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Response to *CP19/5: Retirement Outcomes Review: Investment pathways and other proposed changes to our rules and guidance*

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Which?'s response to the FCA's CP19/5: Retirement Outcomes Review: Investment pathways and other proposed changes to our rules and guidance

Summary

- Which? welcomes the opportunity to respond to this consultation. We broadly support the FCA's proposals for 'investment pathways' which will introduce a simple choice architecture to help non-advised consumers make more informed decisions about investing their pensions savings. However, we outline in our response the changes the FCA should make to their current proposal in order to address our concerns about the pathway requirements and ensure consumers are protected if they do not engage with their savings.

- Which? welcomes the fact that the FCA intends to extend the Independent Governance Committees (IGCs) regime to provide oversight of investment pathways. As part of this the FCA also should commit to a wider review of the effectiveness of IGCs and work with the TPR and DWP to ensure a consistently high standard of governance across the entire pensions and retirement income sector.

- Which? supports the proposals to require consumers to make an active decision to invest in products that are predominantly cash and for firms to be required to explain to consumers the risks of investing in cash or cash-like products before they make a decision to invest.

- Which? supports the proposal that providers of pension schemes should provide consumers in decumulation with annual information on all the costs and charges that the consumer has paid on their pension pot and that this information should be aggregated and provided in pounds and pence to help consumer understanding.

- While all these remedies are welcome, it is essential that non-advised consumers accessing drawdown product, in particular those consumers using the investment pathways, are protected by a charges cap. The proposals in this consultation will not be enough to protect consumers from high charges in a market with such weak competition.

Response

1. The pensions and retirement income sector supports over 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. As a result of the introduction of auto-enrolment and pension freedoms, consumers, who often have low levels of engagement and understanding, are now more exposed to risks in the pensions market.

2. Auto-enrolment has successfully increased the number of people saving for their retirement, with the number of active defined contribution pension scheme members now over 10 million. However, this means that there will be millions of consumers who will reach the age of 55 - having had low levels of engagement with their pensions saving and benefited from the protections of default funds and the associated charges cap - that will be exposed to the risk associated with deciding how to use or invest their pensions savings.

3. The Retirement Outcomes Review (ROR) found that a considerable proportion of non-advised consumers (32%) are invested in cash, compared to 6% of advised consumers. This reflects the fact that many consumers do not make informed decisions when moving into drawdown. The ROR also found that almost a quarter of non-advised consumers are paying 1.5% or higher, double the 0.75% rate that firms are able to charge consumers saving into pension scheme default funds and double the rate that the FCA expects firms to "challenge themselves" against. In large part this reflects that there is little competition as non-advised consumers are unlikely to switch firm when entering drawdown.

4. It is therefore essential that the protections the FCA introduce provide for a robust regulatory environment that takes full account of the risks associated with making retirement income decisions and the risks associated with high charges and a lack of competition.

5. For these reasons we support the introduction of investment pathways, the proposal to introduce new governance requirements and the proposal that require consumers to make an active decision to invest in cash. However, we do have some concerns about the current proposals and these are set out below.

Which? supports the proposals for the 'investment pathways' however we have some concerns about the proposed requirements for the choice architecture.

6. While we support the pathways in principle as we believe they will help non-advised consumers make better decisions, we have two main concerns around the current choice architecture requirements that the FCA plan to introduce:

6.1. It is possible for consumers to make investment decisions without having to consider their retirement income objectives;

6.2. The pathways still do not address what happens if a consumer does not engage.

7. The following section sets out our concerns. These concerns are reflected in the flow chart (see page 6) which reflects how Which? proposes the FCA adapt their proposals.

Ensuring consumers consider their retirement income objectives

8. One of the key reasons consumers have been experiencing harm in the drawdown market it that they have been entering drawdown to access their tax-free savings without thinking about how they will use their pension savings to meet their retirement income objectives - such as wanting fixed income in retirement, wanting to take all their retirement savings on one or wanting to be able to occasionally dip into their savings as and when they need to.

9. The intentions of the pathway is and pathway objectives is to encourage non-advised, and often disengaged, consumers to invest based on what they want to achieve with their pension savings - their retirement income objectives. We are concerned that the proposed requirements, do not ensure consumers will benefit from taking an objectives-based approach as consumers are able to choose to remain invested or to self-select a fund prior to being taken through the 4 pathway objectives.

10. Depending on pot size, between 56% and 76% of consumers are entering drawdown in order to access their 25% tax free cash lump sum, suggesting most consumers are not prioritising their longer term retirement objectives. The FCA's earlier research also suggested that consumers end up in drawdown as a default and that consumers assumed that the provider's default, or recommendation, would be an appropriate investment. It was therefore concerning that around 32% of consumers not taking advice were wholly holding cash compared to 6% of advised consumers, and only half of those fully invested in cash were aware of this.[1]

11. We therefore agreed strongly when the FCA previously said "Our evidence suggests that a more structured set of options would help consumers engage with their

[1] We also believe that these figures are likely underestimates the survey was completed by customers knew in advance that they would be asked about their drawdown and therefore likely to be generally more engaged.
FCA, *MS16/1.3: Retirement Outcomes Review Final report*, June 2018

investment decision, consider their retirement objective, and match their drawdown solutions to these."[2]

12. However, we are not satisfied that the proposed requirement to give 'at least equal prominence' to the investment pathways is sufficient to help ensure that consumers 'consider their retirement objective and match their drawdown solutions to it.' The choice architecture as currently proposed allows for a non-advised consumer to choose how to invest (remain invested, pathways or self-selected investments) before seeing the pathway objectives, but the decision on how to invest will be in part determined by the objective the consumer wants to achieve.

13. We cannot see why the FCA plans to introduce requirements that allow for consumers, who are generally not engaged, to be given the option to 'remain invested' prior to encouraging them to think about their retirement income objectives. Unless the FCA can show that allowing non-advised consumers to exit the pathway requirements without taking them through the pathways will improve outcomes for consumers, the current proposals should be reconsidered.

14. Non-advised consumers should instead 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 or before the pathway, which might confuse the consumer and undermine the purpose of a simple choice architecture. We do recognise that consumers may still choose to opt for non-pathway options and that self-selecting other funds or remaining invested should remain valid options for those taken through the pathways.

A default option for consumers that do not engage

15. While the FCA has clearly set out that it will prevent schemes moving consumers into cash or near cash investments without an active choice for consumers we do not think this is sufficient to address the potential harms. There needs to be clear requirements around what happens if a consumer fails to make a decision to ensure this remedy addresses the harm to those who are least engaged.

16. If a consumer does not choose an investment pathway or an alternative investment option, a consumer may be moved into a backstop or default investment solution. The fact that this default is not reflected in the FCA's proposed pathways flowchart is concerning, as it is essential that backstop option should, as with the pathways, be regulated, and should have the same governance oversight as the pathway

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[2] FCA, *CP18/17 Retirement Outcomes Review: Proposed changes to our rules and guidance*, June 2018

solutions. We do not think this would be a significant burden on firms as the ‘backstop’ could be on of the pathway solutions.

Which’s alternative proposed requirements for drawdown providers

17. We believe that the issues raised above can be addressed by altering the current proposed requirements for drawdown providers.

18. We have outlined the changes below by building on the FCA’s flow chart published as part of this consultation. The proposed changes,in pink, are as follows:

    18.1. We propose that firms are required to present the 4 pathway objective before they are able to ‘opt-out’ of the pathways and choose an alternative solution.

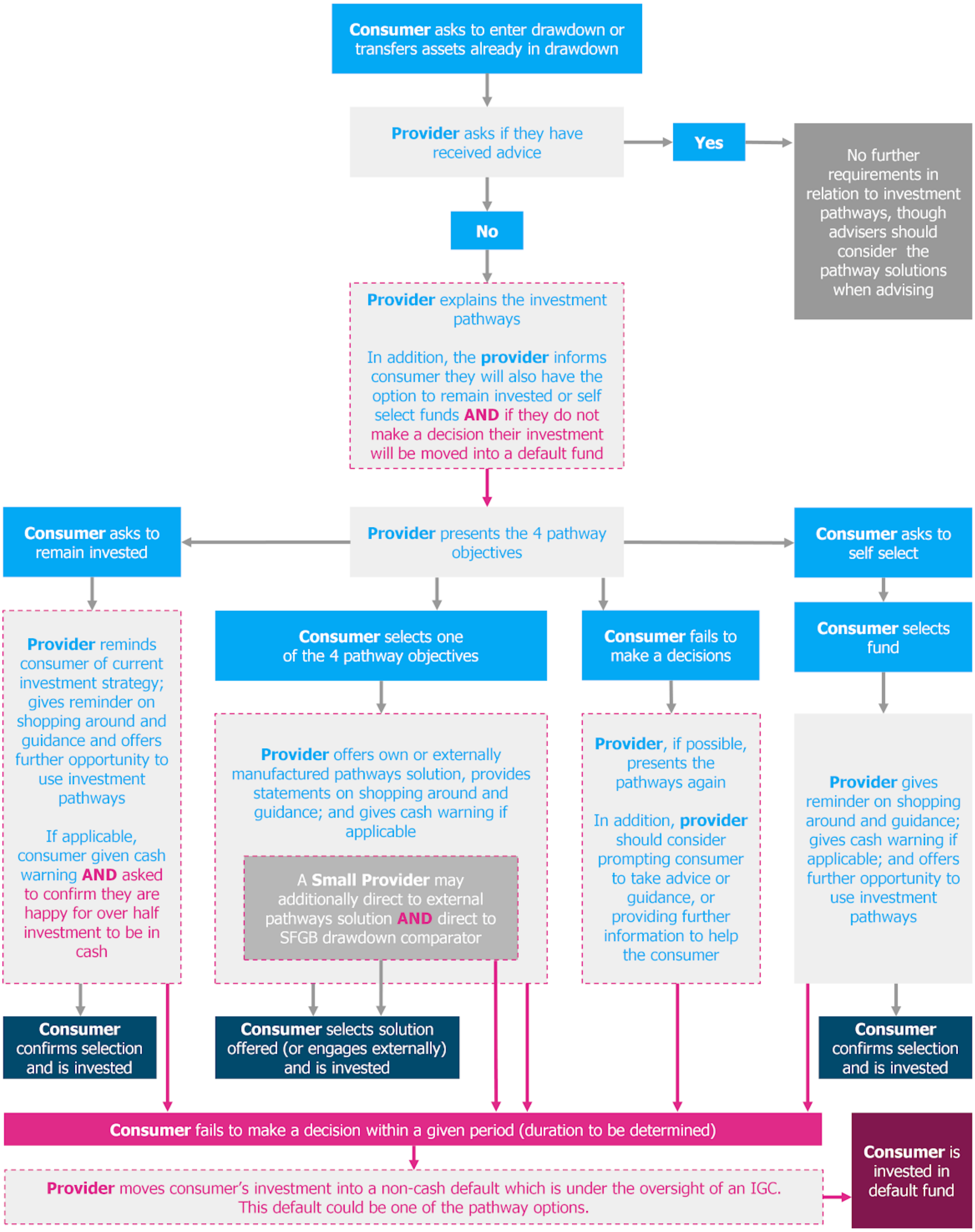
    18.2. We propose firms be required to inform consumers that if they do not make a decision they will be moved into a default which may not be best suited to meet their retirement income needs.

    18.3. Only small firms should be allowed to direct consumers to external pathway solutions offered by other firms. All other firms should either offer their own (or externally manufactured pathways) directly to consumers.

    18.4. Small firms that do not offer their own or externally manufactured pathways must both be required to both direct consumers to an external pathways solution and inform consumers that they could use the SFGB drawdown comparator.

    18.5. If any consumer fails to make a decision and is not invested based on the consumer’s choice then, after a fixed period of time, they must be moved into a default fund which has the same governance and protections as the pathways solutions.

Which?'s proposed alternative to the FCA's Investment Pathways
flow chart showing proposed requirements for drawdown providers



While Which? supports the proposed governance requirements and rules that will require investment in cash to be an active decision, they are not enough. A charges cap for all investment pathway solutions and default funds must be introduced to protect consumers from the highest charges.

19. Which? welcomes the fact that the FCA intends to extend the IGC regime to cover investment pathways, we also believe that the regime should cover any non-pathway defaults offered by drawdown providers to non-advised consumers. The FCA 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.[3]

20. The proposal to require consumers to make an active decision to invest in products that are predominantly cash or near cash investments is also welcome. Which? also strongly 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. Which? supports rules that apply to any investment that is predominantly (over 50%) in cash or near cash investments and believe that the FCA should require firms to record information about the proportion of consumers predominantly invested in cash so the FCA can monitor the effectiveness of this remedy.

21. Despite these proposed protections, Which? continues to believe a charge cap is necessary to protect the least engaged consumers from high charges, which are a result of weak competition in the drawdown market.

22. A charges cap should apply to all pathway solutions and any default funds. It seems inconsistent that a consumer who is less engaged can save throughout their entire career with the protection of a default and a charges cap, but at the point at which they access their funds - when their pot is often at its largest - they lose those protections.

23. It is clear from the findings of the retirement outcomes review that many consumers are being charged excessively and we believe that there is sufficient information for the FCA to immediately introduce a temporary charges cap to protect those bearing the highest charges.

24. The FCA's data from the ROR showed that almost a quarter of non-advised consumers are paying 1.5% or higher, double the 0.75% rate that firms are able to charge consumers saving into pension scheme default funds and double the rate

[3] 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)

that the FCA expects firms to “challenge themselves” against. This was coupled with the FCA’s own finding that there is little competition as non-advised consumers are unlikely to switch firm when entering drawdown.

25. This represents significant consumer detriment. In the year to March 2018 over 188,000 new income drawdown policies were entered into, an increase of over 10% year on year. Given that this trend is set to continue, delaying the implementation of a cap to protect consumers from the highest charges means that tens of thousands of consumers each year will purchase drawdown products with unfairly high charges. The average pot size for consumers entering drawdown in 2017/18 reached £119,000.[4] For the average consumer entering drawdown the difference between 0.75% charge and a 1.5% charge is an initial annual loss of £890. An average consumer being charged at 1.5% and with a drawdown rate of 4% a year would expect to withdraw around £4760 and be paying £1785 in charges.

26. While the new governance requirements will go someway to ensuring consumers views are represented, we believe it is still necessary for the FCA to introduce a charges cap to protect consumers using the investment pathways or any backstop or default investment options. Though they will hopefully improve comparability the pathways requirements, they will not encourage significant competition as they are unlikely to address the consumer preference for the path of least resistance and the bias towards their current scheme provider. So while the pathways will act as a protection against poor choices for the least engaged, they will not protect consumers from the lack of competition.

27. Which? still believes a temporary charges cap should be introduced immediately for all non-advised consumers. If this is not going to be the case, 12 months should offer the FCA sufficient time to review and implement a charge cap for investment pathway solutions and any default products. A cap set at 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 and the fact that close to a quarter of non-advised consumers are being charged over 1.5% on their pot annual reflects that, but some firms do have low charges and they will still retain the incentive to do so.

Which? supports the proposal that information on charges should be aggregated and provided in pounds and pence to help consumer understanding.

28. Which? supports the proposal that providers of personal or stakeholder pension schemes should provide decumulation consumers with annual information on all the costs and charges, including transaction costs, that the consumer has paid on their

[4] FCA, *Data Bulletin: September 2018 - Retirement income market*

pension pot, and that this information on charges should be aggregated and provided in pounds and pence to help consumer understanding.

29. However, Which? believes there should be clear guidance around how costs are calculated to ensure they are comparable and that consumers are given information that accurately reflects the cost of the investment.

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.

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Annex: Response to Questions

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

Yes.

We have some concerns about excluding those who take UFPLS. However, on balance, we think it is likely that those who take UFPLS will be more engaged than most consumers and be making a more informed decision on how to use their pension for their retirement income.

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

Yes.

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

Yes.

We particularly welcome the work that was done with consumers to consider which objectives to include and agree that is will benefit consumers to consider the option of an annuity when accessing drawdown. The FCA's own evidence suggests that it is access to tax-free savings and not planning for a retirement income that triggers most consumers to access drawdown.

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

Yes.

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

We have answered this in more detail above.

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

Yes.

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

Yes.

Though the FCA must continue to review the language used by firms around pathways and the types of products offered to ensure that the pathways are effective in helping consumers to invest appropriately.

Q8 and Q9: Do you agree with our proposed rules requiring larger providers to provide pathways solutions for at least 2 of the 4 objectives and to refer consumers to another provider's pathways solutions for any objectives where they don't provide a pathways solution? *and* Do you agree with our proposed easement for smaller providers, including our proposals for the operation and level of the threshold for qualifying for this easement?

No.

Larger providers must offer their own or externally manufactured pathway solutions for all objectives. We do not think that any schemes should be directing consumers to external solutions unless it would be such a significant cost to the scheme to provide their own or externally-manufactured scheme that the passing on of the costs would be detrimental to the scheme members.

Only small firms should be allowed to direct consumers to external pathway solutions. Small firms that do not offer their own or externally-manufactured pathways must both be required to both direct consumers to an external pathways solution and inform consumers that they could use the SFGB drawdown comparator.

This is addressed more fully in our response to Question 5 and Question 8 above.

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

No response.

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

Yes. We agree with the proposed approach, and we also believe it is essential that consumers are shown what they have been charged for their investment in pounds and pence.

Q12: Do you agree with our proposed approach for the records providers should keep?

Yes, however, we also believe that the FCA should ensure providers are keeping a record of the following:

- The proportion on non-advised consumers who are taken though the investment pathways but remain invested wholly in cash or near cash, the proportion invested over 50% in cash or near cash and the proportion invested over 25% in cash.
- The proportion of consumers in each pathway solution with annual charges - equivalent to those capped for default pension funds - Under 0.5%, between 0.5% and 0.75%, between 0.75% to 1%, between 1% and 1.5% and over 1.5%.
- The proportion of consumers that, within three months of identifying themselves as a non-advised consumers looking to enter drawdown, have not made an active investment decision, Firms should also record how they are invested and the proportion of those consumers with annual charges - equivalent to those capped for default pension funds - Under 0.5%, between 0.5% and 0.75%, between 0.75% to 1%, between 1% and 1.% and over 1.5%.

Q13: Do you agree with our implementation timeline?

While we accept time is required to implement the pathways, we believe the FCA could commit now to introducing a charges cap alongside the pathways. We have previously said that a temporary charges cap should be introduced immediately for all non-advised consumers.

If this is not going to be the case, 12 months should offer the FCA sufficient time to review and implement a charge cap for investment pathway solutions and any default products. A cap set at 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 and the fact that close to a quarter of non-advised consumers are being charged over 1.5% on their pot annual reflects that, but some firms do have low charges and they will still retain the incentive to do so.

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

Yes. In particular we agree that a pre-population form should not be a means by which a consumer makes an active choice.

The FCA should provide further guidance as to what constitutes an active decision for the consumer in order to ensure there is some clarity and to ensure the consumer is genuinely making an active decision. The FCA should also, in reviewing the success of the policy, consider whether firms are genuinely ensuring consumers are making an active decision when they invest in cash and whether any difference in the approach taken by firms is leading to a difference in consumer behaviour.

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

Yes.

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

Yes.

Q17: Do you agree with our proposed approach for the records providers should keep?

Yes.

See question 12 for what we think providers should keep on record in relation to cash investments and the investment pathways solutions.

Q18: Do you agree with our implementation timeline? In particular, do you agree with our view that these remedies should be implemented at the same time as investment pathways?

Yes.

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

Yes.

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

We agree rules should require the disclosure of transaction costs.

However, it seems inconsistent with that as part of a remedy to improve transparency that the regulator would not at least provide clear guidance as to how costs should be calculated.

There needs to be clear guidance around how costs are calculated to ensure they are comparable and that consumers are not given information that does not truly reflect the cost to them of the investment.

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

Yes.

Q22: Do you agree with our implementation timeline?

Yes.

These requirements should be in place by the time the investment pathways requirements are introduced.