	£ -	£ -	£ -	£2500	£3600	£4600	£6800	£7500
Number of years someone would be able to draw £2,000 a year for	20	19	19	18	18	17	16	16

Providing consumers with a good quality backstop provider

A charge cap will provide protection from charges for consumers who do not make an active choice and remain with their existing provider in the circumstances explained above. However, it is equally important to encourage and support retirees who do take an active choice. Consumers who do so will need access to a good quality drawdown product provider when they retire. Given the complexity of these products and the way consumers behave at retirement, we cannot simply sit back and wait for the supply-side of the market to reform itself: a further safeguard is needed.

The OECD has argued that '…in certain pension structures, cost issues can be addressed by establishing large and centralised pension schemes, on a non-profit base, such as NEST (the National Employment Savings Trust) in the UK'[23]. We believe this principle would help consumers receive good value during retirement.

A universally available state-backed drawdown product would ensure that every saver has access to a viable choice between annuitisation and drawdown so can make best use of pension freedom and choice. This provider could stimulate better competition between established firms. Automatic enrolment demonstrates that offering providers a price to beat through the introduction of NEST can help promote healthy competition.

[23] OECD, Design and Delivery of Defined Contribution (DC) Pension Schemes, March 2013

Recommendation: Creating a Government-backed backstop provider. In the same way as it created NEST, the Government should lay foundations for a low-cost, high value government-backed scheme for the decumulation stage. Once appointed, that provider should develop product defaults that match consumers' needs (e.g. by managing risk and volatility, offering low charges, and offering some flexibility so that members can adjust to changes in personal circumstances).

International experience, and trends following auto-enrolment, suggest that a backstop provider will need to meet some important criteria:

- **Availability to all savers.** A backstop product provider should have a Public Service Obligation to accept all savers who wish to use it.
- **Achieve significant scale.** The economies that larger schemes realise on behalf of their members make a significant improvement to retirement outcomes[24]. Which? wants consumers to benefit from these economies of scale through decumulation as well as accumulation.
- **Strong governance and aligned incentives (e.g. accountability through a trust law) –** The OFT's 2013 market study confirms the importance of an alignment of incentives between savers and those governing the pension schemes they use.

It is also critical that a regulated backstop provider offers an appropriate default drawdown product. Default product offerings should:

- **Be low cost and value for money** because charges, compounded over many years, make a material impact on retirement outcomes.
- **Offer a limited number of appropriate choices** because behavioural research suggests that consumers do not want to be overwhelmed by too much choice.
- **Provide the highest possible level of income in retirement.**
- **Manage risk, volatility and downside protection,** since volatility, particularly around the year(s) of retirement, has a critical impact on outcomes.
- **Offer some longevity protection**, since many consumers express the desire to ensure that they do not run out of money in retirement.
- **Allow consumers to draw down their capital, by default.** Whilst running out of money in retirement is a distinct risk so too is the reverse, as experience in Australia shows.
- **Offer some flexibility,** so that consumers can respond to changes in personal circumstances in ways they feel are appropriate through retirement.
- **Offer stable and sustainable default levels of withdrawal**, to help consumers to take regular income without increasing their exposure to longevity risk.

Further action if the industry is slow to respond

This measure should help the market respond to consumers' needs. However, the Government should also be clear that it is willing to take further action if insufficient progress is made. A credible threat of firmer action would provide industry with a spur to action and would ensure that these solutions could be more quickly instigated if ultimately needed. With this in mind, the Government should commit to assessing whether it could default consumers who do not exercise active choice into this backstop provider to ensure they receive value for money.

Recommendation: Defaulting disengaged consumers into the backstop provider. Should consumers not engage with their retirement decision, or should the market fail to provide

[24] OFT, Defined contribution workplace pension market study, September 2013, p.66

real choice and good value, the Government should consider whether particular groups of consumers should be defaulted onto the state-backed scheme[25].

Making the market work better for consumers

As well as ensuring that consumers have access to a good quality set of default products and have the option of using a backstop provider, it will also be important to ensure that consumers looking to make active choices are supported to make that decision and are protected from mis-selling, scams and the poor practices we have seen in the past. The remainder of this section outlines proposals to ensure that is the case.

Comparable products

The pension reforms provide consumers with greater flexibility about how they access their retirement income. For example, rather than retiring at a single point in time, and making a single retirement decision, the transition from work to retirement could become more gradual and involve the incremental purchase of secured income. These hybrid products are likely to be very complex, making comparison difficult. Further action will be needed if competition is going to work to reduce charges for drawdown and hybrid products and make them more suitable for the mass market.

> ***Recommendation:* Making comparison easier.** To ease product comparison and drive effective competition, the FCA should work with industry and consumer groups to develop a requirement for standardised, simplified presentation of charges for drawdown and hybrid products.

Protection of drawdown and hybrid products

In the event of a product provider going out of business, some funds invested via SIPPs are subject to protection under the Financial Services Compensation Scheme (FSCS), but only to a maximum compensation level of £50,000[26]. This level of protection would prove inadequate for many consumers' retirement savings. Annuities, on the other hand, because they are classed as insurance products, are subject to more generous protection.

> ***Recommendation*: Extending the FSCS coverage of drawdown products.** To avoid damage to consumer confidence in the event of a product provider going out of business, the Government should work with the FSCS to ensure better protection is afforded to users of drawdown products as soon as possible.

Making the most of annuities for those who choose them

Drawdown products will not be the right choice for everyone. Many people are not comfortable with significant investment risk in retirement and might not be able to absorb losses. Many people also value the security of knowing their pension pot will not run out in later years[27]. This means it is likely that annuities will remain important to many people. These consumers also need good value for money in retirement.

Past problems in this area are well documented: the FCA recently identified 26 types of poor practice associated with the sales of annuities[28]. There are a number of areas where the

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[25] This could become necessary, for example, if there is evidence that measures to improve default outcomes have not succeeded.
[26] See FSCS: http://www.fscs.org.uk/what-we-cover/eligibility-rules/compensation-limits/
[27] NEST, The Future of Retirement, 2014, p.44
[28] FCA, Annuities sales practices (TR14/20), December 2014, P.33

Government and regulator could go further to improve outcomes for consumers engaged in the annuity market and protect them from existing and future poor sales practices.

> ***Recommendation*: Holding providers to account for past behaviour.** The FCA should act urgently to clarify exactly which standards it believes apply to annuity sales at which periods in the past. It should enforce these standards robustly and ensure that customers who have lost out as a result of poor practice receive compensation.

Even after April, consumers could still suffer from the effects of inappropriate purchase of a standard annuity[29]. This makes it important that the FCA takes action to ensure that providers are doing all they can to make sure that retirees get products that meet their needs and provide value for money. In this respect, it is particularly important that standards at the point of sale, including the requirement to ask customers whether they have any lifestyle or medical conditions that may mean they are eligible for an enhanced annuity are incorporated into standard practices.

> ***Recommendation*: Preventing poor practice in the future.** The FCA must make clearer definitions of what constitutes an enhanced annuity and act on its stated intention to incorporate the ABI Code of Conduct on Retirement Choices into the Conduct of Business Sourcebook (COBS) quickly.

It is also vital that the FCA continues to monitor compliance. Data collection in this area would be more effective if firms were placed under a positive obligation to provide the regulator with evidence that they have sought and recorded information from customers that affects their qualification for enhanced annuities. However, at the very least, the FCA must repeat its recent work in this area to review progress.

> ***Recommendation*: Monitoring compliance progress.** The FCA should repeat its independent survey of retirement income sales practices within 12 months to test whether progress has been made. If that review finds insufficient progress, the FCA must consider further action.

Scams and unregulated investments

The Pensions Minister, Steve Webb, recently said 'where there is money, there are crooks'. Given that Freedom and Choice increases the potential flow of money from DC pension pots, it is important to be mindful of this risk. We are concerned that without close scrutiny this could leave some people vulnerable to scams and unsuitable, unregulated investments.

The FCA, government and industry must act swiftly to raise awareness of these potential dangers and tackle them swiftly when they arise.

> ***Recommendation:* Increasing awareness and prevention of scams and poor practice in the promotion of Unregulated Collective Investment Schemes (UCIS).** During 2015, the Government should focus its scams awareness outreach work on pension scams. The FCA should also step up its monitoring and enforcement activity against scams and inappropriate promotion of Unregulated Collective Investment Schemes and take action with industry to support consumer awareness.

[29] FCA, Annuities sales practices (TR14/20), December 2014, P.3

Section 3: Pension Wise – making guidance work

As a great number of consumers will be making more choices over a larger range of decumulation products, it is important they get the right support to make these decisions. The impartial and independent Pension Wise service aims to support consumers to make active and informed choices at retirement. It should be the first line of defence for all consumers, and must be accessible to all and deliver high quality guidance to help consumers make the right decisions. To build on the preparation completed to date, Which? proposes a number of recommendations that would further ensure Pension Wise is successful.

Easing the customer journey
Encouraging take-up should be a key priority for government and industry. One way to encourage this is to make the process of engaging with Pension Wise as easy as possible. This could be done by streamlining appointment booking by enabling consumers to access the Pension Wise service seamlessly through their pension provider.

> ***Recommendation:*** **Easing the Pension Wise customer journey.** The Government should work with industry to introduce infrastructure to allow the providers to book appointments directly with Pension Wise for customers, or put them through (if communication is by phone) to the Pension Wise appointment booking service.

A single Pensions Passport
In order to make the most of their guidance session, people will need to prepare sufficiently and will need to be given or be able to access all the right information in advance. One way to facilitate this would be for consumers to receive a simple, single communication that brings together all the key information they need to know about all their pensions, in order to receive worthwhile guidance.

> ***Recommendation*: Introducing a pensions passport.** The Government should work with industry to introduce a single Pensions Passport to ensure consumers have the information they need before guidance. In the long-term, the Government should create a comprehensive pensions and savings dashboard that enables consumers to see all of their pensions and savings in one place.

A cooling-off period
The FCA and industry could go further to ensure that consumers have appropriate time to consider their options, and take guidance (and/or advice) before making a decision. Research suggests consumers often regret decisions more when they have had to rush[30]. Which? believes that it is important that consumers are allowed to pause and consider their decisions before finally committing to a significant withdrawal from their pension.

The Government has already proposed safeguards for those with defined benefit pensions[31]. Many pension providers already offer a cooling-off period, but are not required, and their duration varies.

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[30] Inbar, I, Botti, S, Hanko, K, Decision speed and choice regret: When haste feels like waste, Journal of Experimental Social Psychology, May 2011

[31] Clauses 48-53 of the Pension Schemes Bill 2014-5 create a requirement for individuals to take "appropriate independent advice" before transferring their defined benefit pension to another provider to use the new freedoms . We welcome this, and think that significant withdrawals from defined contribution pensions should also be processed in a way that allows consumers the time they need to reflect on their options.

Recommendation: **Introducing a cooling-off period.** The FCA should explore how providers can be required to give customers looking to withdraw significant portions of their accumulated DC pot a cooling-off period each time they withdraw. This would allow further signposting to available support, guidance and advice and the chance for the consumer to reconsider their decision in an unpressured environment.

Implementing a check of this sort need not be onerous or difficult. The FCA has already said it expects firms to enquire again whether customers would like to use Pension Wise if they have not already done so[32]. The regulator should also require firms to inform customers that:

- Withdrawals could have a significant impact, therefore, will be processed after 14 days rather than immediately;
- They are entitled to change their mind at any time during this 'cooling-off' period, without any penalty; and
- Free guidance from Pension Wise is still available to them throughout this period to help them consider their options.

[32] FCA, PS 14/17 Retirement reforms and the Guidance Guarantee, including feedback on CP 14/11, November 2014, pp.22-3.

Section 4: Defining success – a market that works for consumers

It will be important to understand how the reforms play out in practice for consumers. This will help to identify further steps that might need to be taken to make the reforms more effective in boosting consumer outcomes.

Two things matter here: the *results* of decisions people make at retirement; and *how* those decisions are made. Consumers need to be helped to make informed, active, appropriate choices, but they also need the right options available to them for choice to be meaningful.

> ***Recommendation:*** **Monitoring progress of the new reforms.** It will be important to assess whether the new pension reforms are leading to greater choice and better value pension products, whether people can access their money without high charges and whether pensions guidance is fit for purpose. The Government should monitor the market closely, using five key tests:
>
> 1. Do people have the information they need before guidance?
> 2. Are people able to access good quality guidance via Pension Wise?
> 3. Are active choices taking place, or are consumers being passively defaulted?
> 4. Are drawdown and new products accessible to the mass market?
> 5. Do drawdown and new products offer good low cost options?

It is important that data is collected so that these questions can be answered in the months ahead. Progress should be reported on by April 2016 at the latest, then annually thereafter. More detail on each test is highlighted below.

Test 1: Do people have the information they need before guidance?
Making informed and appropriate retirement decisions requires some key information. In order to assess whether an annuity, drawdown, direct withdrawal, or other product best meets their needs and preferences, consumers will need to be aware of, amongst other things:

- How many existing defined contribution pension pots they have;
- How much is in each of these;
- Their state pension entitlement, or the best available forecast of this;
- Any other sources of income;
- How much income they feel they will need in retirement;
- Their individual longevity risk and health and lifestyle conditions that affect this;
- Their attitude to risk and potentially volatility and loss; and
- Any benefits they are or may be entitled to in future.

Which? analysis of data from the Wealth and Assets Survey[33] suggests that many retirees are not currently engaged with these questions. A third of retirees (35%) 'do not follow the financial markets' at all[34] and just one in ten (11.1%) 'keep an eye on' the value of the financial products they hold.

[33] Office for National Statistics, Wealth and Assets Survey, Wave 3 (2010-2012)
[34] Ibid, base: all respondents

How can this be measured? This information can be collected by surveying a representative sample of people aged over 55, who have not retired yet and who have a DC pension. Working with the Government and Pension Wise providers, this information could also be collected from those individuals using the guidance service.

Test 2: Are people able to access good quality guidance via Pension Wise?
Once consumers are ready for guidance, they must be able to receive guidance of sufficient quality from Pension Wise to help them make the most of their options.

How can this be measured? The number of people accessing Pension Wise should be monitored by both the guidance providers and pension providers. One way to measure the quality of the guidance given would be to conduct mystery shopping of Pension Wise providers. This would reveal how well it is operating in practice and could be used to distinguish variations in quality between different channels, regions or types of consumer circumstances. This work could be complemented with qualitative focus groups of retirees.

Test 3: Are drawdown and new products accessible to the mass market?
Consumers with an average sized DC pension pot should have a meaningful choice between product options, for example, between taking an annuity and entering drawdown.

How can this be measured? This could be measured by monitoring the minimum pot size stipulated by drawdown product providers. Further analysis would also be needed to assess how well drawdown products meet the needs of consumers at and around the median pot size at retirement.

Test 4: Do drawdown and new products offer good low cost options?
It is important that the drawdown products offered to the mass market of DC savers offer value for money. Section 2 of this report outlined the potential impact that fees levied can have on savers' quality of life in retirement.

How can this be measured? Which? has surveyed the cost of drawdown products in February 2015 to provide a snapshot before the reforms take effect. This could be repeated to test whether drawdown providers are reducing costs in order to meet mass-market demand and offering value for money to retirees.

Test 5: Are active choices taking place, or are consumers being passively defaulted?
The FCA's recent market study confirms that passive defaulting of consumers into a product purchase is a leading cause of consumer detriment in the retirement income market[35]. It is important that lessons are learned from this experience so that more consumers are supported to make active decisions when they retire.

How can this be measured? This can be measured by monitoring the proportion of annuity and drawdown purchases that take place internally. Current figures stand at 52% for annuities and 33% for drawdown products. The proportion of internal sales for both of these products should fall if guidance, and improved communication by providers, is encouraging customers to make the most of the freedom and choice available to them in retirement.

[35] FCA, Retirement income market study: Interim Report, December 2014

Conclusion

The positive reforms to the UK pension sector announced at the Chancellor's 2014 Budget were some of the most radical in decades. Since then, the Government, industry, regulator and consumer groups have been working hard to ensure that implementation in April 2015 is a reality and that consumer outcomes are not put at risk.

The interventions identified in this paper will help to build on these reforms, and ensure that all consumers, including those who do not engage in making a decision, benefit from freedom and choice in retirement.

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Which? March 2015