

RETIREMENT OUTCOMES REVIEW: INVESTMENT PATHWAYS AND OTHER PROPOSED CHANGES TO OUR RULES AND GUIDANCE

CP 19/5: PLSA RESPONSE

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THE PLSA

We're the Pensions and Lifetime Savings Association; the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes and over 400 supporting businesses, we are the voice for pensions and lifetime savings in Westminster, Whitehall and Brussels.

Our purpose is simple: to help everyone to achieve a better income in retirement. We work to get more money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

INTRODUCTION

The PLSA believes that the FCA's proposals on investment pathways represent an important first step in improving saver outcomes in the at-retirement market. We agree with the FCA that consumers need further support and protection in the at-retirement market. The FCA's work on the *Retirement Outcomes Review* has highlighted a number of ways in which customers are at risk of sub-optimal and, indeed, adverse outcomes.¹ We believe that the measures outlined by the FCA are a sensible and proportionate response to the issues uncovered by the *Review*.

However, it is important to recognise that the measures set out by the FCA are intended to remedy an immediate problem. In other words, they are calibrated to improve the market as it is now. The FCA's focus on investment pathways principally 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, where many people also have a defined benefit (DB) income to fall back on, and, as a last resort, significant property wealth they could draw an income from.

While this is the state of the market now, we anticipate that consumer needs will change as automatic enrolment (AE) continues to evolve, pot sizes increase, and DB entitlement becomes rarer. Individuals in AE schemes are unlikely to have engaged with their pension saving, as the policy was designed to rely on inertia. It is not clear whether the FCA's investment pathways solution will be appropriate for future cohorts of retirees, who may require different levels of help and support to current retirees.

Moreover, it is unclear that individual drawdown will automatically be the best product for future generations of retirees. When used as a single option rather than in conjunction with other options, such as annuitisation, drawdown has serious risks attached to it. For example, drawdown deals poorly with longevity risk, one of the major issues for those intending to draw an income over the long-term.

Although we believe that the approach set out by the FCA offers a proportionate solution for those savers who decide not to take advice, we do have some specific concerns (see below).

- a. **Assumptions:** Although the present proposal in the FCA's consultation enables savers to plan for different circumstances by enabling them to split their pension pot between different objectives, it continues to presuppose that, in the absence of advice, a customer has chosen drawdown over other product options. We do not think it likely that customers would make this sort of product choice.
- b. **Allocation:** Rather than presenting the individual with a choice of pathways defined as, for example, cash, drawdown, or guaranteed income, we believe that savers would prefer a blended product offer. The typical customer journey could, for instance, present information on the typical blends between the three pathways to enable savers to make an informed choice. This would also enable easy access to both cash and an income.

¹ FCA, *Retirement Outcomes Review: Final Report*, (2018).

- c. **Support:** There is a wider policy issue regarding the appropriateness of savers making drawdown decisions on a non-advised basis, which the FCA consultation does not address. Where decisions are made on a non-advised basis, the quality of the support provided clearly becomes paramount.

The FCA's proposed investment pathways policy is aimed at savers in contract-based schemes who, having received prompts to take advice or guidance, decide to access their pensions through drawdown without taking advice. However, recent PLSA research suggests that more scheme members are opting to stay in the trust-based environment post-retirement, rather than transferring to individual personal pensions or annuities.² Over the course of 2019, the PLSA will be carrying out further work aimed at understanding the legislative and regulatory framework appropriate for trust-based DC decumulation.

² PLSA, *The Evolution of Drawdown: At-Retirement Choices in Trust-Based DC Schemes* (2019).

CONSULTATION QUESTION RESPONSES

1. 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?

We believe that it is appropriate for all non-advised savers to be offered an investment pathway if they move all or part of their pension savings into drawdown and/or if they transfer funds from an existing drawdown arrangement into a new drawdown product. These arrangements will provide a much higher degree of consumer protection than is present in the market today.

We agree that investment pathways should not apply where a saver takes an UFPLS and takes an active decision to keep their remaining savings in their accumulation vehicle. However, we are concerned that it might not be clear to savers what the difference is between, on the one hand, taking an UFPLS and, on the other hand, the FCA's proposed option 4 ('I plan to take out all my money within the next 5 years') with flexi-access drawdown. We would like to see the FCA provide greater clarity about the intended differences.

Where a saver selects an investment pathway, but takes only part of their tax-free cash entitlement and does not designate how they want to take future cash (tax-free) and drawdown income, we believe that it is essential that they undertake the full investment selection process.

2. 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?

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 agree with the FCA that all drawdown providers should be required to provide access to investment pathways in some form. If they are not applied to the market as a whole, then the remedy package will create an uneven playing field between those providers who are subject to the remedies and those who are not.

If an exception were to be made for SIPP operators, savers in these vehicles could, potentially, receive worse outcomes than savers in workplace pension schemes simply as a result of the type of scheme they are in. This situation would be unacceptable and non-trivial, given the number of savers in a SIPP who enter drawdown without taking advice.³

We do not believe that it is possible for providers to differentiate between 'sophisticated' non-advised customers and other types of saver. As a result, we agree with the FCA's conclusion that SIPP providers should not be permitted to offer drawdown solutions to some non-advised savers on this basis alone. We feel that presenting a clear choice to SIPP operators between, on the one hand, only taking advised customers and being exempt from the requirement to offer investment pathways and, on the other hand, taking non-advised customers and complying with the remedy package is preferable.

In the absence of this clear distinction, the FCA's proposal that SIPP providers with a small number of non-advised savers could direct them elsewhere rather than offer investment pathways themselves appears, to us, to be a reasonable compromise. However, there needs to be clear and transparent

³ The FCA found that 36% (35,000) of plans went into drawdown without the consumer taking advice in the 3 years following the introduction of the pension freedoms. Moreover, 18% of non-advised SIPP customers who entered drawdown are highly invested in cash.

governance surrounding the choice of the provider of the alternative investment pathways, so that savers are able to select the option that suits their needs best.

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

We believe that the FCA's objectives approach to the investment pathways is clear and appropriate. It will present non-advised savers who have chosen to enter drawdown with a range of options that are clearly differentiated. The addition of a fourth objective ('I plan to use my money to set up a guaranteed income within the next 5 years') is also welcome, particularly as the FCA's research shows that the inclusion of this objective improves savers' understanding of the distinction between a guaranteed retirement income and drawdown.⁴ This is an essential distinction.

The inclusion of a defined timeframe (5 years) over which savers are 'nudged' to consider their investment options is welcome. People's circumstances change over the course of retirement, as they do pre-retirement, and, consequently, their income requirements may also change. For example, some savers may need to prepare for circumstances in which they will no longer be able to take effective financial decisions and, therefore, will require a guaranteed income. The 5 year timeline of each investment pathway and the review process that the FCA has outlined⁵ provide a framework within which savers can consider these issues.

Given that these pathways will be rolled out across the market and, in some circumstances, savers will be referred by the provider of their accumulation vehicle to suppliers of investment pathways, consistency in the presentation of these pathways is essential to promote good understanding amongst customers of their options. As a result, we agree that the FCA is right to prescribe the wording of the investment pathways and the order in which they are presented to savers.

4. Do you agree that providers should only be able to offer 1 pathways solution for each investment pathway objective?

We agree with this proposal. It is important that the investment pathways are clearly recognisable to savers, based on the objective that they have selected. It is also important that the four proposed investment objectives are sufficiently different to avoid confusion between investment pathways. Multiple pathways for the same objective would blur the lines between different objectives. This would not help savers.

5. 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?

It is not clear whether the choice architecture will lead to scenarios where providers are giving unintended personal recommendations or not. As stated in the FCA's proposals, the customer will have to meet application criteria first, which may involve a degree of personalisation, and state an objective before being offered the investment pathways which may or may not sit alongside non-pathway solutions.

As the proposals are currently written, the provider is then meant to give several nudges in the direction of the investment pathways solutions over the non-pathway solutions. We appreciate that

⁴ FCA, *Retirement Outcomes Review: Investment Pathways and Other Proposed Changes To Our Rules and Guidance* (2019).

⁵ Guidance that if the consumer has not made any changes to their investment pathway in the 5 years since entering it, or after a further 5 years has elapsed, their provider should consider including in the next annual statement they are due to receive a statement reminding the consumer that 5 (or 10, as relevant) years has elapsed since they selected the investment pathway.

the ‘Perimeter Guidance’ that is due to follow this consultation will set out examples of how this may work in practice, but without exemptions written into regulations and/or legislation, this may leave the choice architecture open to the challenge that providers are offering unregulated advice.

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

Yes. It is important that the investment pathways are sufficiently different such that the objectives of the individual pathways can be achieved.

7. Do you agree with our proposed rules on labelling of pathways solutions?

Yes. It is essential that non-advised savers are clear about the four investment pathways designed specifically to suit their needs as customers who have chosen not to take advice. If other investment solutions were labelled in a way which was similar to the investment pathways, there would be a very real risk that savers could inadvertently choose a strategy ill-suited to their needs.

8. 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?

Yes. 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 circumstances where their employers will have paid this issue little or no attention. 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 – otherwise, the proposed remedy package will not work as intended.

9. 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?

In principle, we agree that an easement for small providers is a practical proposal, given the evidence that only a small proportion of non-advised customers that go into drawdown are in such schemes. However, the FCA will need to monitor the use of this easement carefully to ensure that it is not being abused.

For example, we are concerned that a corporate parent might be able to circumvent these rules by setting up subsidiary advisers, each of which could be limited to less than 500 non-advised consumers. In this case, each subsidiary would qualify for the easement even though the corporate group could have a much larger number of non-advised consumers. We would like the FCA to set out how it plans to prevent this sort of behaviour from taking place.

The qualifying threshold (fewer than 500 non-advised customers entering drawdown a year) appears to be sensible, given that 90 per cent of non-advised customers who go into drawdown are with providers who have 500 or more such savers.⁶

⁶ FCA, *Retirement Outcomes Review: Investment Pathways and Other Proposed Changes To Our Rules and Guidance* (2019).

10. 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?

Good product governance is essential to the quality of solutions delivered to savers. Consistent standards across the market are essential to ensure proper consumer protection is in place and that savers receive equivalent treatment no matter what type of provider they source their decumulation product from.

As a result, we agree with the FCA's proposal to extend its PROD 4 rules beyond insurers and intermediaries to providers of arrangements that do not take the legal form of an insurance contract. This accords with the spirit of the FCA and TPR's Joint Regulatory Strategy, one of the aims of which is to improve consistency between contract- and trust-based pensions.⁷

However, we believe that distributors should have to review their choice of investment pathway solutions annually (in line with manufacturers), rather than every 2 years as FCA proposes.

11. 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?

We agree with the FCA's approach to this issue, particularly the statement reminding them of the current size of their drawdown pot in pounds and pence. The accurate and simple presentation of this information accords with the PLSA's work on the Simpler Annual Statement, which aims to improve savers' understanding of their retirement savings.

Moreover, as we stated above, people's circumstances change over the course of retirement and we believe that it is appropriate for providers of investment pathways to include information on other investment pathways in their annual statement, as well as a reminder that they can switch their strategy at any time.

12. Do you agree with our proposed approach for the records providers should keep?

No response.

13. Do you agree with our implementation timeline?

Yes. We feel that although these proposals will take significant resource for providers to implement, it is appropriate for investment pathways to be implemented as soon as is practicable. Consequently, we believe that it is appropriate to require that providers make such solutions available to customers by the end of July 2020.

14. Do you agree with our proposals to ensure cash investment is an active choice?

Yes. We have long argued that this should be the case, most recently in our *Hitting The Target* report.⁸ We also agree with the FCA's assessment of what constitutes 'predominantly' invested in cash (50 per cent or more of the saver's drawdown pot).

15. 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?

⁷ FCA, TPR, *Regulating The Pensions and Retirement Income Sector: Our Joint Regulatory Strategy* (2018).

⁸ PLSA, *Hitting The Target: A Vision For Retirement Income Adequacy* (2018).

Yes. These are appropriate warnings to ensure that customers are aware of the risks of investing in cash.

16. Do you agree with our proposals on the ongoing warning around investment in cash?

Yes. In particular, we feel that it is essential that providers regularly communicate the risks of remaining invested in cash. We are, therefore, pleased that the FCA is proposing a review mechanism (12 month period) that will prompt savers to reconsider their investment choices.

17. Do you agree with our proposed approach for the records providers should keep?

No response.

18. 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.

19. 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. In the spirit of presentation of information about savers' pensions in the simplest possible form, we are pleased to see that the FCA will require this information to be presented in pounds and pence.

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

Given the complexities that the FCA has identified, we agree with the proposal that no particular methodology should be specified.

21. 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.

22. Do you agree with our implementation timeline?

Yes.

23. Do you have any comments on our cost benefit analysis?

No response.

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