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Response to: Financial Conduct Authority consultation on *Retirement Outcomes Review Interim Report*

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Summary

- Which? welcomes the Financial Conduct Authority's (FCA) Retirement Outcomes Review, and the opportunity to respond to the publication of the FCA's interim report. Which? has also recently completed research of consumers who have recently accessed their pension pots, which we have presented to the FCA's review team and is cited in the interim report. This found many similar issues as the FCA's review.

- In particular, Which? is concerned at the FCA's finding that, when accessing their pension savings, most consumers accept the income drawdown option offered by their pension provider without shopping around. This implies limited competitive pressure to offer good deals and that consumers are unlikely to be getting good value. Other Which? research confirms the high levels and complexity of charges for drawdown products.

- We therefore strongly agree with the FCA that there needs to be appropriate protections for consumers least able to engage and that effective measures are needed to promote competition for those who buy drawdown, either with or without advice.

- The FCA should also analyse the level of total charges that different groups of consumers are currently paying for income drawdown, through a targeted information request to relevant firms. It is disappointing that the FCA's interim report does not contain any data on total charges, including fund management charges, especially given that the FCA's recent Asset Management Market Study concluded there was weak price competition in the asset management industry and found evidence of sustained, high profits over a number of years.

- Although advised sales were out of scope of the review, the FCA should still seek to compare outcomes for advised and non-advised sales, to see either whether advised sales are also suffering poor outcomes or alternatively what lessons can be learnt from the advised market. As well as comparing the total charges borne by advised and non-advised consumers, this should explore the appropriateness of income drawdown investment strategies.

Which?'s response to the FCA interim report is focused on the FCA's four proposed remedies:

FCA remedies	Which? view
Remedy 1: Additional consumer protections for consumers who buy drawdown without advice	• The FCA should introduce default income drawdown investments and an associated charge cap for the least engaged consumers. • The FCA should benchmark the charge cap against the most competitive pensions and savings products in the market. • The FCA should also: ○ analyse the level of total charges that different groups of consumers are currently paying; and ○ assess how charges relate to providers' costs.
Remedy 2: Remedies to enable consumers to access their savings early without having to move into a new drawdown product	• The FCA is right to review any contractual or legislative barriers that prevent consumers from accessing their tax-free cash without being required to access income drawdown. • The FCA should also consider what further measures are required, especially given the incentives providers have to sell income drawdown products.
Remedy 3: Remedies to make it easier to compare and shop around for drawdown	• The FCA should develop and mandate summary cost metrics and encourage comparison tools for income drawdown. This will help consumers, increase shopping around, and promote competition. • Summary cost metrics should also reflect reforms to the way charges are shown across the wider asset management industry.
Remedy 4: Helping consumers understand their options after pension freedoms	• We support proposals to provide pension "wake-up" information packs via the pensions dashboard initiative. Crucially, the pensions dashboard needs to enable consumers to compare the value for money of their pension products, consolidate their pension pots, and switch providers. • The FCA should oversee ongoing user-testing and evaluation of retirement outcomes following the issue of wake-up packs to consumers by providers. The FCA should also set out stronger requirements for mandatory information and safeguards against inappropriate or misleading information. • The FCA should encourage increased take-up of the Pension Wise guidance service, including potentially via a 'default' offer of guidance for non-advised consumers that request access to a pension pot. The service also needs to have a stronger focus on improving consumer outcomes, with regular monitoring and evaluation.

Further detail

Remedy 1: Additional consumer protections for consumers who buy drawdown without advice

Which? view: The FCA should introduce default income drawdown investments and an associated charge cap for the least engaged consumers. The FCA should benchmark the charge cap against the most competitive pensions and savings products in the market. The FCA should also: analyse the level of total charges that different groups of consumers are currently paying; and assess how charges relate to providers' costs.

Of those consumers that have opted for income drawdown since the pension freedoms, the FCA's findings show that a significant share have not shopped around or engaged with their choice of provider when initially purchasing income drawdown. In our research, half of the respondents (55%) either said they did not know (36%) whether it was possible to switch providers after initially purchasing income drawdown, or incorrectly thought that you could not switch (19%).[1] This suggests that low switching rates could persist beyond the initial purchase of an income drawdown product. The low levels of switching and lack of engagement in the choice of provider and investment product mean that consumers need to be protected from potentially excessive prices and inappropriate or unsuitable investment products.

Disappointingly, the FCA interim report does not provide data on total charges for income drawdown. However, the FCA's interim report does show that providers can levy up to 16 different administration charges and that consumers with a pension pot of £75,000 could be losing out on up to £3,000 over 20 years by not shopping around for the lowest administration charges. Furthermore, the FCA's Asset Management Market Study concluded there was weak price competition in the asset management industry[2] and found evidence of sustained, high profits over a number of years.[3] This means that consumers are potentially paying excessive income drawdown administration charges on top of excessive and uncompetitive fund management charges. Namely, there is an even greater consumer detriment in the income drawdown market than in the wider asset management industry. Which? research has found, for example, that consumers with a pension pot of £250,000 could save more than £10,000 in total charges over 10 years by investing in the same popular fund with the cheapest pension provider.[4] Another Which? investigation was unable to obtain like-for-like quotes for a hypothetical consumer without Which? asking pension providers to confirm their charges – highlighting the issues faced by consumers in understanding and comparing charges.[5]

The FCA interim report proposes two key options for safeguards that should be introduced for the least engaged consumers: default investment pathways for consumers who do not or cannot engage with their investment decisions; and a charge cap for these default investment pathways. Our 2015 Better Pensions report welcomed the pension freedoms and called for two

[1] The key findings from the research are available here: http://consumerinsight.which.co.uk/articles/pension-decumulation-feb2017
[2] FCA (2016), *Asset Management Market Study – Final Report,* p.4
[3] FCA (2016), *Asset Management Market Study – Interim Report,* pp.116-120
[4] Which? (2015), 'The fees of freedom', *Which? Money*, August 2015
[5] Which? (2017), 'Are you missing out on a pension goldmine?', *Which? Money*, April 2017

similar safeguards to be introduced as part of a package of pre-emptive measures.[6] We argued at the time that these safeguards were necessary because the retirement income market was characterised by low levels of consumer engagement, which the FCA's findings have confirmed. Moreover, the FCA's consumer research shows that "hardly any" non-advised consumers had shopped around, with many not even aware what product they had, what their charges were or what products they were invested in.[7]

The FCA should benchmark the proposed income drawdown charge cap against the most competitive pensions and savings products in the market. This means that it should be significantly lower than the current 0.75% annual cap for auto-enrolment pension schemes in accumulation.[8] The FCA's asset management review found that the average fee for passive equity funds was 0.15% in 2015.[9] Such passive equity funds, when diversified and combined with other asset classes such as bonds, are appropriate for the vast majority of consumers who do not actively choose their income drawdown investments. The FCA should also:

- analyse the level of total charges that different groups of consumers are currently paying, through a targeted information request to relevant firms; and
- assess how charges relate to providers' costs.

Remedy 2: Remedies to enable consumers to access their savings early without having to move into a new drawdown product

Which? view: The FCA is right to review any contractual or legislative barriers that prevent consumers from accessing their tax-free cash without being required to access income drawdown. The FCA should also consider what further measures are required, especially given the incentives providers have to sell income drawdown products.

Consumers can now access their pension pots from age 55, and the FCA's data shows that accessing pots before the age of 65 has become "the new norm". Recent Which? consumer research found that the decision to access tax-free cash is often distinct from any decisions about retirement income.[10] 45% of respondents to our survey that had accessed a tax-free lump sum were in full-time employment, which suggests that most of these consumers would be unlikely to be taking a retirement income. The qualitative interviews that we conducted reinforced that tax-free cash lump sums were typically being used for other purposes than retirement income. Many interviewees said that they saw their tax-free lump sum as "win-win" with little consideration of the opportunity cost, such as the impact this could have on their available pot size when it comes to taking a future product decision.

The FCA has also found emerging evidence that many consumers have accessed their pots to withdraw the tax-free cash and have then purchased an income drawdown product with their

[6] Which? (2015), *Better Pensions*, available at: http://www.staticwhich.co.uk/documents/pdf/better-pensions-report---march-2015-397468.pdf

[7] Ignition House/FCA (2017), *Retirement Outcomes Review: Interim Report: Annex 3 Qualitative consumer research for assessing the non-advised journey*, p.51 & p.67

[8] Which? is calling on the Department for Work and Pensions to make a corresponding reduction in the auto-enrolment charge cap in its current review.

[9] FCA (2016), *Asset Management Market Study – Interim Report,* p.15

[10] The key findings from the research are available here: http://consumerinsight.which.co.uk/articles/pension-decumulation-feb2017

remaining pot, but are not yet withdrawing an income. Some pension providers told the FCA that they estimated that between 60% to 80% of their new drawdown customers were in so-called "zero income drawdown", whereby they are not yet taking an income. This is worrying if consumers had not intended to purchase a retirement income product, if they are paying higher charges than under their previous pension accumulation products, or if their new investment product is less suitable for their pension savings and retirement income goals than their previous product.

The FCA has proposed to decouple the decision to access tax-free cash from the decision about the rest of a consumer's pension savings. Which? agrees that this would potentially help many consumers that have not engaged with the decision to opt for income drawdown. Further work is needed to understand the unintended consequences of such changes, including whether any groups of consumers might be less likely to switch out of high-cost pension schemes to lower-cost income drawdown products with other providers.

We therefore support the FCA's proposals for a review of any contractual or legislative barriers that prevent consumers from accessing their tax-free cash without being required to access income drawdown. However, removing these barriers may not achieve the desired outcome without further measures, given the potential incentives on providers to sell income drawdown products, which the FCA's findings show can include a significant number of administrative charges on top of fund charges.

Remedy 3: Remedies to make it easier to compare and shop around for drawdown

Which? view: The FCA should develop and mandate summary cost metrics and encourage comparison tools for income drawdown. This will help consumers, increase shopping around, and promote competition. Summary cost metrics should also reflect reforms to the way charges are shown across the wider asset management industry.

The FCA interim report's evidence of a vast array of complex charges for income drawdown, including up to 16 administration charges, shows that it is almost impossible for consumers to compare charges between income providers and investments. This is not just a problem for income drawdown: the FCA's asset management market study has recommended a single, all-in fee for asset management. Delivering this is crucial for any simplification of charges for income drawdown.

The FCA's consumer research has highlighted how simpler cost metrics can make it easier for consumers to make comparisons. Given the current lack of standardised cost information across providers, mandatory costs metrics would be a major breakthrough, particularly if these can be used to help enable comparison tools to emerge. As many of the costs borne by consumers are dependent on their behaviour, including how often they make withdrawals and the impact of withdrawals on the size of their investment, meaningful comparisons may also require consumers to input some information on their intended withdrawal strategy. Even with simplified cost metrics, consumers will therefore need to be supported in considering how they might use income drawdown products, including using the Pension Wise guidance service.

Cost metrics and comparison tools are likely to take some time to develop. With such weak levels of engagement for most consumers, these remedies are also unlikely to be sufficient to deliver good outcomes for the vast majority of consumers. These remedies are therefore not a substitute for the FCA's proposed protections for the least engaged consumers.

Remedy 4: Helping consumers understand their options after pension freedoms

Which? view: We support proposals to provide pension "wake-up" information packs via the pensions dashboard initiative. Crucially, the pensions dashboard needs to enable consumers to compare the value for money of their pension products, consolidate their pension pots, and switch providers. The FCA should oversee ongoing user-testing and evaluation of retirement outcomes following the issue of wake-up packs to consumers by providers. The FCA should also set out stronger requirements for mandatory information and safeguards against inappropriate or misleading information. The FCA should encourage increased take-up of the Pension Wise guidance service, including potentially via a 'default' offer of guidance for non-advised consumers that request access to a pension pot. The service also needs to have a stronger focus on improving consumer outcomes, with regular monitoring and evaluation.

The FCA's evidence indicates that consumers struggle to understand their pension decumulation options and to think through the implications of such decisions. This is not due to a lack of availability of information or lack of willingness to access information: Which? research has found that nine out of ten consumers (93%) had accessed some form of information or advice when making their decumulation decision. However, this shows that the key issue is that many consumers find sources of information to be too basic and lacking in information tailored to their circumstances. This was a common criticism of government websites by consumers in our qualitative research.

We therefore support the FCA's proposal to provide pension wake-up packs via the new pensions dashboard initiative, as this has the potential to become the key route for consumers to find out about the pension pots that they hold. This will both prompt and facilitate consumers to think about their retirement income options. Indeed, the pensions dashboard project should be more than just a service offering basic information on the pension pots that consumer have and their options. On the contrary, the pensions dashboard has the potential to radically improve outcomes by enabling consumers to compare the value for money of their pension products, to consolidate pension pots, and to switch providers. Which? will soon be publishing further details of our recommendations on how the pensions dashboard project can best achieve this.

We strongly share the FCA's concerns about the reliance of many consumers on their existing provider for information on their pension options, especially given the evidence of low levels of switching for income drawdown products. Half (53%) of the respondents to our research said they used their existing pension scheme provider when deciding how to access their defined contribution (DC) pension pot; and four in 10 (42%) of those who took an annuity or income drawdown product said they used their existing pension scheme provider when choosing which provider to purchase from. The FCA has proposed that a government guidance body should issue wake-up packs instead of consumers' existing providers. However, there is no clear evidence that this will alter many consumers' reliance on their existing provider for information. Moreover, our qualitative research found that being contacted by their existing provider, often prior to a pension pot maturing, was the most common trigger point that prompted many consumers to consider their options.

The other key issue with pension wake-up packs is the effectiveness of providers' communications in improving consumer outcomes, including improving awareness of further sources of information and guidance on their options. There therefore needs to be ongoing testing and evaluation of outcomes from different providers, overseen by the FCA and publicly available. We note that the FCA is currently conducting behavioural research with several providers, and we look forward to seeing the findings from this as a first step. The FCA should set out stronger requirements for mandatory wake-up pack information, based on the evidence from its behavioural research. The FCA should also create stronger safeguards against pension providers issuing inappropriate or misleading communications. The FCA has found examples of this among some providers, including a minority of firms that presented their own (or partner) guidance in a more prominent manner in written communications than the signpost to Pension Wise.[11]

For non-advised consumers, guidance can provide more personalised information and support. So far, take-up has been low for the free guidance that is available via phone and face-to-face from the government-backed Pension Wise service. Some estimates suggest that less than one in ten consumers that accessed their pots had a Pension Wise guidance session.[12] While consumer satisfaction with the guidance service has been high, this does not necessarily mean that the service is helping materially to improve consumer outcomes. We therefore continue to share the concerns of the Work and Pensions Committee, which in 2015 criticised the Government for the "dearth of Pension Wise statistics", including a lack of data on consumer outcomes.[13]

The FCA should therefore promote increased take-up of the Pension Wise guidance service. One option would be to offer a guidance session as a 'default' for non-advised consumers that request access to a pension pot. Further work is required though to understand precisely why take-up has been so low and whether a prompt such as a default offer could improve take-up. The service also needs to have a stronger focus on improving consumer outcomes, with regular monitoring and evaluation, especially if the service is to be significantly scaled up.

About Which?

Which? is the largest consumer organisation in the UK with more than 1.5 million members and supporters. We operate as an independent, a-political, social enterprise working for all consumers and funded solely by our commercial ventures. We receive no government money, public donations, or other fundraising income. Which?'s mission is to make individuals as powerful as the organisations they have to deal with in their daily lives, by empowering them to make informed decisions and by campaigning to make people's lives fairer, simpler and safer.

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[11] FCA (2016), *Signposting to pensions guidance: our findings, https://www.fca.org.uk/publications/research/signposting-pensions-guidance-our-findings*

[12] House of Commons Work and Pensions Committee (2015), *Pension freedom guidance and advice,* p.7

[13] House of Commons Work and Pensions Committee (2015), *Pension freedom guidance and advice,* p.3