Which?, 2 Marylebone Road, London, NW1 4DF
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Response to: ***Retirement Outcomes Review: Proposed changes to our rules and guidance***

Adam Summerfield and Richard Wilson
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

Which?'s response to the FCA's CP18/17 Retirement Outcomes Review: Proposed changes to our rules and guidance

Summary

- Which? welcomes the work the FCA has done for the Retirement Outcomes Review (ROR) and believes the findings support our call for significant new consumer protections in the market.

- Which? broadly supports the FCA's 'investment pathways' proposal which aims to introduce a simple choice architecture to help non-advised consumers make decisions about investing their pensions savings. Concerns are set out in more detail below.

- Which? supports the introduction of rules preventing firms from defaulting consumers into cash or cash-like investments. Consumers should have to make a clear and informed choice to invest in these products.

- Which?'s key recommendations are that the FCA should:

    - Immediately introduce a charge cap to protect consumers that are not advised when investing in drawdown products.

    - Commit to do further work on the current 'backstop' options for consumers not engaging in the market. These are in reality defaults and Which? would expect the FCA to introduce a charges cap and independent governance for these products.

- The FCA should continue to work with government to support the introduction of a comprehensive pensions dashboard. The dashboard could be a significant tool in increasing informed engagement for consumers and decreasing detriment in the retirement outcomes market. In the potential absence of the pensions dashboard the FCA will have to do more to protect consumers from potential harm in the pension market.

Detailed Response

1. Which? welcomes the work the FCA has done for the Retirement Outcomes Review (ROR). The pensions and retirement income sector supports 34 million consumers either saving for, or taking a private pension in the UK and decisions on pensions can have a significant impact on the financial well-being of consumers.

2. As a result of the introduction of auto-enrollment and pension freedoms, consumers, who often have low levels of engagement, are now more exposed to risks in the pensions market. Which? believes that a robust regulatory environment that reflects those risks is vital for the protection of consumers and that the findings of the ROR support our call for significant new consumer protections in the market.

The FCA should introduce a charges cap for 'investment pathways' and backstop investment solutions

3. Which? has called for default income drawdown products and an associated charge cap to protect the least engaged consumers from high charges, which are a result of weak competition in the drawdown market.[1]

4. While Which? is supportive of the decision to introduce 'investment pathways', we believe the remedies currently proposed do not offer sufficient protection for consumers and that the FCA should introduce a charges cap. We acknowledge that the market will evolve in response to the introduction of investment pathways and that work will need to be done before the 'right' price for these pathways is known. However, even in the absence of this knowledge, it is clear that many consumers are being charged excessively and there is sufficient information for the FCA to immediately introduce a temporary charges cap to protect those bearing the highest charges.

5. The FCA's data shows that almost a quarter of non-advised consumers are paying 1.5% or higher, double the 0.75% rate that the FCA expects firms to "challenge themselves" against. This represents significant consumer detriment. Over 200,000 pension pots were moved into drawdown products in the two years to September 2017, so by delaying the implementation of a cap, thousands of consumers could be purchasing drawdown each month without protection against high charges. For an individual with a £50,000 drawdown fund, an additional charge of 0.75% represents an annual loss of £375. This could have large quality of life implications for some pensioners - it may mean not being able to take a holiday or keep their car on the road.

[1] See Which?'s response to the FCA and TPR call for input on *Regulating the pensions and retirement income sector: Our strategic approach* and Which?'s response to the FCA *Retirement Outcomes Interim Report* (https://www.which.co.uk/policy/money)

6. A temporary charges cap may have to be set at a price above that of a permanent cap. However, a level that will address the worst of the consumer harm could be quickly determined and we do not believe that fears that a ceiling price would reduce competition or stifle innovation are credible. Competition in the drawdown market for non-advised sales is clearly very weak, but some firms do have low charges and they will still retain the incentive to do so. Further, a temporary cap should be replaced by a permanent cap as soon as possible. Which? is disappointed that the FCA has yet to review the costs to firms of providing drawdown or how much firms are charging advised consumers in drawdown, which we called for in our response to the Interim Report. We see no reason why the FCA should not do this immediately to allow them to set a permanent cap for the investment pathways as soon as possible.

7. The FCA's proposed choice architecture for the investment pathways states that 'If the consumer still does not choose an investment pathway, the firm may move the consumer into a backstop investment solution.' This backstop investment solution is the firm's default drawdown product. While the investment pathways will hopefully improve the investment choice for consumers, it is essential that the FCA protects consumers who do not engage.

8. The backstop option should, as with the pathways, be regulated, be subject to a charge cap, and should have oversight from an independent governance regime.

9. The FCA's proposals for an improved Key Features Illustration (KFI) with a single charge figure and for all drawdown consumers to receive annual statements which include actual charges could help promote competition. These new requirements should also be extended to any backstop investment solutions. These remedies, however, will be insufficient to drive effective price competition in a market with such low engagement. As such a drawdown charges cap will remain a vital protection for non-advised consumers.

10. Following further work on costs in the drawdown market, the FCA should introduce rules to standardise how charges in drawdown products are applied and presented to consumers. This should help consumers to understand the costs they are paying and help them to compare prices in the market.

Investment Pathways

11. Which? supports, in principle, the 'investment pathway' proposals which will help protect non-advised consumers by introducing a simple choice architecture, based on consumers' objectives, to encourage better decision making for those purchasing drawdown. There are, however, a few issues the FCA should take into consideration while developing the pathways:

11.1. The FCA should prescribe each pathway objective and, as a minimum, give guidance as to what investment solutions and risk profiles they would expect from firms. In developing the pathways the FCA should consider whether to include an extra option of a 'guaranteed income for the rest of my life', which would provide an option for consumers to purchase an annuity with some or all of their savings held in drawdown. This could help consumers to consider their broader retirement income options. The FCA's findings show that many consumers have entered into drawdown as a result of a decision to access a tax-free cash lump sum via the path of least resistance, without considering how best to plan for their retirement.

11.2. As the focus of the investment pathways remedy is to reduce poor choices, it is essential that consumers are always offered all investment pathways, so that those who do not shop around can make an appropriate investment choice. If firms are not going to be required to provide their own investment solution for each pathway, then they must still be required to offer all pathways by having an arrangement with another firm.

11.3. Firms should not be allowed to charge different prices to different consumers accessing the same investment solution, even if it is as a result of an arrangement with another firm in order to fulfil their obligation to provide the consumer with all pathway options. Given consumers are often choosing the path of least resistance, the FCA should test whether the point at which consumers are informed that a product is being provided by a different firm has an impact on their decision making. It may be better to inform them after they have made the choice regarding which pathway they think is more appropriate.

11.4. Non-advised consumers should be offered the investment pathways before being given the option of choosing an alternative investment solution or staying in their current allocation. This would require consumers to opt out of the pathway, rather than allowing firms to offer a range of other products alongside/before the pathway, which might confuse the consumer and undermine the purpose of a simple choice architecture. Non-advised consumers expressing a preference before being offered the pathway (e.g. cash or remaining in their current asset allocation) should be offered the pathway before a final investment choice is made.

12. The FCA's proposed objectives-based approach should make it easier for consumers to make an appropriate choice. Many consumers will not understand the jargon that surrounds pensions and investments, including the meanings of 'drawdown' and annuity'. It is important that the FCA does the necessary work to test any proposed pathways and their wording with consumers to ensure they will be

effective. The FCA should publish findings from consumer testing on the pathway alongside the next consultation.

13. Which? supports the FCA's proposed requirement for firms to review the products annually and, in principle, the proposals for independent governance of products offered via the pathways. It is essential that any such oversight is effective in protecting consumers' interests in the market and that oversight is extended to cover backstop investment solutions. The FCA, therefore, should commit to a wider review of the effectiveness of Independent Governance Committees as part of any decision to extend the regime to the investment pathways.[2]

14. While the FCA considers the 'investment pathways' to be a consumer protection remedy focused on tackling poor investment choices, the FCA should also consider the impact of the proposed pathways on competition. The remedy has the potential to increase competition as it is likely consumers will see pathways with similar or the same objectives as comparable. It is therefore important that the investment solutions developed by firms for pathways are comparable, which may require rules or guidance from the FCA, as we propose in paragraph 11.1.

15. Which? agrees with the FCA that, for the purpose of the pathway, consumers should only be considered advised if they have received advice on the relevant investment decision. All other consumers, including those who may have recently received more general financial advice, should be considered non-advised. The investment pathways and solutions should be offered to all non-advised consumers and to advised consumers who would like to use them. The pathways should be offered each time a consumer moves money into drawdown, as the objective for each tranche of money may be different. The protection offered by the investment pathways should cover the entire non-advised drawdown market.

The FCA should introduce rules banning firms from defaulting consumers into cash or cash-like drawdown products, and consider extending the ban to all areas of the pensions sector

16. Which? supports the FCA's proposal to ban firms from defaulting consumers into cash or cash-like defaults for drawdown and believes consumers must make an active and informed choice to invest in cash. Which? therefore supports the FCA's proposal that firms should be required to explain to consumers the risks of investing in cash or cash-like products before they make a decision to invest.

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[2] Which? has called for a review of Trustees and IGCs for workplace pensions schemes as poor and variable standards of governance could be facilitating in effective competition in the market. See [Which?'s response to the FCA and TPR call for input on *Regulating the pensions and retirement income sector: Our strategic approach*] (https://www.which.co.uk/policy/money)

Which? believes it will be necessary for the FCA to give clear guidance as to what sort of products would be considered a cash or cash-like default.

17. The FCA should consider banning firms from defaulting consumers into cash in all areas of the pensions and retirement income sector. Which? has concerns about the impact of pension savings being 'lifestyled' into cash or cash-like products and then left by consumers who do not engage until after their pension scheme retirement age.

Improvements to 'Wake-up' packs are welcome, but the focus needs to be on the introduction of a comprehensive dashboard

18. Which? welcomes efforts to increase consumer engagement. However, it is important that the FCA makes sure any new rules are effective, this should include determining whether the FCA's proposal for a 'wake-up' pack every five years is the optimal means of improving engagement.

19. While the changes to the 'wake-up' packs to include a single page summary of information should result in better engagement from consumers - as testing has shown it increases the number of consumers accessing Pensionwise - the vast majority of consumers still do not engage.[3] A much better remedy for engagement, as well as competition, would be the introduction of a comprehensive pensions dashboard, as Which? has called for on multiple occasions.[4]

20. Which? is currently concerned about the progress from government on the pensions dashboard. The dashboard could be a significant tool in increasing informed engagement for consumers and decreasing detriment in the retirement outcomes market. The FCA has supported a pensions dashboard and acknowledges that the initiative would have the 'potential to support some of the measures proposed' in the ROR Final Report.[5]

21. The FCA should continue to work with government to support its creation. If there continues to be little progress on the pensions dashboard, Which? would expect the FCA to do significantly more to ensure consumers are able to engage in the pensions market, and do more to protect consumers as it will be harder for consumers to access pensions information, make informed decisions and drive competition.

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[3] HM Treasury/DWP, *Improving engagement with pension decisions: The results from three randomised controlled trials*, October 2017

[4] See Which?'s The Pensions Dashboard report and Which?'s response to the FCA and TPR call for input on *Regulating the pensions and retirement income sector: Our strategic approach* (https://www.which.co.uk/policy/money)

[5] FCA, *Retirement Outcomes Review Final Report: annex 2 - Regulatory developments in the market,* para 50, June 2018

The FCA should commit to undertake work on reducing barriers to switching

22. The FCA concludes that 'for those consumers who do consider switching, there are likely to be some barriers that make this difficult.' These include both the time it takes to switch and fund exit fees.[6]

23. The FCA should review the potential impact of exit fees and commit to work on reducing other barriers to switching. The issues raised in relation to exit fees and barriers such as time taken to switch, are similar to those raised in the FCA's Investment Platform Market Study Interim Report.[7] The FCA should use this opportunity to look at exit fees and barriers to switching in the broader investment market and take a coordinated approach on exit fees and reducing barriers to switching.

The FCA must continue to monitor whether the market is supporting good outcomes

24. It is important that the FCA continues to monitor whether the market is supporting good outcomes for consumers in retirement. For instance, it is important that the FCA continues to consider the potential harm for consumers withdrawing pots fully when first accessing their pensions. Over half of those accessing a pot for the first time in the two years after the introduction of the pension freedoms withdrew the entire pot. As pot sizes and the average number of pots held by each consumer change, decisions to withdraw pots could have a materially greater impact on consumers' retirement incomes.

About Which?

Which? is the largest consumer organisation in the UK with more than 1.3 million members and supporters. We operate as an independent, apolitical, social enterprise working for all consumers. We are funded solely by our commercial ventures and 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.

For more information, contact Justin Protts, Policy Adviser: justin.protts@which.co.uk

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[6] FCA, *Retirement Outcomes Review Final Report,* para 4.31, June 2018
[7] FCA, *Investment Platform Market Study Interim Report,* July 2018