

RETIREMENT OUTCOMES REVIEW: PROPOSED CHANGES TO OUR RULES AND GUIDANCE, PLSA RESPONSE

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SUMMARY

- ▶ The PLSA supports the FCA’s proposed remedy package, subject to some comments outlined in this response.
- ▶ We think it is a proportionate response to potential harms to consumers that are clearly identified in the final report of the review.
- ▶ We do not think that it is the final regulatory settlement for the decumulation market. We think that, as people with larger DC pots come to market, the market will need to evolve to offer products that are more sophisticated than individual drawdown. This will require a different regulatory approach devised to help non- advised customers find suitable income products.
- ▶ We are pleased that the FCA has chosen to use reforms to choice architecture at decumulation to enable one of the main proposed remedies. Changing choice architecture is a powerful means of connecting customers with a good quality outcome. We are also pleased that the FCA has chosen to retire the term “default” in relation to the joining mechanism for products. This term increasingly obscured more than it described.
- ▶ We think that remedies that make use of choice architecture as a tool to achieve a particular outcome can potentially be manipulative and should therefore be overseen by a fiduciary or an IGC. We think that this is a general rule: where remedies are deployed that make use of the lessons of behavioural economics, these should be overseen by a fiduciary or an IGC.
- ▶ We do not feel that the customer journey for entry into the pathways is ready for use. This is for two reasons:
 - ▶ First, we anticipate that people will want to spread capital across more than one pathway. Therefore, rather than presenting the individual only with a choice of three pathways defined as cash, drawdown or income, the journey could also present typical blends between the three pathways. This would enable easy access to both cash and an income.
 - ▶ Second, we believe that people will not present themselves to a provider asking for “drawdown”. They will most likely present asking either for cash, for an income or a combination of cash and an income. In the first instance a customer journey should enable people to choose between the pathway options suitable for cash withdrawal. In the second instance, the customer journey should enable non-advised customers to choose between the income pathway and an annuity or a combination of the two.
- ▶ We believe that SIPP’s should be brought within the scope of the remedy package in order to ensure a level playing field between providers and equal treatment of non-advised customers. This will present SIPP providers with a choice: either to provide products for non-advised customers and adopt the remedy package or to provide products only for advised customers.
- ▶ Subject to our main point: that the ROR remedies should not be thought of as the end point for regulation of the market, we believe that this is a well-designed remedy package deserving of the industry’s support.

INTRODUCTION

THE PLSA SUPPORTS THE FCA'S REMEDY PACKAGE

We agree with the FCA that consumers need further support and protection in the “at retirement” market. The retirement outcomes review has highlighted a number of ways in which customers are at risk from adverse outcomes. We believe that the measures outlined by the FCA are a sensible and proportionate response to the issues uncovered by the review. Subject to some minor specific comments, we believe that the recommendations should be adopted and that similar arrangements should be brought forward for trust based pensions.

THE REMEDY PACKAGE WILL NEED TO EVOLVE WITH THE MARKET

The measures outlined, though, are a sensible response to the market as it is now. The review primarily addresses issues of detriment arising from the purchase of drawdown without advice. This is sensible in a context in which many people are not using drawdown to provide an income in retirement and where many people also have a DB income to fall back on.

While this is the state of the market now, we anticipate consumer needs will change as pot sizes increase and DB entitlement becomes rarer. Furthermore, before long, savers who have built up pension entitlements through automatic enrolment will begin to decumulate. These individuals are likely not to have engaged with their pension saving, as automatic enrolment does not encourage this. It is not clear whether this and successive cohorts of retirees will require different levels of help and support to current retirees.

It is also not clear to us that individual drawdown is automatically the best product for future generations of retirees, when it is used as a single option rather than in conjunction with other options such as annuitisation. Drawdown as a single option has potentially serious drawbacks. Sequencing risk remains a serious risk for those taking an income in falling markets. Similarly, drawdown deals poorly with longevity risk, one of the major issues for those intending to draw an income over the long term.¹

We note that it took policy action to improve the governance and pricing of products in the accumulation phase and hope that a similar response will not be required in decumulation. We suggest, therefore, that the FCA keep the policy area under review and continues to track customer needs through regular surveys of customer behaviour and provider activity.

THE USE OF CHOICE ARCHITECTURE TO PROTECT CONSUMERS

We support the use of reforms to choice architecture at retirement in order to protect savers. We believe that these sort of innovations, like the investment pathways, are key to ensuring that savers get the income they tell us that they want from their DC pots, now and in the future. As automatic

¹ See for instance: <https://www.actuaries.org.uk/documents/challenge-longevity-risk-making-retirement-income-last-lifetime-0>

enrolment shows, reforming choice architecture is a particularly powerful tool that may help customers by aligning the path of least resistance in a decision with outcomes that are suitable for the majority. Reforms to choice architecture may also simplify choices for consumers such that non-advised consumers have a good prospect of taking a good quality decision.

We also welcome the retirement of the term “default”. Few in the pensions sector have argued for a hard, accumulation phase style default in decumulation. Many have argued for reforms to choice architecture to align the line of least resistance at decumulation with an income product. The PLSA advocates an approach we call “signposting”. NEST have used the term “guided pathways” and the Australian CIPR proposals use the term “soft default”.

Moving on from the term “default” will put to rest the argument about the merits of “defaults” versus “choice”. It will enable a more helpful conversation about how different variations in choice architecture at retirement will complement access to advice and guidance. This is much closer to the substance of the positions that different organisations actually hold and hence the real policy debate.

We have a number of thoughts on the use of choice architecture as a consumer protection tool. These inform the way we have approached the questions in the consultation document.

First, we believe that reforms to choice architecture that promote a particular outcome should be subject to independent governance. This is because initiatives based in behavioural economics often use weaknesses in human decision making ability to achieve a particular outcome or may actively steer individuals towards a particular outcome, whether that be choosing to save or remaining in a default fund.

We think it is important that reforms to choice architecture are used to promote the interests of consumers and are not used to the detriment of consumers. Independent governance is, in our view, an effective check on that possibility in the accumulation phase and should be given strong consideration in decumulation also.

Second, the interaction between choice architecture and interventions that intend to engage the member and promote choice needs to be considered carefully. Choice architecture based interventions tend to promote a particular course of action over alternatives. Engagement based interventions tend to encourage the consideration of many different options. They may, potentially, push against one another.

Third, choice architecture based interventions need to be regularly evaluated and reviewed. The intention of the intervention is to streamline the decision making process and reduce the need for the saver to think about their options. It follows that someone – potentially a fiduciary or an IGC - should do the thinking that is now not required of the saver.

CONSULTATION QUESTIONS

Q1: Do you agree with our current high-level thinking on the key elements of our potential remedy? If not, what would you suggest?

We agree with the FCA's proposed remedy package. We see the package as a compelling response to the market as it is now and believe that the measures should be adopted. While we believe that the remedy package is the right package for the market at the present time, we are not convinced that it anticipates future problems. For that reason, we urge the FCA to keep the market under review and respond as the market evolves.

Q2: Does the approach we are considering taking adequately capture the objectives of non-advised consumers entering drawdown who might use the investment pathways? If not, what would you suggest?

With amendment, we believe that the three investment pathways adequately capture the objectives of non-advised customers. The pathways themselves are defined appropriately and capture the range of possible objectives that customers may have. We anticipate though that some will want to spread capital across the different pathways rather than just selecting one pathway. We believe that the customer journey for the pathways should take account of this and enable customers to spread capital in this manner.

In terms of individual decision making, while the objectives for the path ways are clear to us, we note that people do not always approach decisions in the way that one might reasonably expect and are aware of issues like choice paralysis² and naïve diversification in similar choice architectures e.g. investment fund choice. We recommend further behavioural testing in order to ensure that people react to the proposed choice architecture in the way that is intended.

Q3: Do you agree with our suggestion that firms should only offer 1 investment solution in respect of each of the objectives? If not, what would you suggest?

Yes, we think that further investment solutions are likely to over-complicate the decision making process and make it harder to navigate. The risk of choice paralysis should be factored in to any decision to increase the number of available options.

Q4: Do you agree with our suggestion that firms should not be permitted to provide a single investment solution to cover all of the objectives? If not, what would you suggest?

We agree with this suggestion. It is important that the investment pathways are differentiated such that the objectives of the individual pathways can be best met.

² See Iyengar and Lepper (2000) [https://faculty.washington.edu/jdb/345/345%20Articles/Iyengar%20%26%20Lepper%20\(2000\).pdf](https://faculty.washington.edu/jdb/345/345%20Articles/Iyengar%20%26%20Lepper%20(2000).pdf)

Q5: Do you think that firms should offer investment solutions for all the investment pathways? If not, what would you suggest? If a firm does not offer an investment solution for a particular investment pathway, should it be required to enter into an arrangement with another firm to provide it?

If firms do not offer access to all the investment pathways then the remedy will not work as intended. Given that over 90 per cent of non-advised customers will remain with the incumbent provider, the main influence on which firm they choose to decumulate through drawdown will be incumbency. In many cases, the original purchasing decision will not have been made by them as individuals but by their employer choosing their provider to supply a workplace pension. The scope of their decumulation choices, therefore, may well have been dictated by their employer's choice. We imagine that there could be circumstance where their employers will have paid this issue little or no mind.

That being the case, we believe that the customer experience should be reasonably similar between different providers. As such, where providers do not offer all of the pathways, they should enter into an arrangement with another provider to ensure all the pathways are provided.

Q6: Do you agree with the approach we are considering taking on prescription around the investment solution and risk profile of investment pathways? If not, what would you suggest?

Yes.

Q7: Do you agree with the approach we are considering taking on permitting firms to use pre-existing investment solutions to offer an investment pathway? If not, what would you suggest?

Yes.

Q8: Do you agree with the approach we are considering taking on allowing firms to offer investment solutions other than investment pathways? If not, what would you suggest?

We agree with the proposed approach. We think that restricting access to other offerings could, potentially be detrimental over the long term. In more depth, we do not think that drawdown is always going to be the best product for non-advised customers in the medium to long term.

People tend to say that they want a lifetime income, something that non-advised customers may have difficulty obtaining from drawdown. We hope that schemes and providers will innovate in order to provide products that combine the advantages of drawdown with some of the advantages of an annuity. It is therefore important that the pathways do not inadvertently crowd out the development of alternatives to drawdown. As such, we agree with the proposed approach but think that this area will have to be the subject of further thought as new products come to market.

Furthermore, we are aware of some trust based schemes that offer carefully selected decumulation options to both advised and non-advised scheme members. Any regulatory approach needs to

ensure that decumulation options chosen by a trustee are with the interests of their membership in mind are among the first options members are presented with. Scheme members should be able to access the pathways but options chosen by a trustee should come ahead of access to the pathways in the customer journey.

Q9: Do you agree with the approach we are considering taking for the choice architecture to be implemented by firms? If not, what would you suggest?

We have some significant concerns about the outline customer journey suggested by the FCA and included in the flowchart on page 63.

This is for two reasons. First, we suspect that customers may want to spread their capital across more than one pathway. We think that the journey should explicitly recognise this. Therefore, rather than presenting the individual with a choice of three pathways defined as cash, drawdown or income, the journey could also present typical blends between the three pathways. This would enable easy access to both cash and an income.

Second, the journey presupposes that a customer has chosen drawdown over other product options in the absence of advice. We think this is unlikely. We think it is more likely that non-advised customers will present saying “I want to take cash” or “I want to take an income”. In the first instance, the task is to enable those customers to choose between the investment pathways that offer cash. In the second, the task is to enable customers to choose between the relevant investment pathway and an annuity or a combination of the two. At the moment, the customer journey does not enable this sort of comparison.

Q10: Do you agree that investment pathways should also be made available to advised consumers? If not, what would you suggest?

Yes. We feel that non-advised and advised are not permanent states of affairs. A customer may take advice at the point of decumulation and not thereafter – such that they are effectively left to manage withdrawal rates and portfolio rebalancing as, effectively, a non-advised customer. As such, we think that there are situations where advised customers might also benefit from the pathways.

Q11: Do you agree with the approach we are considering taking on how we should define advised consumers for the purposes of the application of our rules on investment pathways? If not, what would you suggest?

Yes.

Q12: Do you agree with the approach we are considering taking in relation to circumstances where consumers are designating funds to drawdown on multiple occasions? If not, what would you suggest?

Yes.

Q13: Do you agree with the approach we are considering taking to require firm review of investment pathways on an annual basis? If not, what would you suggest?

Yes

Q14: Do you agree with the approach we are considering taking for ongoing disclosure to consumers about investment pathways? If not, what would you suggest?

Yes

Q15: Do you agree that we should apply our remedies to the whole of the non-advised drawdown market, including SIPP operators serving this market? What would be the costs and how would the market respond?

If the remedies are not applied to the whole market then the remedy package will create an uneven playing field between those providers subject to the remedies and those who are not. While we do not usually comment on non-workplace pensions, this situation is an exception to that general rule as the workplace/non-workplace distinction is not present in the same way in decumulation as it is in accumulation.

We consider the costs for SIPP operators to be potentially significant but think that these are outweighed by the potential for customer detriment in the market as it stands.

Q16: Do you think we should consider carving out from our remedies those SIPP operators focused on advised consumers and sophisticated investors? If so, how do you think we should do this? Should we consider an alternative proportionate solution?

We are not sure that this is possible. We feel that presenting a clear choice to SIPP operators between only taking advised customers and being exempt from these elements of the remedy package and taking non-advised customers and complying with the remedy package is preferable.

Q17: Do you think that we should limit the scope of application of our rules on the investment pathways? What would be the impact on the SIPP market if we don't limit the scope?

No response.

Q18: What would be the costs and challenges of the different options set out? Are some more likely than others to distort the market? Are there ways to mitigate the impact of this?

No response.

Q19: Would SIPP operators be able to demonstrate that their consumers are advised and/or sophisticated/high net worth investors?

No response.

Q20: How might an appropriateness test work in practice?

No response.

Q21: Should we not apply the remedy to non-advised consumers who have self-selected an investment strategy even though these consumers might benefit?

No. While a given customer's portfolio might have performed poorly in the past, it does not follow that it will continue to do so. We are not sure what would happen were they to be switched into a pathway only for their previous strategy to begin to outperform the pathway.

Q22: Should we instead not require firms with small numbers of non-advised consumers to offer investment solutions for any of the investment pathways, but require them to refer consumers directly to another provider for investment pathways?

We think that this is an appropriate solution provided that there is no immediately visible distinction between the different pathways that might inappropriately influence a customer's decision between them.

Q23: Do you agree that the IGC regime should be extended to investment pathways? If not, what alternative regime would you propose?

Yes. We believe that the IGC regime should be extended to the investment pathways. This is because of the weakness of the buy side in both accumulation and decumulation. Buy side weakness has two components. The first is the principal/agent issue that arises in accumulation as a result of the employer rather than the employee selecting the pension scheme. With over 90 per cent of non-advised drawdown customers remaining with their accumulation phase provider, it is clear that employer's choice of pension scheme, dramatically shapes the employee's choice of decumulation provider. As such, we see the principal/agent issue – one of the main reasons for the IGC regime in the first place – as persisting into decumulation.

The second is that we see significant power imbalance in the relationship between purchaser and provider and argue that a surrogate customer is required in order to advocate for the customer. In the trust based world that is the trustee and in the contract based world that should be the IGC. We see this imbalance resulting variously from low levels of financial knowledge and skill, disinclination to engage, the impact of heuristics and biases on decumulation choice and cognitive decline. An engaged surrogate customer may serve to counterbalance some, if not all, of the potential detriment caused by this power imbalance.

We are mindful, though, that IGCs and trustees are different and that IGCs are purely advisory bodies. We are looking for IGC supervision of decumulation products, in the same manner that IGCs supervise accumulation products. We are not arguing for IGCs to somehow "become" trustees.

Q24: Do you consider that a requirement for independent oversight should apply to other decumulation products (ie not only to investment pathways)? If so, why?

We think that the requirement for independent oversight should be strongly considered for other decumulation products, especially if they are purchased without advice. We think that the two arguments outlined in our response to Q23 may carry over to this question also. We also think that where providers or regulators are deploying innovations, like the pathways, that are grounded in behavioural economics, then a fiduciary or IGC should oversee the arrangement. This is because such innovations typically channel customers towards a particular outcome. It is important that outcome is genuinely in the saver's best interest.

Q25: Do you think we should carve out from the requirement those providers which only provide decumulation products for advised consumers, or those in less need of protection? How would this work?

We believe that there is a case for carving out providers who only provide decumulation products for advised customers. By that, in the case of drawdown, we mean customers who will remain advised through the course of their time in a particular product.

Q26: Do you have any other issues or concerns about the proposals?

No.

Q27: Do you agree with our current thinking that a single, default investment pathway is unlikely to be suitable in drawdown? If not, please provide reasons why you disagree.

Yes.

Q28: Do you agree with the approach we are considering taking to require making investment wholly or predominantly in cash an active choice? If not, what would you suggest?

Yes.

Q29: Do you agree with the approach we are considering taking in relation to mandating warnings to those making an active choice to invest in cash? If not, what would you suggest?

Yes.

Q30: If relevant to you, what have you done – or what do you plan to do – about your current drawdown consumers who have already been 'defaulted' into cash until now, but who are unlikely to be best served by this investment strategy for the remainder of their retirement?

No response.

Q31: Do you think we should require firms to issue warnings to consumers who are invested in cash on an ongoing basis? If not, what would you suggest?

Yes.

Q32: Do you agree with the approach we are considering taking in relation to a minimum limit and the cooling-off period? What minimal limit would you suggest? If you do not agree with the approach we are considering taking, what would you suggest?

We agree with the approach suggested.

Q33: What impact do you think our proposals on preventing 'defaulting' into cash would have on the business models of SIPP operators? Do you think this change would be appropriate?

No response.

Q47: Do you agree that consumers should receive information on actual charges paid expressed as a cash amount?

We agree in principle. We understand, though, that there is a variety of charging practice in the industry and some may be unable to record how much is taken per day per pot in charges. While we agree with the intent, we are concerned that some may simply not be set up to deliver the proposal.

Q48: How do you consider this would best be achieved by firms?

We feel that this proposal should be subject to further consultation. It is not clear to us that this proposal will be fully feasible in the short term, although we agree with the intent. A first step could be to encourage those firms able to comply to comply with the proposal rapidly, while setting a timeline for further compliance.

Q49: What would you estimate to be the cost of these changes?

We have no estimate of the costs.

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