Retirement Outcomes Review
Final report

MS16/1.3

June 2018

How to respond

In this final report we set out our final findings of the Retirement Outcomes Review.

Please send any queries to:
Nir Reshef
Competition and
Economics Division
Financial Conduct Authority
25 The North Colonnade
London E14 5HS

New address from 1 July 2018:
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Email:
RetirementOutcomes@fca.org.uk

How to navigate this document onscreen

returns you to the contents list

Contents

1 Executive summary

Introduction

1.1 Deciding how to use pension savings is one of the most important financial decisions people will make. The government's 2015 pension freedoms provided more flexibility in how and when consumers can access their pension savings. At the same time, the freedoms require consumers to make more complicated choices about their retirement. These include important decisions on how to invest their pensions pots, when to withdraw income (and at what level), and the need to consider longevity risks.

1.2 The pensions and retirement income sector provides a way for 34 million consumers[1] to save for retirement or later life (accumulation), and to then convert their savings into retirement income (decumulation). It is early days and the market is still evolving as providers adapt to the pension freedoms. Defined Contribution (DC) pots are still relatively small for most current retirees and are often not their main source of retirement income. However, Defined Benefit (DB) schemes have been declining over a number of years and automatic enrolment has increased the number of people saving into DC pots. As a result, many consumers will rely increasingly on DC pots as a major source of retirement income over the medium and long term, alongside their state pension and any property wealth or savings.

1.3 In June 2016 we launched the Retirement Outcomes Review (ROR). We wanted to assess how the market is evolving, to address any emerging issues that might cause consumer harm and to put the market on a good footing for the future. We are taking action based on the evidence of how the market is working now, while recognising that the market will change over time as DC pots become larger and the primary source of retirement income for many. This may increase both consumer engagement and incentives for product innovation. The measures we are outlining here are therefore about dealing with current and near term issues. We are acting now to help consumers make informed choices and protect the less engaged from poor outcomes, but we will continue to watch this market closely as it evolves and take further action as needed.

1.4 Our review focuses primarily on consumers who do not take regulated advice ('non-advised consumers'), on the basis that those taking regulated advice receive support already. However, regulated advice is not affordable or appropriate for everyone, and this review focuses on those who will look to their pension provider or public sources for support and guidance around their retirement decisions.

1.5 This review is part of a wider package of FCA activity covering the pensions and retirement income sectors. This includes our work on a joint pension strategy with The Pensions Regulator (TPR), our on-going efforts to help consumers avoid investment and pension scams through ScamSmart, and work on DB pensions transfers to assess the advice consumers are receiving from firms and whether they are at risk of harm.

1 Regulating the pensions and retirement income sector: Our strategic approach, Joint call for input by the FCA and The Pensions Regulator; https://www.fca.org.uk/publication/call-for-input/call-for-input-regulating-pensions-retirement-income-sector.pdf

Findings

1.6 In July 2017, we published our interim report. It summarised our interim findings, and presented a range of potential remedies for discussion. We have since undertaken further work to assess the extent of harm in the market, particularly focusing on investment choices and charges in drawdown. We summarise our key final findings below, based on both the work done for the interim report and since.

Many consumers have welcomed the pension freedoms

1.7 Many consumers have welcomed the pension freedoms and the ability to access their savings in ways they previously couldn't. From the introduction of the pension freedoms in April 2015 to September 2017, over 1.5 million DC pension pots have been accessed. Most (72%) consumers who accessed their pots did so before the age of 65. And over half (55%)[2] of all pots accessed were fully withdrawn. These were mostly small pension pots (88% below £30,000), and **nearly all (94%) those who fully withdrew had other sources of retirement income**.[3] Over half (52%) of the fully withdrawn pots were not spent but were transferred into other savings or investments.

1.8 Since the pension freedoms, we have seen substantial shifts away from annuities and towards taking drawdown without advice. **Twice as many pots have been used for drawdown than to buy an annuity**. A third (32%)[4] of these were accessed without advice, compared to 5% before the freedoms.

1.9 We have seen that many consumers, particularly when focussed on taking their tax-free cash, take the "path of least resistance" and enter drawdown with their existing provider. We expect levels of engagement to increase over time as pot sizes grow.[5] However, as pots become bigger, those who do not engage effectively could lose out on income in retirement, through poor investment choices or paying higher fees and charges.

1.10 While commentators have flagged the risk of consumers drawing down their pension wealth at unsustainable rates, we have not at this stage seen much evidence of this. However this is clearly something to watch, particularly as pot sizes increase and DC pension savings become a more central part of many consumers' pension wealth.

Consumers need further support and protection

1.11 For many, retirement income choices start with a decision to access tax-free cash rather than other questions. At that point, consumers face a range of complex decisions such as which provider to use, where to invest their remaining pot and how quickly to drawdown. They also need to think about how long they expect to live. We found many consumers who do not take advice struggle with these decisions, and many end up in investments that may not be right for them, including in cash.[6]

1.12 **Our research[7] found that around one in three consumers who have gone into drawdown recently are unaware of where their money was invested**. Others only had a broad idea.

2 Retirement income market data. Of the total number of pots accessed for the first time since October 2015.

3 Our research was with consumers who had withdrawn a pension pot worth at least £10,000 without taking regulated financial advice. See the interim report and annex 4 for further details.

4 Retirement income market data. Of the total number of pots accessed for the first time since October 2015. We publish these data on a periodic basis - www.fca.org.uk/publications/data/data-bulletin-issue-12

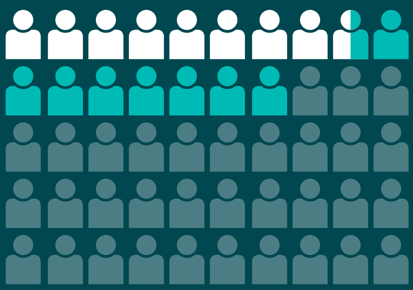
5 See the Australian case study in chapter 5 for detail.

6 See details of our analysis and findings in chapter 3 and 4.

7 See further details in chapter 3.

More than 60% of consumers not taking advice were not sure or only had a broad idea of where their money was invested

1.13 We saw that some providers were **'defaulting' consumers into cash or cash-like assets**.[8] Overall 33% of non-advised drawdown consumers are wholly holding cash. Holding funds in cash may be suited to consumers planning to drawdown their entire pot over a short period. But it is highly unlikely to be suited for someone planning to draw down their pot over a longer period. We estimate that over half of these consumers are likely to be losing out on income in retirement by holding cash.[9]



1/3

of consumers not taking advice in drawdown are entirely in cash.

Over half

of these are at risk of losing out by being in cash.

Source: FCA data and analysis

1.14 Someone who wants to drawdown their pot over a 20 year period could increase their expected annual income by 37% by investing in a mix of assets rather than just cash.[10]

Consumers in cash could get an income from their pot up to 37% higher over 20 years by moving to a mix of assets

1.15 Our evidence also suggests that if firms offer consumers a more structured set of options – making the decision simpler to navigate – it can improve the investment outcomes for consumers, better aligning with their objectives in retirement.

1.16 We are also concerned about the high proportion of consumers fully withdrawing their pension pots to move savings elsewhere. In many cases, keeping money in a pension would have resulted in better returns, on average, and in paying less tax.[11] Some consumers might also lose out on employer contributions and other benefits as a result. We found this behaviour was partly driven by a lack of trust in pensions, stemming from a range of factors including past pension scandals (where consumers tend not to distinguish between DB and DC) and frequent changes to pension rules and tax treatment.

Competition is not working well for some consumers

1.17 We also found **weak competitive pressure and low levels of switching** in the non-advised drawdown market, and looked at whether this might drive higher prices and less innovation. Comparing the behaviour of advised and non-advised consumers presents a starkly different picture. 94% of consumers who accessed their pots

8 This includes direct holdings in cash and holdings in cash-like assets, such as money market funds or short-dated maturities. In some cases, we will refer to cash and cash-like assets as 'cash', for simplicity.

9 We estimate that there are around 50,000 non-advised consumers wholly holding cash, with more than half at risk of losing out.

10 See details in chapter 4. We have assumed an asset mix of 50% equities, 20% government bonds, 20% corporate bonds, 7% property and 3% cash. For a consumer with a pot of £100,000 this would be an extra £1,500 per year.

11 Our consumer research found that many consumers (32%) put the majority of their money in an ISA, savings or current account. 20% invested the largest share in capital growth. See chapter 4 of the interim report, and the consumer research commissioned by the FCA, annex 4 of the interim report.

without taking advice accepted the drawdown option offered by their pension provider, compared to only 35% of advised consumers.[12]

1.18 Given this lack of competitive pressure, we are concerned that consumers might **pay too much in charges**. Our analysis found that charges for non-advised consumers vary considerably from 0.4% to 1.6% between providers, and are, on average,[13] higher than in accumulation (where in some cases they are capped at 0.75%).[14]

We found charges vary from 0.4% to 1.6%

By switching from a higher cost provider to a lower cost provider, consumers could increase their annual income by 13%.[15]

Some consumers could increase the income from their pot by up to 13% by switching to providers with lower charges

1.19 **Drawdown charges can be complex, opaque and hard to compare**. Products can have as many as 44 charges linked to them. This makes it difficult for consumers to compare products and shop around for the best products, which contributes to the limited competitive pressure on providers to offer good deals. Similarly, our review of non-advised drawdown pensions, published in March 2018[16] **found that some consumers struggle to fully engage with the information providers give them**. This might make it harder for them to make good decisions.

Drawdown products can have as many as 44 charges

1.20 **So far, we have not seen significant product innovation for mass-market consumers**. This too might result from weak competitive pressure, coupled with the fact that the market is still adjusting to the pension freedoms. However, we believe that incentives for innovating will increase over time as DC pot sizes grow. We want to give the market more time to develop before we consider the need to take further action on product innovation, but this will be a key focus for our ongoing work.

Proposed remedies

1.21 The interim report set out proposals for potential remedies and asked for views on them. We have considered the responses received as a result and undertaken further work to develop a package of remedies.

1.22 Our remedy package aims to address the harms and emerging issues we have identified. It balances the need to protect consumers and improve competition in the market, with allowing the market to further develop and innovate. The package

12 FCA analysis of ABI data, April 2015 – March 2017. Based on the analysis conducted for the interim report. See Figure 5 and annex 2 of the interim report.
13 See further details in chapter 4.
14 The charge cap applies to certain DC workplace pensions schemes used by employers to meet their automatic enrolment duties.
15 When consumers consider switching providers or products, they may assess a number of criteria, including fund performance, firm reputation, level of service, charges, etc. The 13% increase in income is due to the impact of charges only. It assumes that investments are identical, and that the consumer looked to fully drawdown their pot over 20 years. For an individual with a pot of £100,000 this would be an extra £650 a year.
16 www.fca.org.uk/publications/multi-firm-reviews/non-advised-drawdown-pension-sales-review-summary-findings

includes a combination of FCA rules and guidance, subject to consultation and cost-benefit analysis, and some joint initiatives with other stakeholders.

1.23 Our remedy package aims to:

- **protect consumers from poor outcomes**
- **improve consumer engagement with retirement income decisions**
- **promote competition by making the costs of drawdown clearer and comparisons easier**

1.24 We are consulting on most of these remedies in CP18/17, which is published alongside this report, and sets our proposals in detail. For some of the remedies in our package, we are seeking further views on their design to ensure they are as effective as possible, before consulting. So, as part of our Consultation Paper (CP), we are including a discussion section (DP) on these remedies. In that section, we are looking for views on a key part of the package which would require firms to provide three investment pathways that meet the main needs of many consumers, to help them make more informed choices about their retirement pot.

1.25 We are also committed to improving trust in markets. While our remedies should build trust by better informing consumers and by preventing potential harm, they will not and cannot address all of the factors that influence the public's view of pensions. We will continue to work with the Government, TPR, industry, consumer groups and public providers of guidance to build trust in pensions.

1.26 Our package of remedies aims to help and protect consumers at each stage as they move through their retirement income choices. Most of these remedies take effect at the point that consumers first access their pot. But consumers also need better information – including signposting to appropriate guidance – at an earlier point in the journey, so they can start to think about planning their retirement income before they are faced with an immediate decision. Decisions about retirement income also need review over time as circumstances can change. So we are proposing that consumers get ongoing communication to help them check that their choices continue to match their objectives.

Before consumers access their pension savings – better communications, support and guidance

1.27 Before consumers access their pension savings, we want to improve the effectiveness of consumer communications and ensure consumers access the support or guidance they need.

'Wake up' packs from age 50 with a one page 'headline' document

1.28 We want the 'wake-up pack'[17] to reach consumers at the right time to inform their decision, and we want the pack to be useful. So we propose to require that 'wake-up' packs:

17 'Wake-up pack' refers to information sent to consumers before they decide which retirement income product(s) to purchase.

- **Incorporate a one-page 'headline' document**,[18] in clear and accessible language. Research suggests that this increases consumer engagement.[19]
- **Are sent earlier in the process**, from age 50, to improve consumer engagement.

1.29 It is important that consumers are aware of the key risks around pensions before they decide how they want to access their pension pot. We are consulting on rules that will require that **'wake-up' packs include risk warnings**, from age 50 onwards.

1.30 Consumers will receive a pack at age 50 and then every 5 years until they have accessed their pension savings. This will provide additional trigger points for consumers to engage with their pension decisions. Testing showed that these changes had a positive impact on consumers' engagement with their pension savings and readiness to seek guidance.

Improving guidance for consumers

1.31 Consumers can look for support from a number of sources including a regulated advisor, their employer, their pension provider, or public sources including Pension Wise. The FCA's priority is to ensure that consumers get the support they need. For some this may come from regulated advice. For others, for example those with smaller pots, this may come from the information given by their provider or from free guidance from Pension Wise.

1.32 Providers are currently required to signpost consumers at various stages to Pension Wise and recommend that they seek appropriate guidance or advice to help them understand their options. The question of whether guidance – or referral to guidance – should be compulsory has been widely debated in recent months. This is particularly in light of the impending merger of Pension Wise, The Pensions Advisory Service and the Money Advice Service into a Single Financial Guidance Body (SFGB) and the passage of the Financial Guidance and Claims Bill (the Bill), which gives legal effect to the SFGB.

1.33 In our work on the ROR, we considered whether consumers should be required to seek Pension Wise guidance before accessing their pension savings (or whether providers should be required to refer consumers to Pension Wise guidance).[20] In their December 2017 report[21] on protecting pensions against scams, the Work and Pensions Committee recommended a system of default guidance for consumers exercising their pension freedoms. The report explained that this recommendation was one of the Committee's priorities for the Bill.

1.34 The Bill has now become the Financial Guidance and Claims Act 2018 (the Act). The Act requires us to make rules providing that, before proceeding with an application to access or transfer a consumer's pension savings, firms must ensure that the consumer has either received appropriate pensions guidance or opted-out of receiving it.

1.35 The Act gives the FCA discretion in certain areas. For example, the Act says we may make rules specifying what constitutes appropriate pensions guidance, and to potentially exempt some consumers, such as those with small pots. This gives

18 Some refer to this as the 'pension passport'.

19 Improving engagement with pension decisions: The results from three randomised controlled trials, a report prepared by the Behavioural Insights Team for the Government's Pension Wise service; October 2017; http://www.behaviouralinsights.co.uk/publications/improving-engagement-with-pension-decisions-the-results-from-three-randomised-controlled-trials/

20 See paragraph 8.60 of the interim report.

21 https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/404/404.pdf

us the opportunity to consider how guidance can best be delivered to maximise take-up and impact, and whether some consumers might benefit from an alternative approach. Further, the Act says we may make rules about how, and to whom, a consumer indicates they have received or opted-out of pensions guidance. Therefore, we need to consider whether the consumer should indicate their decision to opt-out to the SFGB or their pension provider.

1.36 The Act requires us to consult with the SFGB before consulting on rule changes. We will be discussing these issues with the SFGB once it is formed. In the meantime, working with Government, we will look to test various approaches in order to ensure that our rules support consumers effectively.

1.37 Once we have consulted with the SFGB we will be saying more, but our aim will be to ensure consumers get consistent, high-quality guidance.

Government should consider the merits of 'decoupling' tax-free cash from other pension decisions

1.38 We would encourage the Government to consider the merits of 'decoupling' tax-free cash from other pension decisions. Currently, some consumers who want to take a tax-free lump sum need to transfer out of their accumulation product and buy a new product with a drawdown feature. Many consumers focus solely on taking their tax-free cash at this time and do not engage with the decision of what to do with the rest of their pot. Separating the decision to take the tax-free cash from the need to move into drawdown will let consumers put off deciding what to do with the rest of their pot, until they are ready to focus on it. However, this would require major changes to the pension tax regime and we recognise that there are detailed policy and practical issues which the Government would need to consider.

At the point of entering drawdown or buying an annuity – investment pathways

1.39 At the point consumers enter drawdown they need to achieve two things. First, they need to decide what they want to do with their pension pot and what kind of investment solution is appropriate for that. Second, they need to get a good deal on their drawdown solution.

1.40 Our evidence suggests that a more structured set of options would help consumers engage with their investment decision, consider their retirement objectives, and match their drawdown solution to these. So we think that **providers should offer three ready-made drawdown investment solutions ('investment pathways') within a simple choice architecture**.

1.41 These investment pathways are intended to be broadly appropriate for consumers with fairly straightforward needs, which reflect the following standardised consumer objectives:

- I want my money to provide an income in retirement
- I want to take all my money over a short period of time
- I want to keep my money invested for a long period of time and may want to dip into it occasionally

1.42 We want drawdown options to be good value for money. Charges are only one factor in determining value for money, but they are a key component. In our interim report we discussed the possibility of introducing a charge cap for the investment pathways, an option also discussed by the Work and Pensions Committee.[22]

1.43 The option of capping charges remains open. We expect firms to develop investment pathways with consumers' best interests in mind, including appropriate charge structures and levels. At this point, however, we do not know what the "right" price for such pathways is. Firms should challenge themselves on the level of charges and use 0.75% on default arrangements in accumulation as a point of reference. For this reason, we plan to **review investment pathways, including the charges applied to them**, one year after implementation. If at that point we find evidence that firms are charging excessively, we will be highly likely to move towards a cap.

1.44 We also believe there is a case for **independent oversight** of the appropriateness, quality and charges of investment pathways, and are exploring this now as part of our CP.

1.45 To protect consumers from ending up in investments in drawdown that are unlikely to be appropriate for their retirement plans, we propose that new **consumers accessing drawdown will have to make an active choice to be in cash**. Some providers have already taken positive steps to review and change their practice in this respect. We expect firms to have a strategy for dealing with consumers who have already been defaulted into cash, and who are unlikely to be best served by this strategy. We are also considering requiring firms to regularly communicate warnings to consumers who hold cash for significant periods.

1.46 To help consumers compare their drawdown solution we propose to require that firms provide a summary showing key information at the front of the Key Features Illustration (KFI) that consumers receive, including **a one-year charge figure in pounds and pence** which is comparable across KFIs.

1.47 We are also working closely with the Money Advice Service (MAS) and the Association of British Insurers (ABI) to **develop a drawdown comparator tool**. MAS are currently tendering for the development of the tool and we continue to work together on the development of the tool. This tool will help consumers shop around and switch providers.

1.48 Our package of remedies does not only affect those consumers opting for drawdown. At the point that a consumer is considering purchasing an annuity we also want to **ensure that consumers are aware of their eligibility for an enhanced annuity**. Following feedback to the interim report, we propose to require providers to ask consumers simple questions on health and lifestyle factors to assess their eligibility for an enhanced annuity. Providers will then present their quote alongside the highest quote available on the open market for an enhanced annuity.

1.49 We will also require providers to provide information on the best quote available in the open market when consumers are seeking a specific annuity income ('income driven annuity quote').

Once a consumer has entered drawdown

1.50 Once a consumer has entered drawdown they still need information and support.

22 www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/inquiries/parliament-2017/pension-freedoms-17-19/

1.51 We believe that **consumers in drawdown should receive information from their provider annually**, whether or not they are currently drawing an income from their pot. Currently some do not, and for many who do, no information on investment returns or annual charges is given.

1.52 We also believe consumers should be reminded annually of their chosen investment pathway and their ability to switch, to encourage the consumer to consider whether the investment pathway they are in is still appropriate for them.

Next steps

1.53 Alongside this final report, we are also publishing a CP on our package of proposed remedies.

1.54 For some of the remedies in our package, we are seeking feedback from stakeholders but not consulting on rule changes at this time. This is because these remedies represent significant interventions in an evolving market and we want to seek further views on their design to ensure they are as effective as possible before consulting. Also, we want to gather more evidence on how the remedies in this area would apply to the whole of the drawdown market, including Self-Invested Personal Pensions (SIPPs). We are therefore including a DP on these remedies as part of our CP.

1.55 Preventing poor outcomes in the pensions and retirement income market is an important priority for the FCA. The market is still evolving, and it will be some years before most people are primarily reliant on a DC pot for their retirement income. We have identified harms and emerging issues that we are keen to address promptly, so the market is on a good footing for the future. This is why, for instance, we are asking for responses to the discussion questions within 6 weeks. For proposals we are consulting on in this CP, we will consider the feedback received and publish our finalised Handbook text in a Policy Statement in January 2019. For the areas we have raised for discussion, we will consider the feedback received – and whether we need to refine these – and will consult in January 2019.

1.56 We will also hold a pensions 'TechSprint' later in the year to encourage innovation in how firms engage with their customers over these decisions. The event will challenge tech providers and industry to come up with innovative approaches that have a demonstrable impact on effective decision-making.

2 Developments in the pensions market

Chapter Summary

In this chapter, we set out the recent relevant developments in the pensions market since we published our interim report in July 2017. These developments have fed into our thinking on the proposed remedies.

Market developments
Consumers continue to use the freedoms, and full encashment is the most popular option. The vast majority of fully withdrawn pots (88%) continue to be relatively small (under £30k). As before, around 30% of drawdown sales are non-advised. We have also seen a further reduction in the number of open market annuity providers.

Innovation in the market
Product innovation remains limited. Some providers have done more to help their non-advised consumers in making decisions. We have seen some larger providers develop tools and guidance to help consumers with this, and to try and simplify drawdown for them.

Regulatory developments
In annex 2, we provide details of recent regulatory develoments in the pensions and retirement income market.

Market developments

2.1 We monitor the pensions market on an on-going basis and analyse relevant data from providers to identify emerging trends and potential concerns. We have revisited some of the analyses and findings from our interim report and updated them to reflect any changes in the year since its publication.

2.2 We found that the trends we identified in the interim report have continued in the year since we published it. So our findings and concerns remain relevant. Consumers continue to use the freedoms, and most of those who have decided to access their pensions pots have done so early, before the age of 65. Many of these consumers have fully withdrawn their pots. Also, drawdown has continued to be much more popular than annuities.

Update on how consumers have responded to the pension freedoms

Product and option choices

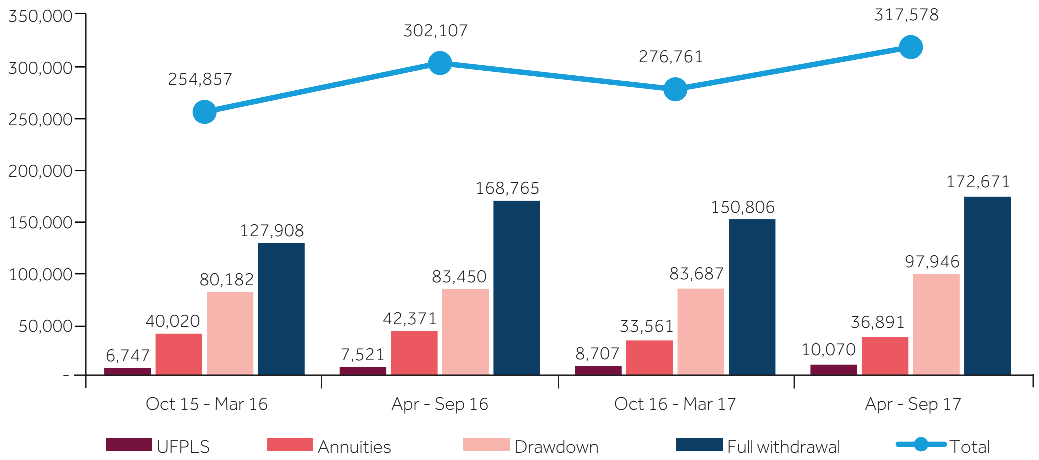
2.3 Our analysis of the retirement income market from our Retirement Income Market Data (RIMD) shows consumers continue to use the pension freedoms. Nearly 600,000 pension pots have been accessed for the first time in the year from October 2016 to September 2017, an increase of around 7% on the year before.[23]

2.4 The figure below shows how many pots consumers accessed for the first time, from April 2015 to September 2017, and the products and options they choose.

23 FCA analysis of the retirement income market data collected from 56 providers.

2.5 Overall, over half (54%) of those who have accessed pension pots for the first time between October 2016 and September 2017 withdrew these pots completely. The second most popular option was to go into drawdown, followed by annuities and uncrystallised fund pension lump sum (UFPLS). This continued the trend from the previous year between October 2015 and September 2016.

Figure 1: Product and option choices made by consumers who accessed their DC pots for the first time, October 2015 – September 2017

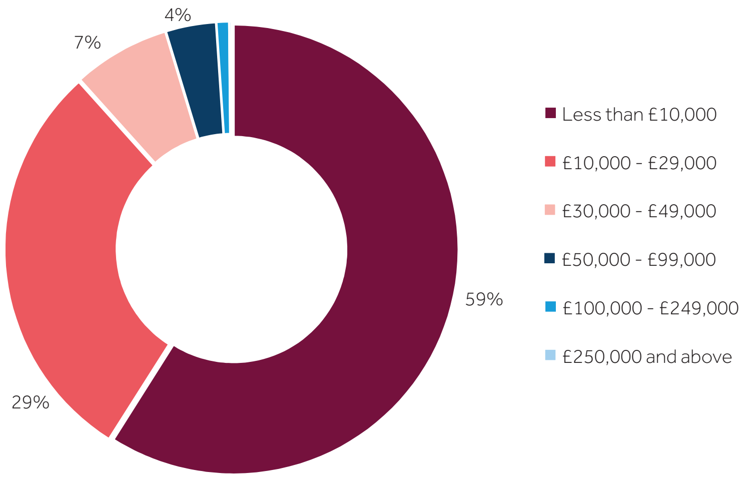


Source: FCA analysis of retirement income market data collected from 56 providers

Sizes of pots that were fully withdrawn

2.6 The vast majority of pots that were fully withdrawn remained relatively small. 88% of them were smaller than £30,000, with nearly 60% of all pots smaller than £10,000. This continues the trend identified in the interim report.[24]

Figure 2: Sizes of pots that were fully withdrawn after the pension freedoms, October 2015 – September 2017



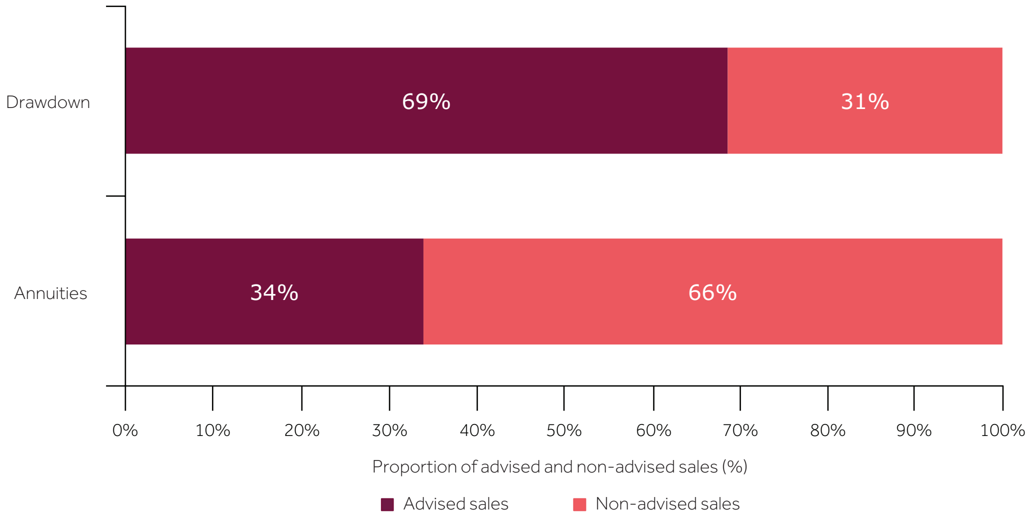
Source: FCA analysis of retirement income market data collected from 56 providers

24 90% of pots fully withdrawn between October 2015 and September 2016 were smaller than £30k. See Figure 13 in the interim report.

Advised and non-advised drawdown and annuity consumers

2.7 Between October 2015 and September 2016, sales to non-advised consumers accounted for 63% of annuity sales and 30% of drawdown sales (Figure 14 in the interim report). Before pension freedoms only 5% of consumers accessing drawdown did so without taking advice.[25] This trend remained largely unchanged in the year between October 2016 and September 2017, with 31% of drawdown sales made to consumers who did not take advice compared to 66% for annuity sales.

Figure 3: Proportion of advised and non-advised sales for drawdown and annuities, October 2016 – September 2017



Source: FCA analysis of retirement income market data collected from 56 providers

Note: these data were not available for the full two years and so we have presented only October 2016 – September 2017

Number of open market annuity providers

2.8 We mentioned in the interim report that several providers, mainly the large insurers, have withdrawn from the open annuity market. We noted that there were several factors that contributed to this reduction in the number of providers,[26] including that some consolidation was to be expected due to lower demand. We decided to continue to monitor this market but did not propose further intervention at that stage.

2.9 In July 2017, seven providers still offered annuities on the open market. As of April 2018, five providers are still doing so.[27] This must be seen in the context of an overall decline in demand for annuities, and many of the providers that have withdrawn from the open market are still offering annuities to their existing customers. We are therefore not proposing to take any direct action in relation to the number of open market annuity providers. However, we want to ensure that the open market remains competitive.

2.10 We are consulting on measures to enhance shopping around for annuities by ensuring that consumers see the difference between the providers' quote and the market leading quote when they request a quote for an annuity for a specific income. We also propose extra requirements to promote shopping around for enhanced annuities. These would require providers to ask consumers basic questions about their health

25 Retirement Outcomes Review interim report, 2017: www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report.pdf

26 See chapter 5 of the interim report for further details.

27 Source: Moneyfacts, UK Personal Pension Trends Treasury Report, Q1 2018.

and lifestyle and use this information when generating the best open market quote for comparison (see chapter 5 for further details).

Innovation in the market

Product Innovation

2.11 In our interim report, we found that product innovation has been limited since the pension freedoms. We said we expected to see development of new products for mass market consumers that combine drawdown flexibility with guaranteed income (as in annuities or deferred annuities).

2.12 We have seen little evidence of this happening, and product innovation in the market continues to be limited. The exception to this is the development of niche products that combine guaranteed income and flexi-access drawdown. But these only apply to a small part of the market and the option is generally not available to mass-market consumers.

2.13 In 2015 NEST, which is a DC occupational Master Trust supporting automatic enrolment, set out their vision to introduce an innovative decumulation product into the market. Their proposed retirement income blueprint was an offer of a hybrid product which blended together an income drawdown fund, a cash lump sum fund and a later-life protected income fund. NEST considered that this product would offer mass-market consumers flexibility through the different phases of retirement to meet their changing needs and objectives.

2.14 In March 2017, the DWP took the decision not to allow NEST to enter the retirement income market at this stage.[28] Although DWP acknowledged that "new, innovative retirement solutions are needed that will meet consumers' needs", they considered that the post-freedoms retirement market was still evolving. They felt that product innovation would progress as the reforms become more established. This decision was coupled with reassurances from the industry that they intended to innovate. However, DWP also stated that it would keep NEST's proposed role in the decumulation market under review, including reviewing the Retirement Outcomes Review conclusions.

2.15 In April 2018, the Work and Pensions Committee (WPC) published its final report of its inquiry into pension freedom and choice. It recommended that Government should allow NEST to provide decumulation products from April 2019.

2.16 We think that there will be growing incentives for providers to develop innovative solutions for non-advised consumers as DC pots grow in size and the post-pension freedoms market develops. With this in mind, we want to give the market time to develop, and so will not take any action on product innovation at this stage, but this will be a key focus for our ongoing work.

2.17 The decision on whether or not to allow NEST to be active in decumulation is a matter for government. We acknowledge however, that active intervention might be needed to stimulate the growth of mass market hybrid products with annuities embedded within them. A lesson learned from the Australian pension market, which has operated a pensions drawdown system since 1993 and has hybrid products available, is that 94%

28 NEST: Evolving for the future. Government Response, 2017: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/596995/government-response-nest-evolving-for-the-future.pdf

of assets in retirement are held in simple drawdown products, as opposed to annuities, blended or hybrid products.

2.18 The Australian Government has acknowledged that this has produced potential consumer harms[29] and is considering changes to the pensions framework by introducing a type of hybrid product. The Comprehensive Income Products for Retirement (CIPR), also known as 'MyRetirement products' would provide mass-market consumers with a composite retirement product, consisting of a constant income for life, with the flexibility to access lump sums.

Tools to help consumers compare drawdown

2.19 As we stated in the interim report, there are no fully functional price comparison tools for mass-market consumers to compare drawdown options. This remains the case, and innovation in this area has also been limited.

2.20 The Money Advice Service currently has a tool on their webpage to help consumers understand income drawdown. While this tool is informative, it only gives consumers limited opportunity to personalise this process to their specific needs. Nor does it allow consumers to actively compare drawdown options against one another, across criteria such as performance, charges and costs.

2.21 As the market develops and grows, we expect to see more innovation in this area, to help consumers to navigate accessing drawdown. In the Australian market, there are a number of independent comparison tools for consumers. These tools allow them to compare drawdown options across criteria such as star rating, annual costs and number of managed funds.

2.22 To help stimulate this innovation, we are working to progress the development of a drawdown comparison tool, together with MAS and ABI. We will also hold a pension 'TechSprint' later in the year to promote the development of innovative solutions for consumers to help engage with and navigate their options.

Innovation in types of pensions

2.23 There have been some general mass-market developments with the exploration of new types of pension schemes, notably in the area of collective defined contribution pension schemes (CDCs).

2.24 CDCs are a form of "Defined Ambition" (DA) pensions, which share features of both DB and DC schemes. CDCs pool together investment and longevity risk across a large number of pension savers, and provide their members with a target pension that will be paid for life.

2.25 Introduction of such a scheme would require legislative changes, and these products are not yet available in the UK. However, Royal Mail and the Communication Workers Union (CWU) have agreed in principle to work towards introducing a CDC scheme for all employees. In November 2017, the Work and Pensions Committee also announced an inquiry on CDC, which will explore the merits of this idea, the role that CDC schemes could play in the pension landscape, the potential benefits to savers and the wider economy, and the legislative and regulatory framework that would be required to make it work.

29 Financial System Inquiry final report: http://fsi.gov.au/publications/interim-report/08-retirement-income/retirement-income-products/

2.26 Introducing CDC schemes will require making legislative changes, which would provide more detail and clarity on the proposals. We will continue to follow the work of the Committee and monitor developments with Royal Mail.

Provider processes and helping consumers navigate their options

2.27 Since we published the interim report, we have seen some encouraging development in providers' processes and propositions to consumers. Some providers have made efforts to make their products and services more appropriate for, and to meet the needs of, non-advised consumers. For example, we have seen a provider offer a guided pathways proposition that requires some active choice between forms of ready-made investments. This is designed to balance the need to access funds either as regular income or lump sums, with the need to grow the pot.

2.28 We have also seen a number of providers stop defaulting consumers who do not engage with their retirement decisions into cash or cash-like assets, and instead move them into mixed assets more suited to a generic 'average' consumer.

2.29 We believe these examples demonstrate that some providers are adapting their offering and processes to better meet the needs of non-advised consumers.

2.30 As the post-pension freedoms market continues to develop, we believe that introducing investment pathways (see chapter 5) will further help to bring about change and development in provider processes. As a result, we expect to see further innovation in this area.

2.31 We have also seen some innovation in market-wide tools to help consumers understand and navigate their pension options. For example, the FCA's Innovate team has been working with several firms to help develop such tools. We have been working with one firm to help develop a 'robo-advice' proposition. This would allow consumers to look at their total pension wealth, across both DB and DC schemes, help them decide what to do with their pots at retirement and guide them to the best options.

2.32 We are encouraged by these positive changes to some providers' processes. We want to ensure that the whole of the market provides better support to non-advised consumers, and are therefore considering the introduction of investment pathways. At the same time we want to encourage further developments and innovation, by increasing competitive pressures and engagement from consumers. We are also conducting a pensions TechSprint to encourage innovation. These proposals are explained in more detail in chapter 5.

3 Consumer investment choices

Chapter Summary

In this chapter, we summarise our analysis of consumer investment choices. We used data from providers to assess consumer investment outcomes in drawdown with a particular focus on those who did not take advice. To supplement this analysis, we also commissioned consumer research on drawdown consumers not taking advice.

A significant number of consumers not taking advice are likely to be holding their drawdown funds in investments that will not meet their needs. In particular:

- Most consumers go into drawdown in order to access their tax-free cash. 28% of all consumers were not sure where they were invested and 34% only had a broad idea. We found evidence that some consumers who thought they knew where they had invested were mistaken, and that some consumers did not know they were entirely holding cash.
- In general, SIPP customers appear to be more engaged with their investment decision. 77% of them said they know exactly where their money was invested, compared to 29% of life insurance customers.
- The least engaged group of consumers tended to be younger (aged 55-64), have a lower pot size, lower income, less pension knowledge and no defined benefit pension pots.
- 33% of consumers that do not take advice hold their whole drawdown pot in cash accounts or exclusively in 'cash-like' funds. We consider that over half of these are likely to be better served by an alternative strategy.
- There is a significant cumulative impact on retirement income of holding an entire pot in cash for a long period of time due to the missing out on investment growth. Consumers holding all of their pots in cash could increase their annual income by over a third if they invested instead in a mix of assets, including equities, over a 20 year period.

The choice architectures firms use as consumers enter drawdown appear to have a significant influence on the consumer's investment outcomes. For example some firms have been defaulting consumers into cash or 'cash-like' funds. Our evidence shows that cash defaults have had a significant impact on where consumers' pots were invested, although this was less pronounced for SIPP consumers.

Firms with choice architectures that offer consumers more structure appear to help consumers end up in more appropriate asset mixes compared to less structured approaches. While this may not only be due to the choice architectures, we found fewer consumers holding cash when this is unlikely to be in their interest. We also found what appears to be a better fit of asset allocations when more structure was offered to consumers.

The issues we explored

3.1 Consumers who enter drawdown without taking advice have to decide where to invest their pots. In our interim report, we said we had concerns that these decisions were complex and that the investment options providers offer do not sufficiently prompt consumers to engage in the process. A poor investment strategy could leave consumers with less money in retirement, either due to missing out on investment growth or by exposing them to too much risk.

3.2 Following our interim report, we examined whether there was any evidence of consumer harm from the investments they were making in drawdown.[30] We also wanted to understand the causes of any harm to help develop any potential remedies.

3.3 Using data from providers, we assessed consumer investment outcomes in drawdown with a particular focus on those who did not take advice. We wanted to understand how providers were influencing the investment outcomes for their customers. To supplement this analysis, we also commissioned consumer research on drawdown consumers not taking advice. This research focused on the level of consumers' engagement with their investment decision when entering drawdown.

3.4 The rest of this chapter gives an overview of our findings. It starts with evidence from the consumer survey of the low level of consumer engagement with, and awareness of, where their pot is invested. We then look at the support firms give for consumer decisions and the impact of that support on consumer outcomes. In particular, we focus on those consumers who have their pot wholly in cash or cash- like investments.

3.5 We provide further details of our analysis in annex 4.

The evidence we collected

Provider information request

3.6 We issued an information request to seven providers and asked for data on consumer charges and investment choices for all of their drawdown customers.[31] We collected data on the investments held by over 100,000 consumers in drawdown, including around 60,000 advised consumers and just over 43,000 consumers who did not take advice.

3.7 We selected the seven providers on the basis of their business strategy and size. To keep the request proportionate, we excluded some drawdown consumers from the analysis, such as those with a pension pot of less than £10,000 [32] when they entered drawdown.

3.8 We also asked providers for information on their drawdown business models and strategies. Providers also gave us details of their choice architectures for consumers

30 Here we use the term investment to refer to the assets held in drawdown and not exclusively to investments in stocks and shares.

31 We sent the request to eight providers, but have excluded one of them because of the low number of consumers that did not take advice in scope. These providers accounted for around two thirds of all consumers not taking advice in drawdown over the relevant period. As explained in annex 4, some of these consumers were excluded from our analysis.

32 Our data did not cover consumers who have entered drawdown/ activated a drawdown option and fully encashed their pot within the period or terminated their contract during the period for other reasons (e.g. death or switching to another provider). Our request also excluded customers who had moved from capped drawdown to flexi-access drawdown, had an initial pot size below £10,000 or were younger than 55. These data covered consumers who entered flexi-access drawdown between May 2015 and May 2017.

entering drawdown. We have combined this information, plus desk-based research, to assess how different types of choice architectures are influencing consumer investment outcomes in drawdown.

Consumer survey

3.9 We commissioned a survey of consumers not taking advice from NatCen Social Research and the Pensions Policy Institute to provide more evidence of how engaged consumers are with their investment choices. NatCen's report, which includes a detailed description of their methodology, can be found in annex 5.

3.10 The survey included a quantitative stage with interviews with 1,005 consumers which asked:

- their needs in retirement, including what they plan to do with their pension pot once in drawdown, and their wider wealth and potential sources of income
- if they know how their money in drawdown is invested and how actively they engage with it
- questions testing their knowledge of how the pensions market works

3.11 NatCen contacted these customers using the details their pension provider gave as part of our data request. We excluded consumers with initial pots of less than £10,000 and those with initial pots of less than £30,000 who had made withdrawals. This is because other customers are more likely to be negatively affected by poor investment choices in drawdown.

3.12 The survey also included qualitative, in-depth interviews for 25 consumers. These involved either a face-to-face or telephone interview, which discussed topics involving their drawdown in more detail.

3.13 We have combined the responses to the quantitative stage with the responses to our data request, and used this in our own analysis. This combined dataset was not available to NatCen, and so has not informed their report. In annex 4 we explain our methodology for combining the quantitative data with the responses to our data request.

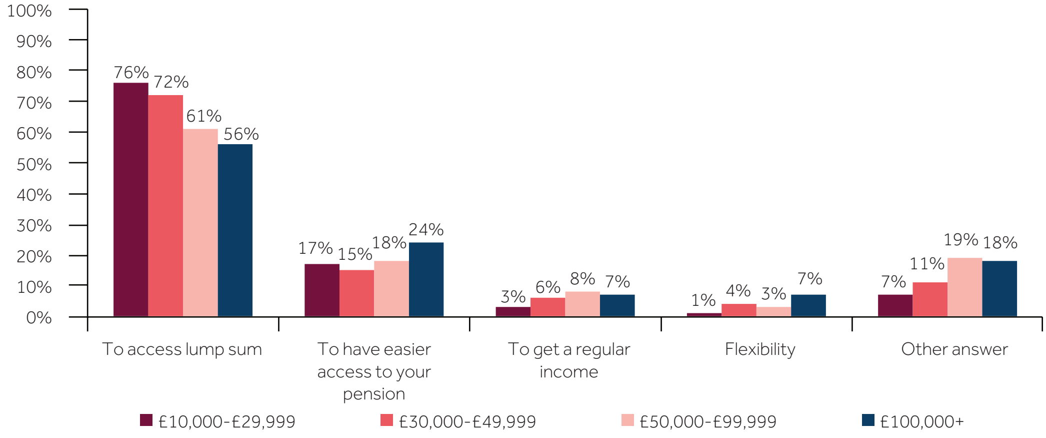
3.14 The findings in this report cover the first two and half years since pension freedoms were introduced and those who were at a point in their life where they could use this freedom. Both the type of people able to access their pensions, and the broader context in which they are doing so, is likely to change in the future. Our results show that many consumers did not intend the pension that they moved into a drawdown to be the main source of income in their retirement.

Consumer engagement on accessing drawdown

Most consumers move into drawdown to access tax-free cash

3.15 The survey asked consumers why they moved into drawdown. The most common reason was to access the lump sum.

Figure 4 Reasons for moving to drawdown, by pot size



Source: Consumer research commissioned by the FCA, see annex 5.

Base: All who recall drawdown and have taken a lump sum (not SIPP) (460).

Note: Customers could give multiple answers, so percentages sum to more than 100.

3.16 The qualitative interviews suggested that some consumers had ended up in drawdown almost by default. They had wanted to take tax-free cash from their pot and did not want to buy an annuity with their remaining pension money. As a result, drawdown felt like their only option. Some consumers said that if it was not for the tax implications, they would have preferred to have taken all the money from their pension pot and taken full control of it, reflecting a degree of distrust in the pension system. This is in line with previous qualitative research with customers who had accessed their defined contribution pensions since the introduction of pension freedoms.[33]

3.17 In the qualitative interviews, consumers also often gave the wish to control their money and bring it 'in-house' as important triggers for moving into drawdown.

> *'I have no confidence in the pension industry anyway, I have no confidence in the way it's performed in my lifetime, and that was one of the reasons that I wanted to take my money. Because with the interest rates as they are, and I've lost such a lot of capital over the years, I didn't see that there was any great benefit in keeping my money in there and I'd rather have it to spend.'*
>
> *INTERVIEWER: 'Did you need the money at the time or was it just more of…?'*
>
> *PARTICIPANT: 'Not at all, no, no. In fact, I've got significant savings and the money's just added to my savings and not getting any interest, but I felt that if I wanted to – I, I felt I'd rather have it than they have it.'*
>
> Aged 60-64; working; £100k+ pot; non-SIPP, has a separate DC pension

3.18 The motivation for entering drawdown is an important aspect of how much consumers engage with the investment decisions they are required to make at the point of drawdown. Knowing how a consumer wants to use their pot during their retirement will be an important factor in deciding the most appropriate investment.

33 Retirement Outcomes Review: interim report: annex 3: Qualitative consumer research for assessing non-advised journey (2017). Ignition House. URL: https://www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report-annex3.pdf

Many customers do not know what investment choices they have made

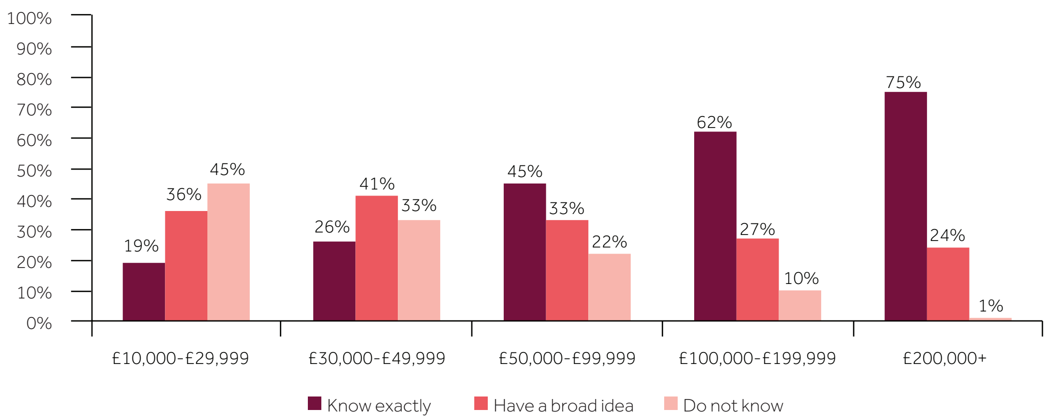
3.19 The survey found evidence of a widespread lack of awareness about investment choices. Consumers who are not aware of where their money is invested are less likely to have engaged and made appropriate investment choices when moving into drawdown. This reinforces our concern that many customers are not sufficiently engaged with their investment choices when moving into drawdown, and so may make choices which do not meet their needs in retirement.

3.20 While 37% of consumers said they knew exactly where their money was invested, 34% had only a broad idea and 28% were not sure. The survey is self-reported and customers knew in advance that they would be asked about their drawdown. Some customers who said they knew exactly where their money was invested, or had a broad idea, could not actually say where it was invested when asked. This increased the number of customers who were not sure where their money was invested from 28% to 33%.

3.21 The most important factor for customers knowing where their money was invested was how much the consumer understood pensions. Those who answered more of the survey's questions on the pensions market correctly were more likely to say they knew where their money was invested.

3.22 Consumers with larger pots were more likely to know where their money was invested. Figure 5 shows that customers in the largest pot band are nearly four times more likely to know exactly where their money is invested.

Figure 5 Awareness of where pension money is invested, by pot size



Source: Consumer research commissioned by the FCA, see annex 5.

Base: All who recall drawdown or took a lump sum (975)

3.23 Consumers with larger pots were also more likely to have other pots, suggesting that greater consumer engagement with larger pots is not simply because a large pot is their only pot.

Figure 6: Pot size by whether or not consumers have multiple pots

Source: Consumer research commissioned by the FCA, see annex 5.

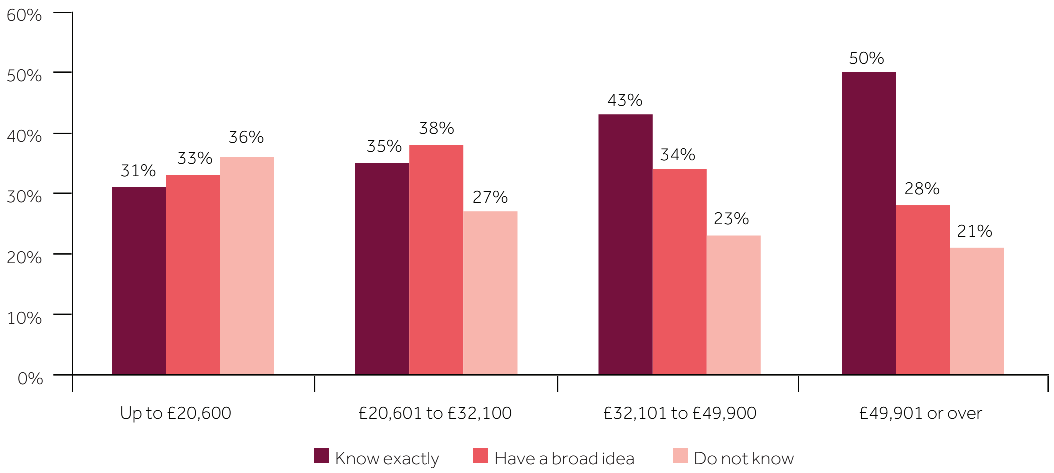
Base: All who recall drawdown or took a lump sum (975)

3.24 SIPP customers of the providers in our sample were much more likely to say they knew where their pension money was invested than customers of life insurance providers. 77% of SIPP customers said they knew exactly where their money was invested compared to 29% of life insurance customers. This suggests that there is on average a higher level of engagement by consumers in SIPPs, as may be expected in products which are 'self-invested'.

3.25 Being unaware of investments was more common among people working full-time (33%), and part-time (30%) than retired people (21%). More than half the consumers in the survey were still in work, suggesting that many consumers were accessing their pension pots before retirement.

3.26 Lower investment awareness was also linked to lower incomes; 36% of those with a reported annual household income of up to £20,600 said they were not sure what their money was invested in, compared with 21% of those with a household income of £49,901 or more.

Figure 7: Awareness of where pension money is invested, by annual household income



Source: Consumer research commissioned by the FCA, see annex 5.

Base: All who recall drawdown or took a lump sum (975)

3.27 Responses to the qualitative stage of the survey give more detail about why customers do not engage more with their investment choices. There were three main reasons:

- they felt this was only a small investment that was not going to be central to their retirement income and so it was not worth devoting more time to it
- not being interested in investing
- not being confident in making investment choices

3.28 Consumers' lack of engagement is illustrated by the following quotes from the qualitative depth interviews:

> *'No, I don't care. I don't know. As long as it doesn't lose money, I will be satisfied'.*
>
> Aged 60-64; working; £100k+ pension pot; non-SIPP, has a separate DC pension

> *'I don't have the details and I'm not too bothered about the details. Because I'm getting more money than I would if I'd stuck it in the bank, if I drew the whole lot out.'*
>
> Aged 65+; retired; £10-50k pension pot; non-SIPP, has a separate DB pension

3.29 Many responses showed consumers assumed that the provider's default, or recommendation, should have steered them to an appropriate investment.

> *'I've no doubt that they probably advised me where it is and what it, you know, who it's with, but, off the top of my head, I couldn't give you an honest answer and say, yeah, I was aware of just where it is. There was a discussion, but what, what was said, I'm, I'm fairly sure I was quite confident in, you know, in leaving it in their hands.'*
>
> Aged 65+; retired; £10-50k pension pot; non-SIPP, has no separate DB or DC pension

> *'My assumption was that it would be invested, I'm assuming the stock market. I don't know what, I don't know why I'm thinking that but it seemed logical to and I don't know where else it would be invested in but that's what I had in my head.'*
>
> Aged 60-64; retired; £100k+ pension pot; non-SIPP, has a separate DB pension

3.30 Another response highlighted how low financial confidence affects consumers' decisions when making investment choices. Low financial confidence can make consumers less willing to engage and more likely to follow a path of least resistance when moving into drawdown.

INTERVIEWER: 'Would you be interested in getting more information about how the fund or the product is performing?'

PARTICIPANT: 'No.'

INTERVIEWER: 'Is there a reason why you're not interested?'

PARTICIPANT: "Yes, 'cause I'm not interested in financial things. I, as I say, I have no confidence with the way that everything's performed and I've lost the capital on investments over the years, so that's one of the reasons. I don't have any confidence in the financial services industry. That's the truth of it. And it's my money that I've put in and if I could have taken it all out, I'd rather have it all out under the bed than with [pension provider]. And if I could take it tax free, I would have done.'

Aged 60-64; working; £100k+ pension pot; non-SIPP, has a separate DC pension

'So [pension provider] sent a lot of information and particularly about, a kind of risk questionnaire to see how what risk you were prepared to accept and recommended different sums and bonds and things to put your money in. So, in fact I think, yeah, they had various examples of, of people..., this person will accept a low risk or a medium risk and... their, what kind of options there were. And I basically, went for, went for one of those.'

Aged 55-59; caring; £50-100k pot; SIPP, has a separate DB pension

3.31 We used information on consumer engagement to create four engagement profiles:

- least engaged (34%)
- invested in ready-made funds and moderately engaged (34%)
- invested in cash and moderately engaged (5%)
- most engaged (26%)

3.32 We found that 34% of consumers were in our Least Engaged profile. These consumers were generally aware they were in drawdown, but had a limited idea of where their money was invested or what their charges were. Some consumers in this group felt their pot was too small to justify them engaging more. Others were either fatalistic about their investment decision or trusted their pension provider to look after their money. Consumers in this group tended to be younger (aged 55-64), have a lower pot size, lower income, less pension knowledge and no defined benefit pension pots.

Providers offer a variety of options and level of support

3.33 Given these consumers' lack of engagement, we looked at the range of options firms offer and the support they give to non-advised customers to choose between those options. As consumers enter drawdown, most providers seek to provide some support to customers to help them decide where to invest their pots. This includes giving them information and, in some cases, even restricting the number of fund options available. The options given, and how consumers are presented with them as they enter drawdown are likely to affect how they decide where to invest and how engaged they are in the process.

3.34 We saw a range of different choice architectures across providers. For example, while most providers offer consumers at least some information to help them invest, its format varied significantly. For example, some providers allowed consumers to select investments as they wished, without guiding this process too much. Other providers restricted the investment options presented to consumers and tried to guide consumers to investments suitable for their needs through a mix of structure and information.

3.35 We draw a distinction between providers within our sample that offer more structured frameworks and those that offer less structured frameworks, in terms of the support they give consumers entering drawdown.

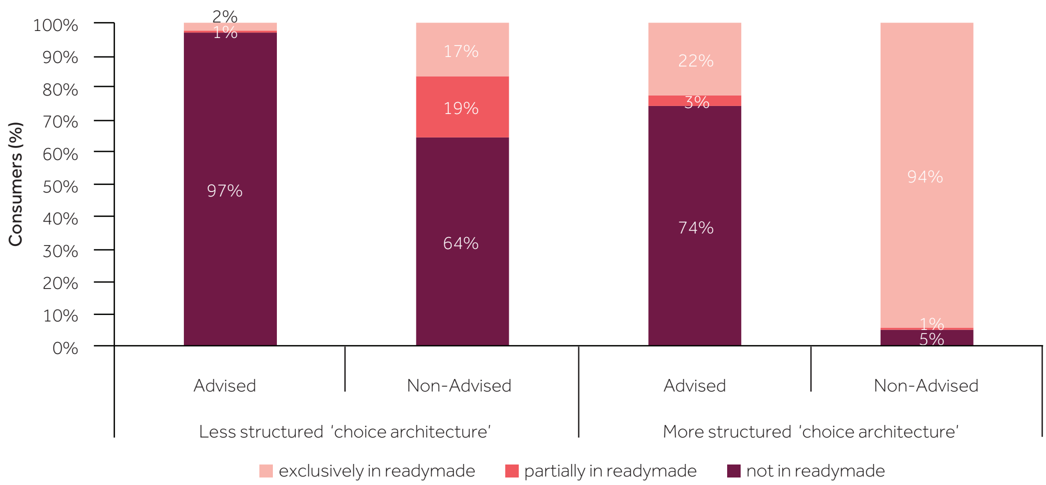
3.36 There were different forms of more structured choice architectures. For example limiting the number of available investment options and giving clearer prompts or guides.

3.37 Less structured choice architectures tended to offer a wide variety of investment choices but fewer prompts to help consumers navigate this choice. Some providers in this category did offer ready-made funds but, unlike the more structured architectures, choice was not restricted to these alone. We saw a mix of more and less structured approaches across different providers. Some providers tended to offer a greater range of options with less structured choice architectures.

3.38 As well as offering different choice architectures, some providers offer 'ready-made' funds to their consumers. These are managed by the provider and have different levels of risk and reward. They are designed to help consumers building a portfolio with a balanced asset distribution and tend to be multi-asset funds. If managed appropriately, they can therefore be an effective way of managing the investment of a consumer to fit a risk or withdrawal profile.

3.39 As Figure 8 shows, providers with a less structured choice architecture tend to have a smaller proportion of consumers who did not take advice that are only invested in their ready-made funds than in providers with a more structured choice architecture. This is true to an even greater extent for advised consumers. Consumers with providers with a less structured choice architecture therefore have to rely more on their own selection of funds to build an investment portfolio.

Figure 8: Proportion of customers invested in provider's ready-made funds



Source: FCA analysis of drawdown charges and investment choices collected from 7 providers.

More structured architectures may help consumers avoid poor investments

3.40 We explored whether more structured choice architectures had helped consumers invest in more suitable asset mixes. This analysis is inevitably limited as we could not conduct a full analysis of consumer preferences and objectives. The results were nevertheless indicative that consumers can benefit from the presence of a structured choice architecture for their investment decisions.

3.41 To understand the impact of a more structured architecture on consumers' investments, we compared how different consumers with different characteristics invested in their portfolios to understand:

- whether more structured choice architectures help non-advised consumers invest in asset mixes that better fit with their profiles
- if non-advised consumers who are more confident in making their own choices make similar investment decisions to advised consumers

3.42 First, we identified consumers with different expected needs in drawdown, such as whether they were making withdrawals or had different pot sizes. From this, we identified a number of different consumer profiles. We then calculated[34] the average amount that consumers in these profiles invested in the different investment categories, based on the European Fund Classification.[35]

3.43 So we have focused on testing whether:

- investments in higher-risk assets, eg equities, increase for consumers in larger pots that have not made any withdrawal since entering drawdown
- investments in lower-risk assets, such as cash or money-market funds, are higher for consumers with smaller pots that have made withdrawals since in drawdown, and so are more likely to use up their pots shortly

3.44 The rest of this section sets the findings of our analysis.

3.45 In summary, we find that:

- consumers with providers offering more structured choice processes are on average invested in assets more consistent with our expectation based on their pot characteristics and behaviour
- there is more variation in portfolio performance for consumers that do not take advice in providers with a less structured choice architecture

3.46 Overall, the evidence suggests that providers with a more structured choice architecture help consumers that do not take advice. This increases these customers' knowledge and they have outcomes which are more similar to those of advised consumers. This suggests that supporting consumers through more structure as they enter drawdown can lead to better outcomes. The investment pathways remedy in

34 More information can be found in annex 4.

35 One limitation of this analysis stems from the fact that we could not use more granular definitions of investment categories, which would allow to better control for share classes' volatility. Keeping this in mind, we have assumed that investment categories like equities and equity funds are exposed to higher risks than 'cash-like' investments.

this report is an example of this kind of structure and we believe it can lead to better consumer outcomes.

A more structured architecture leads to expected asset allocations

3.47 We compared the investments held by consumers not taking advice across providers. In particular, we compared those with more structured choice architectures against those offering less structured ones.

3.48 While it may not be the case for each individual consumer, in general we expect consumers with larger pots to be more likely to keep their pot invested for longer. Given this, they have a longer amount of time to ride out periods of negative returns and higher volatility. So we would expect to see individuals with higher pot sizes investing in higher risk assets than those with smaller pots.

3.49 To further control for the fact that some consumers might be looking to fully encash their pot in the short term, we also considered whether consumers had made withdrawals from their pot. We noted that consumers with larger pots and no withdrawals were unlikely to use up all their pots in the short term.

3.50 Customers with providers that offer a more structured process are invested in patterns more consistent with our expectations. For example, the amount invested in cash for customers of one provider with a more structured architecture tails off significantly as pot sizes increase. Customers of another provider with a less structured architecture do not seem to show such a clear pattern. We saw similar patterns in other providers with less structured choice architectures.

3.51 In theory, these results could reflect differences in the types of customers attracted to the different providers. However we see no particular reason for material differences in such customer types between providers. Instead we believe it implies that providers' choice architectures at least partially explain differences in how non-advised consumers invest.

Consumers who opt out of a structured architecture have similar outcomes to advised consumers

3.52 Out of the providers that offer a structured choice architecture, some also allow consumers to choose from a wide range of funds if they wish to do so, rather than being restricted to a smaller range. We assessed the investment choices of consumers that do not take advice and who are with providers that have a structured choice architecture, but choose to select their investments from a wide range. These consumers chose to take more control over their investments instead of following the defined structure the provider offers. We then compared their investments to those of advised consumers in order to assess whether they were able to invest similarly to advised consumers, who we assume make suitable investment choices with their adviser's help.[36]

3.53 Broadly speaking, our analysis shows that there is little difference between the two groups.[37] As expected, both sets of consumers appear to be investing in a higher proportion of equities as their pot size increases. This provides some evidence that a structured architecture can provide better outcomes for consumers while allowing consumers who are confident making their own choice to do so.

36 Advised consumers might not be engaged and benefit from advice when deciding where to allocate their assets.
37 Due to the confidentiality of the underlying information, we are unable to present more granular results of this analysis.

Consumers not taking advice in providers with a less structured choice architecture have different outcomes to advised consumers

3.54 We also analysed the investments of consumers with a provider with a less structured choice architecture and compared between consumers taking advice and those not. In this case we saw that the investments of consumers not taking advice had some significant differences when compared to those of advised consumers. While advised consumers seem to invest with a pattern consistent with their profiles, consumers that do not take advice do not. For example, investments in higher-risk assets, such as equity funds, increase for advised consumers in larger pots who have not made withdrawals. We did not see a similar trend for consumers without advice.

3.55 While the evidence is based on observations from a few firms and therefore has some limitations, it supports the idea that consumers might improve their investment outcomes if their provider helped them take their investment decisions. Introducing a more structured choice architecture based on consumers' plans and circumstances therefore might help them make more informed decisions.

More variation in investment performance for consumers in providers with a less structured choice architecture

3.56 We compared average investment performance and the variation in returns for non-advised consumers across different providers that offer more and less structured choice architectures. We also compared the investments of advised and consumers not taking advice.

3.57 As a measure of performance, we used average annualised returns and the standard deviation[38] of these returns over five years.[39] Average returns are similar across both advised and non-advised consumers in providers with different choice architectures. But we find large differences in the variance of investment returns depending on the provider's choice architecture. In providers with less structured architectures, there is a higher standard deviation in investment performance for consumers that do not take advice. For consumers with providers who offer more structured choice architectures the standard deviation of returns is more similar to advised consumers.

3.58 This could partly be explained by the restricted range of ready-made funds offered by providers with more structured architectures. Consumers with providers with less structured processes tend to have more funds in their portfolios, which they select from a much longer list. This could also reflect consumers with providers with a less structured architecture investing in higher risk and reward assets, such as equity funds, leading to a slightly higher but more volatile average investment return.

38 The standard deviation here measures the dispersion of investment returns. A low standard deviation indicates that investment returns are close to the average investment return.

39 We recognise that five years might not be a long enough timeframe to provide a reliable picture of how investments performed over time and, more generally, historical returns do not necessarily give a clear indication of the pattern the fund will follow in the future. In addition due to limited data availability on investment returns, we had too low samples for some providers and returns were missing for most providers' ready-made funds because these have been introduced within the past five years.

Table 1: Comparison of portfolio's performance measured by annualised five years returns, advised and non-advised consumers across providers.

		Portfolio's performance			
		Average return		Standard deviation of return	
		Advised	Non-Advised	Advised	Non-Advised
Providers with a less structured architecture	**Provider 1**	7.4%	8.6%	2.8%	7.3%
	Provider 2	7.2%	8.6%	2.2%	4.1%
	Provider 3	6.6%	9.0%	3.7%	7.4%
Providers with a more structured architecture	**Provider 4**	8.0%	8.3%	2.3%	2.8%
	Provider 5	7.5%	6.5%	0.8%	1.3%
	Provider 6	6.6%	6.1%	2.3%	2.4%

Source: FCA analysis of drawdown charges and investment choices collected from 7 providers.

Note: We have not reported data for one provider due to limited data availability. We have excluded consumers invested in cash from this analysis. Provider numbering randomised.

Consumers investing entirely in cash

With the information available, it is difficult to assess in detail how suitable consumer investments are. However, we considered that holding all or most of their pots in a cash account or cash-like funds for an extended period was likely to lead to customers missing out on potential returns.

3.59 Consumers can be 'in cash' either if they hold their entire drawdown pot in their cash account or hold their pot in cash-like assets.[40]

3.60 In this section, we find that:

- The risk of losing their money is an important factor influencing consumers' investment decisions.
- A much higher proportion of non-advised customers hold their pot in cash than for advised customers. The proportion of non-advised customers in cash varies substantially across providers and with pot size.
- Holding cash does not appear to be temporary. Many consumers appear to remain in cash for a prolonged period.
- For some providers holding money in cash has been the default arrangement if a consumer does not make an alternative choice, and many consumers are not aware that their money is held in cash.

40 'Cash-like' investments have some similar characteristics to bank deposits, such as liquidity, low volatility and investment growth. We also considered consumers holding most but not all of their assets in cash, but found there were are very few in each provider we have not included them in our analysis.

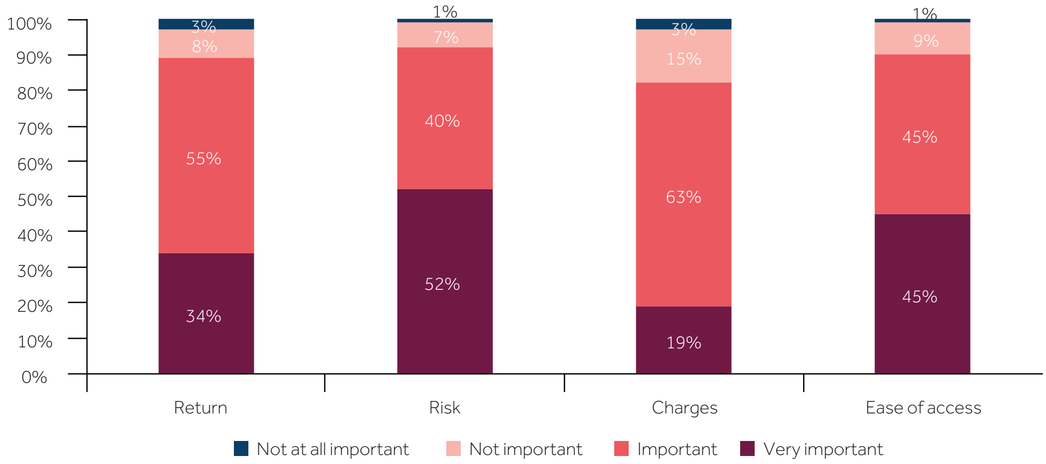
- Many non-advised customers holding their money in cash are not making withdrawals and are relatively young (under 65). These, and other similar groups of customers, appear to be at risk of harm that they will lose out on investment returns by holding their pot in cash.

- We estimate that consumers in cash who draw down their pot over 20 years could increase the expected annual income from their pot by more than a third by investing in a mix of assets.

Holding pot in cash may reflect consumers' aversion to risk

3.61 The survey asked consumers how important various factors were in making their investment decisions.

Figure 9: Important factors for investment decision



Source: Consumer research commissioned by the FCA, see annex 5.

Base: All who have made an investment decision (754).

3.62 Respondents rated the risk of losing their money as the single most important factor in making their decision. If a consumer said both the risk of losing money and return on investment were very important, the survey asked which was more important. With this additional question a majority (59%) of consumers said that the risk of losing money was more important than the return.

3.63 SIPP customers were more likely to say return was very important (57%) compared with life insurance customers (27%). Return was also of high importance to retired customers (41%) compared with those working full-time (27%).

3.64 Responses from the qualitative survey indicate that some consumers who said they were invested in cash made a conscious decision to do so to avoid risk. They wanted to be absolutely sure that the value of their pension investment would not go down.

> *'I talk to my friends who have got the [pension provider] accounts as well, ... one of them invests quite a lot of money. So, in, in my view quite a lot of is ten, 20,000. He'll invest 20,000 for about six months and see how it grows...His pension's far bigger than mine, so he can afford to say lose ten or 20,000 on a high stakes investment. I personally won't do that I'm against gambling, always have been. I like to know that things are safe, things are in place.'*
>
> Aged 65+; retired; £10-50k pot; SIPP only provider, has a separate DC pension

3.65 Being in cash may be appropriate for those wanting to maintain value over the short-term and to minimise their exposure to losses before withdrawals.[41] However, people retiring at 65 may typically expect to live into their mid 80's and one in 10 may expect to live to a hundred.[42] Those accessing their tax-free cash at 55 and expecting to rely on their pot over the course of their retirement face an even longer term planning period. For those holding assets for these longer periods, cash may be a poor choice even with the lower risk.

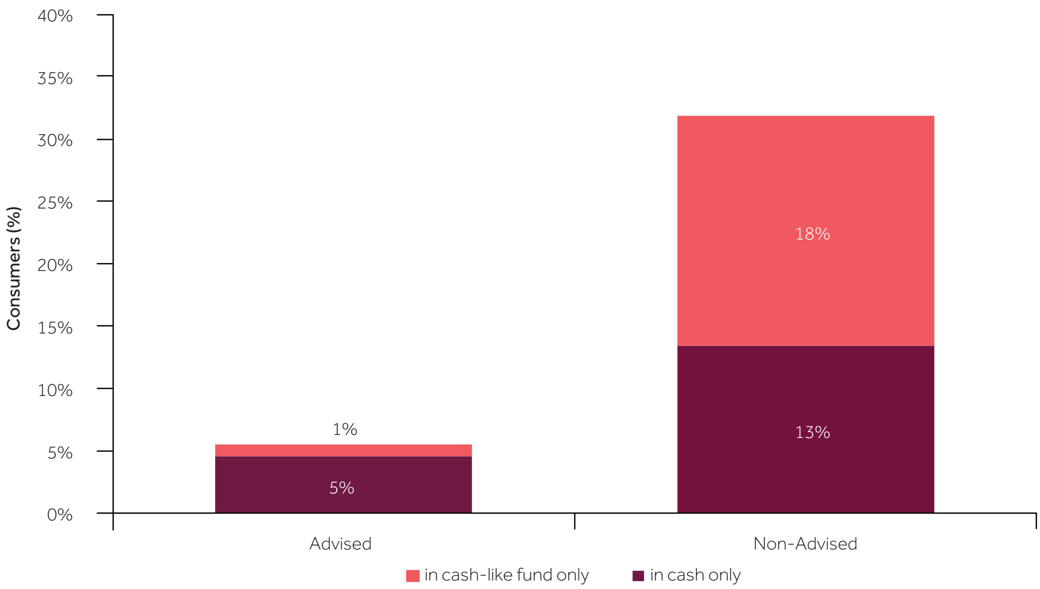
3.66 While past performance is not a guide to future performance, historic returns data show that since 1899, those holding assets in cash rather than equities for a period of 10 years would have been better off in equities in 99 out of 109 periods. For a 20 year period, which is less than the expected typical length of retirement, cash outperformed equities only twice out of 99 periods.[43] Risk free assets such as gilts have also outperformed cash over longer periods.

More consumers not taking advice are in cash than advised consumers

3.67 The number of consumers holding all of their assets in cash or cash-like investments after entering drawdown varies significantly across the providers in our sample. For consumers not taking advice, this ranges from approximately 15% to 65% of all of their consumers not taking advice wholly holding cash.

3.68 A higher proportion of consumers not taking advice are in cash than advised consumers. Overall, around 32% of consumers not taking advice were wholly holding cash, compared to 6% of advised consumers (see Figure 10 below).

Figure 10: Percentage of consumers in cash and cash-like investments across providers.



Source: FCA analysis of drawdown charges and investment choices collected from 7 providers.

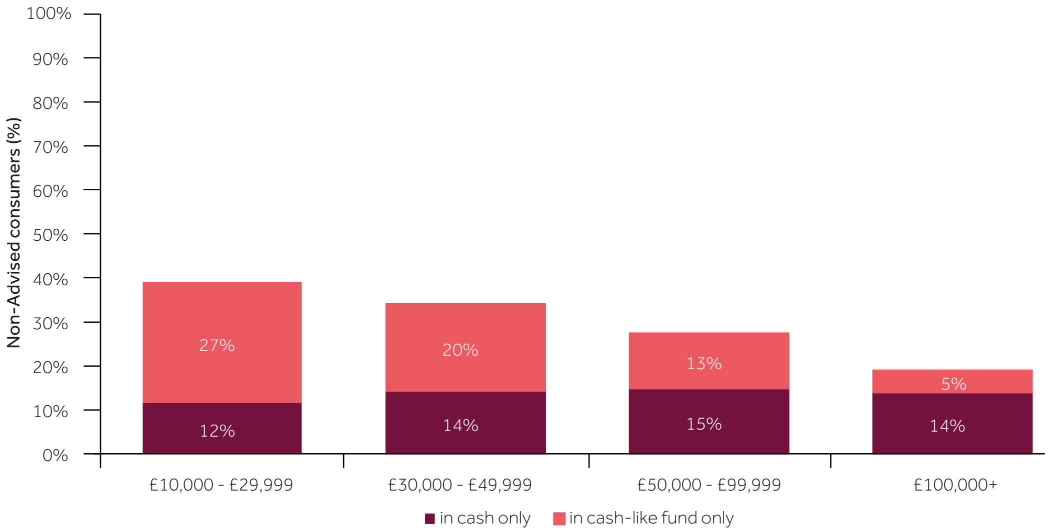
41 Although the effects of inflation and charges could affect the value of the pot.
42 According to data provided by the ONS. See https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/lifeexpectancies
43 FCA analysis of Barclays Equity Gilt Study 2018. FCA analysis of cash returns using the Bank of England base rate also shows similar outperformance of equities over cash for the same period.

Lower pot values more likely to be wholly in cash

3.69 Consumers who hold their assets in drawdown for long periods of time have a higher risk of missing out on returns if they only hold cash. So we compared the proportion of consumers that do not take advice in cash by the value in their pots at the point they moved into drawdown (see Figure 11 below).

3.70 Across all providers, there seem to be fewer consumers with larger pots in cash. But looking at pot values does not fully capture the time period over which consumers need to use their savings. There might be some consumers that have a lower income but still need to use it over a longer time period. Being in cash might be as poor a strategy for them as for consumers with higher income, although this might not be their only retirement savings provision.

Figure 11: Percentage of consumers who have not taken advice wholly in cash by pot size, May 2017.



Source: FCA analysis of drawdown charges and investment choices collected from 7 providers.

Consumers are holding cash for more than just a few months

3.71 Some consumers might be in cash because they have recently moved into drawdown and would invest in other assets over time. To test this, we compared the proportion of consumers currently in cash for groups that had been in drawdown for different periods of time.

3.72 In general, we found only a slight decrease in the proportion of consumers holding cash as the length of time in drawdown increases. This suggests that large numbers of consumers are entirely holding cash for more than just a few months and this is unlikely to change in the future.

Choice architectures influence the proportion of consumers in cash

3.73 We considered the extent to which different types of choice architectures influenced the proportion of consumers holding only cash.

3.74 As well as more and less structured architectures, the way that providers treat consumers who do not make decisions can have a direct effect on whether they end up entirely in cash or not.

3.75 Consumers in cash could have:

- Chosen to hold their pot in cash, either due to a pre-meditated plan or based on the information they are given.
- Not made a choice of where to invest upon entering drawdown and so been defaulted into cash. If consumers do not decide where to invest when they move into drawdown, some providers keep their pots in their cash accounts or in cash-like funds until the consumer has an alternative investment strategy.

3.76 For example, some providers' customers did not make an active decision and were defaulted into cash. In most cases, these provider's customers will hold their pot in the cash account until the providers directs them otherwise. Not all providers have continued this strategy. We know that some providers stopped defaulting their consumers into cash midway through the period we were investigating.

3.77 In providers that have stopped defaulting consumers into cash, the proportion of consumers in cash or cash-like investments has fallen significantly since this changed This provides evidence that defaults have a strong impact on the investment choices of consumers that do not take advice upon entering drawdown.

3.78 However having a default does not fully explain the high proportion of consumers in cash. Some providers have relatively high numbers of customers deciding to be in cash.

Many consumers invested in cash do not know it

3.79 Using the combined dataset of the quantitative stage of the survey, and our data request, we find that almost half the consumers who are fully invested in cash do not know that this is the case.[44] As consumers responded to the survey at a different time than providers responded to our information request, this could be due to consumers having changed investments over time. However, we have seen few consumers not taking advice change their investments once in drawdown. So we believe this apparent lack of awareness provides some evidence that consumers have not actively chosen to be wholly in cash and are making poor investment choices.

Consumers are at risk of harm from being in cash or cash-like investments

3.80 Cash could be a suitable strategy for some consumers. We cannot observe directly when this is the case. However, to estimate the proportion of consumers in cash for whom this is unlikely to be a good outcome, we identified five consumer profiles that we considered at highest risk of harm from being wholly in cash.[45] The scale and likelihood of harm differs across profiles. Consumers most likely to keep their pot invested for longer are more likely to miss out on investment growth than others.[46] We give more details of these profiles in annex 4.

3.81 We used these profiles to identify consumers that are more likely to be at risk of harm in each provider. The profiles in particular identified younger customers (under 65)

44 In our survey 52% of the customers who were fully invested in cash were aware that this was the case. As we only consider customers where the provider says they are fully in cash, this is from a base of 93 customers.

45 However, we do not have information on the wider use consumers make of their pots.

46 This analysis covers exclusively consumers that do not take advice. For simplicity we refer to them as 'consumers' while illustrating our findings. We would expect a consumer that is retired and/or close to fully withdrawing their pot to be less at risk of harm from being in cash.

with larger pots and not making withdrawals as those most likely to be losing out from keeping their pot in cash.

3.82 Table 2 below shows a description of each profile and why we believe consumers in each of them may be harmed by staying in cash. Profiles are ordered based on the likelihood of harm, with most likely first.

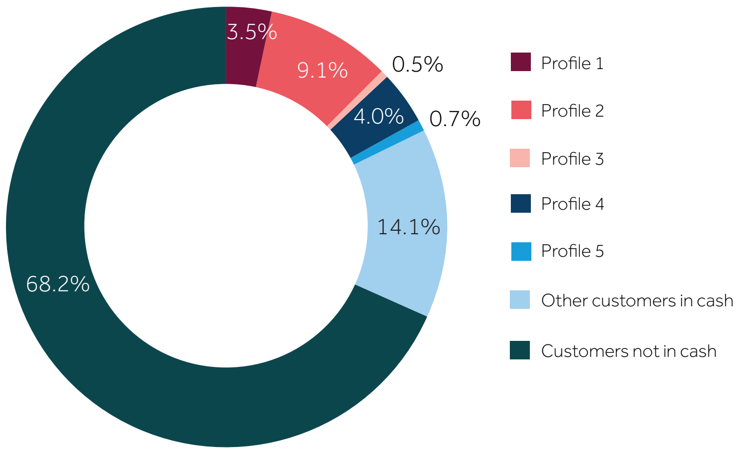
Table 2: Profiles of consumers at risk of harm from staying in cash

Profiles	Description
Profile 1	**Consumers under 65 that have not made withdrawals, having moved into drawdown with a pot above £50K.** These consumers are likely to plan on keeping their pots invested over the longer term, although we do not have information on their wider use. For some consumers, these pots will be one of the main sources of income at retirement.
Profile 2	**Consumers under 65 that have not made withdrawals, having moved into drawdown with a pot below £50K.** These consumers are likely to plan on keeping their pots invested over a longer term. Although these pots might not be their only source of income, these consumers might still be better off by investing their money in higher risk-return assets.
Profile 3	**Consumers under 65 making ad-hoc withdrawals only and unlikely to fully withdraw their pots in the short term.** Although these consumers have made some sporadic withdrawals from their pots, there is still a significant part left that they could be planning to keep invested in the longer term. As such, they could get benefit from investing in higher-growth funds. This could be less harmful for consumers with very small pots.
Profile 4	**Consumers above 65 that have not made withdrawals.** Although these consumers are likely to be retired, they have not withdrawn from their pots yet. As such, they might still make better returns by choosing to invest. This holds particularly if they have high pots that are unlikely to be fully withdrawn in the short term.
Profile 5	**Consumers making regular withdrawals but unlikely to fully withdraw their pots in the short term.** Staying in cash could be a poor investment choice for some of these consumers, even if they are less likely to be harmed than those that are not withdrawing. These consumers might still benefit from investing, although in balanced funds.

Source: FCA analysis of drawdown charges and investment choices collected from 7 providers.

3.83 Overall, 32% of consumers that do not take advice are in cash or cash-like investments and more than half of these are at risk of harm as a result. Figure 12 illustrates our findings. The figure shows consumers in each profile as a percentage of total consumers not taking financial advice by provider. The table shows aggregate figures of potentially harmed consumers that do not take advice across providers.

Figure 12: Percentage of consumers not taking advice at risk of harm from being in cash on total non-advised by profile, May 2017



Source: FCA analysis of drawdown charges and investment choices collected from 7 providers.

Note: Percentages averaged across providers in our sample. DB

Harm from being in cash

3.84 Historically, customers investing for long periods of time have been better off investing in equities or gilts rather than cash. Given the high proportion of drawdown customers holding all of their assets in cash or cash-like funds, we considered the likely benefits these consumers could expect from instead investing in a broader mix of assets.

3.85 To do this, we used an adjusted variant of the expected rates of return the FCA prescribes for financial projections.[47] We considered someone who would drawdown their pension pot over 20 years after accessing drawdown. This equates roughly to someone at 65 drawing down until life expectancy but could also reflect a number of other scenarios such as accessing drawdown earlier. We give full details of the assumptions we have used in annex 4.

3.86 Based on these figures, consumers investing wholly in cash or cash-like funds and drawing down over a 20 year period, could expect an annual income from their pot 37% higher if they were instead invested in a mix of assets.[48] Clearly the actual amount of income available will depend on a customer's personal circumstances and rates of return can vary. Nevertheless, this demonstrates the potential harm consumers could suffer if they remain in cash for long periods.

Conclusion

3.87 Following the work from the interim report, we have explored in more detail whether there is evidence that consumers in drawdown may be harmed as a result of their investment choices.

3.88 The evidence suggests that those with larger pots are most likely to be engaged with where they invest their pots. So, as the average pot size of consumers entering drawdown increases, we think engagement is likely to improve. Nonetheless, we

47 We have adjusted the asset allocation to include a higher mix of lower risk assets. Further details are contained in annex 4. www.fca.org.uk/publication/research/rates-return-fca-prescribed-projections.pdf

48 We have assumed an asset mix of 50% equities, 20% government bonds, 20% corporate bonds, 7% property and 3% cash.

expect there will always be a group of consumers who struggle to engage with the complexity of these decisions.

3.89 We are particularly concerned about consumers holding all their assets in cash for long periods of time. We estimate that 32% of consumers are wholly in cash and that this is unlikely to be the best strategy for over half of them. Someone wanting to drawdown their pot evenly over a 20 year period could benefit from an increased expected annual income from their pot of 37% by investing in a mix of assets rather than cash.

3.90 The choice architecture that providers use as consumers enter drawdown also appears to have a significant influence on investment outcomes. We found that consumers of providers with more structured choice architectures had asset allocations more consistent with our expectations than consumers of providers with less structured choice architectures.

4 Competition and charges in drawdown

Chapter Summary

In this chapter, we summarise our analysis of competition and charges in drawdown. We look at the causes of low shopping around and switching and the variation in drawdown charges (administration and fund charges) between providers. We present the results of our further analysis on drawdown charges which includes fund charges. We used data from seven pension providers offering retirement options.

Barriers to switching
We were concerned that low shopping around and switching of drawdown providers may be drivers of high prices and weaker competition.

Few consumers are even considering switching. Our survey found that around half of the consumers not taking advice do not even consider switching, and those who did consider switching mostly do not. Nearly a quarter of consumers surveyed also admitted they had no idea about the charges they were paying.

We also found differences across providers in how easily consumers can switch providers, with some processes taking longer than others. This could be further reducing the likelihood of consumers switching.

Drawdown charges are complex and not consistent across providers. This makes it hard for consumers to make meaningful comparisons. Consumers' ability to compare and switch between different providers is an important part of a well-functioning competitive market.

Range of Charges
We were concerned that some consumers who do not take advice are paying high charges. So we investigated the range of drawdown charges (administration and fund charges) offered to consumers not taking advice. While charges are not the only important factor for consumers to consider when choosing a drawdown provider, they can have a significant impact on the value of a pot over time.

On balance, our analysis shows that:

- Total charges vary substantially across providers with average total charges ranging from 0.4% to 1.6%. By switching from a higher cost provider to a lower cost provider, consumers could increase the annual income from their pot by 13%. For an individual with a pot of £100,000 this would be an extra £650 per year.
- Nearly a quarter of consumers who did not take advice are paying 1.5% or more of their pots in charges every year.
- Consumers holding cash face administration charges with some providers but not with others.

The issues we explored

4.1 In the interim report we found that there were very low levels of consumer switching by non-advised customers entering drawdown and that this could be leading to weak competition. We also said that drawdown charging structures can be complex and so it could be difficult for consumers to assess and compare across providers. We found that the spread in administration charges across providers suggests consumers might benefit from shopping around. Our initial assessment did not take into account fund charges.

4.2 In this chapter, we present the results of our consumer survey which also explored consumer attitudes to switching, look at the barriers to switching, and report further analysis on drawdown charges which includes fund charges using data from seven pension providers offering retirement options.

4.3 In this chapter we look at:

- the causes of low shopping around and switching which may be a driver of high prices and less effective competition
- the level of and variation in drawdown charges (administration and fund charges)

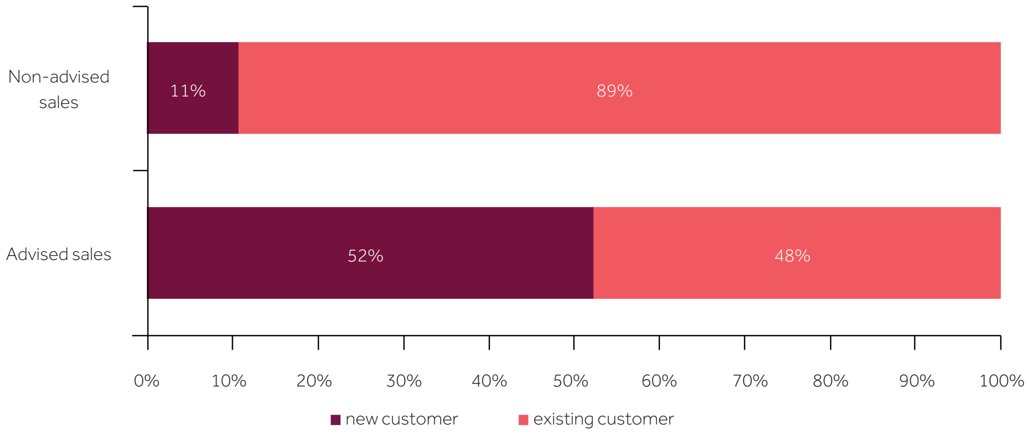
4.4 Although the focus of our review is on consumers who do not take advice, we also consider advised consumers when assessing the complexity and variation of drawdown charges.

Consumer attitudes to switching

Few consumers who do not take advice are switching provider

4.5 Nearly 90% of consumers not taking advice in our survey sample opted to stay with their existing provider when accessing drawdown. This compares to closer to half of advised consumers, as shown in Figure 13.

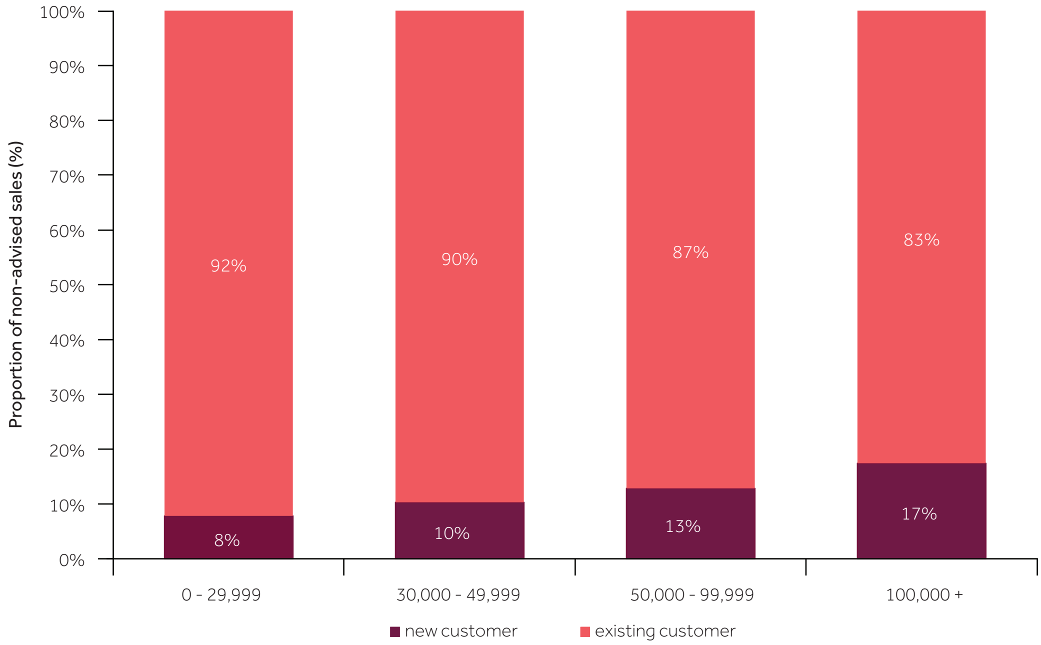
Figure 13: Proportion of drawdown sales to new and existing customers: advised vs. non-advised sales, 1 May 2015 – 1 May 2017



Source: FCA analysis of drawdown charges and investment choices collected from 7 providers.

4.6 The proportion of consumers not taking advice that switch providers increases for larger initial pot sizes. However, even for those consumers with the largest pots, four out of every five consumers remain with their existing provider.

Figure 14: Non-advised drawdown sales: new and existing customers by pot size, 1 May 2015 – 1 May 2017



Source: FCA analysis of drawdown charges and investment choices collected from 7 providers.

4.7 In any market, the level of switching is only one factor when considering how well it is functioning. Good value products for consumers do not necessarily require high levels of switching. However, as we show below, there are potentially large gains to be had from switching provider. Given this, we are concerned about the low level of switching. If only a few consumers are willing to switch this will put little pressure on providers to increase the value of their products.

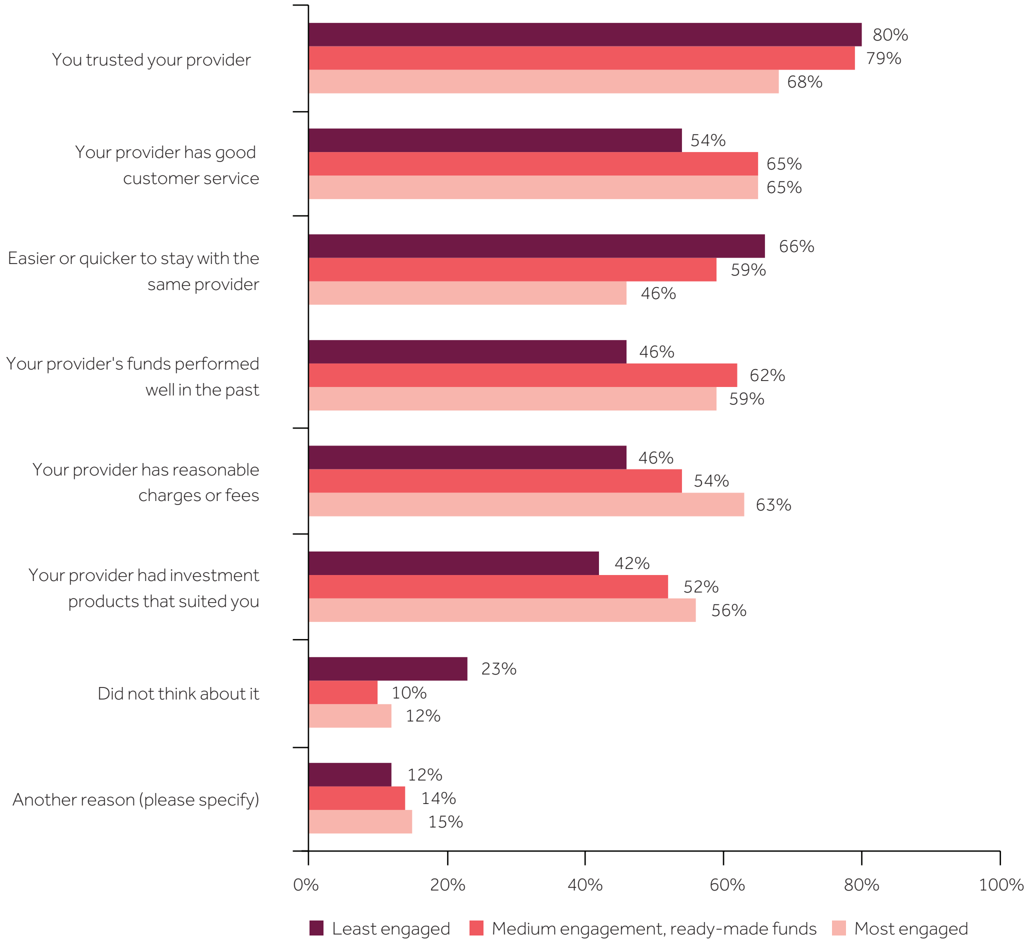
Many consumers do not consider switching on entering drawdown

4.8 Responses to the survey showed that while 89% of consumers said they were aware that they could change provider, most did not change provider and many did not even consider it. Around half of the consumers not taking advice did not consider switching despite being aware that they could, and those who did consider switching mostly did not. Consumers who did not consider moving providers were asked why they did not. The most commonly mentioned reasons were related to positive feelings towards their current provider.

4.9 We compared the reasons for not considering moving across the four engagement profiles.[49] The Least Engaged group (66%) were more likely than the Most Engaged (46%) and Medium Engagement (59%) groups to say that it was easier or quicker to remain with their current provider. The Least Engaged group were more likely to rely on their provider as a source of guidance or information.

49 These profiles are discussed in more detail in annex 5.

Figure 15: Reasons for not considering moving providers, by engagement group[50]



Source: Consumer research commissioned by the FCA, see annex 5.

Base: All who aware could change provider but did not consider it (335).

Note: Respondents could give multiple answers, so percentages sum to more than 100.

"Did you consider moving to any other provider?"

> **"No, I didn't no, no because I felt that [pension provider] had performed fairly well and better the devil you know than the devil you don't really."**
>
> Source: FCA consumer research

4.10 Our consumer research also revealed that some consumers who recall switching providers are not classified as new drawdown consumers by providers in our data request, and vice versa.[51] There could be many reasons for this. One explanation is that for some consumers the important decision concerns the pension product and not the act of accessing drawdown – a consumer who switched provider in accumulation, may not be recorded as a new drawdown consumer by the provider.[52]

50 The "Medium Engagement, In Cash" group is not included in the chart due to a low base size of less than 50 respondents for this question.

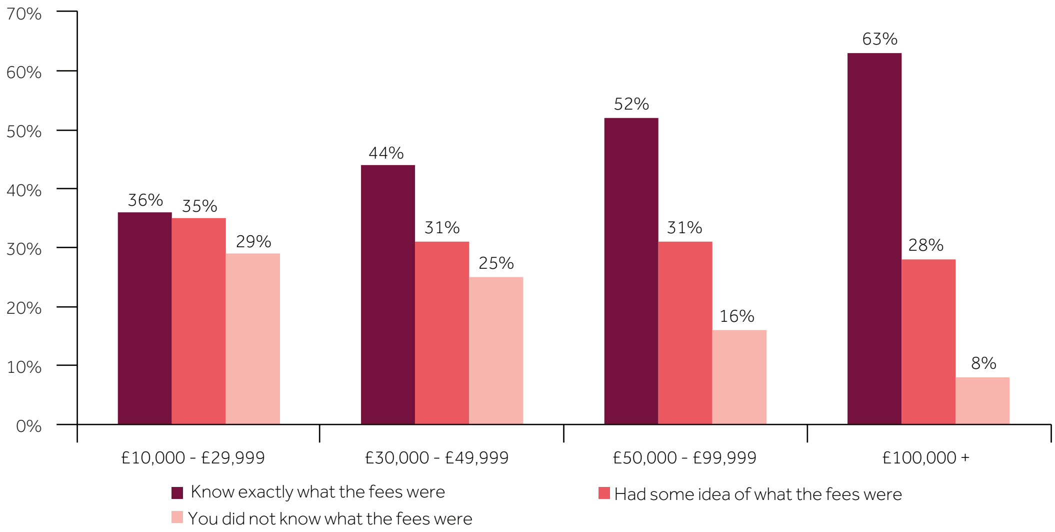
51 If a consumer moves to another provider while in accumulation and then accesses drawdown shortly after, they will be classified as an existing customer by the provider. This may not match how they view their own actions.

52 For example, they may have opened an account in accumulation and entered drawdown a few years later.

4.11 The research also revealed that fewer than half (46%) of people surveyed stated they knew exactly what the charges associated with drawdown were. 22% admitted they had no idea at all.[53] As noted above, consumers not being aware of their charges is likely to be a factor in reducing the amount they shop around for alternative drawdown providers.

4.12 Lack of awareness of fees was also associated with smaller pot sizes, 29% of those with a pot of £10,000-£29,999 said they did not know what the fees were, compared with 8% of the highest pot size group.

Figure 16: Self-perceived awareness of fees, by pot size



Source: Consumer research commissioned by the FCA, see annex 5.

Base: All who recall drawdown or took a lump sum (not SIPP) (529).

Barriers to shopping around and switching

4.13 We considered whether there were barriers that prevented consumers switching providers, such as the time and cost of actually switching or difficulty in finding and comparing alternative providers.

4.14 This section sets out our findings on the costs of switching, including the difficulties consumers face in understanding and comparing charges across providers of drawdown.

It can be costly and time consuming to switch between drawdown providers

4.15 To assess how difficult it is to switch between providers once in drawdown, we asked providers for information on their switching process, stating:

- the likely time involved in transferring out to another product
- whether consumers need to sell and re-purchase their investments when they switch to another provider

53 It is worth noting that we did not test whether those stating they knew exactly what they were being charged actually knew their charges. It is therefore possible, and perhaps likely, that the level of knowledge of charges is even lower than suggested by these figures.

- any charges when consumers switch away or exit,[54] such as admin or fund exit fees, including details of the charges and when they are applied

4.16 From the responses we received, providers appear to be using a mix of different approaches. Some are more costly in terms of charges, time taken or overall hassle. Where there is a charge or significant delay in the switching process, this may act as a barrier to switching for consumers. Table 3 summarises the range of approaches providers have taken to some of the main elements of switching. This shows there is a significant difference between what can be done to make the process less costly and what is done in some cases. This suggests there is room for improvement for some providers.

Table 3: Overview of the switching process

	Less costly	More costly
Requiring the sale and repurchase of shares to switch	Products allow all assets to be transferred as they are.	Products require either all assets to be sold and repurchased or a mix of selling, repurchasing and transfers depending on the type of assets.
Time involved in switching away	Usually less than a week depending on the assets invested in.	Usually 6-8 weeks depending on the assets held.
Any fees for switching away?	Typically do not have direct charges for switching away. There might be a charge involved if switching to an overseas scheme.	Products charge for a switch to a domestic or overseas product and there are also fund exit charges depending on the assets held in the product.

Providers apply and describe charges differently

4.17 Our interim report showed that charges for drawdown were complex, and that this made it difficult for consumers to shop around and compare drawdown options. We were concerned that, by making it difficult for consumers to compare charges across providers, providers had limited incentives to reduce prices, raise quality, or both, in order to attract new customers or retain existing ones.

4.18 There are two main types of charges paid by consumers who do not take advice:

- **Administration charges:** these are charges for providing a personal pension or a SIPP where a drawdown option has been activated and include:
  - *Product charges:* charges that all consumers in drawdown are likely to pay.
  - *Contingent charges:* charges that are only paid by consumers taking certain actions like making ad-hoc withdrawals or dealing in shares. Within our sample of providers these were mainly charged by platform SIPP providers.
- **Fund charges:** the on-going charge figure (OCF) is the total charge consumers pay on their investments (e.g. single assets, funds). It includes the annual management charge (AMC) and any other additional expenses for the management of the fund or asset.

54 Consumers that want to fully encash their pot.

4.19 Drawdown providers differ in whether or not they offer consumers investment products that they run themselves or those run by third-parties. If an investment product is provided by a third party rather than the provider, they will set the fund charge. Consumers pay administration and fund charges in different proportions across providers. For example, some providers only apply fund charges and no administration charges as these are included in the fund charges. Others charge both administration and fund charges. Some apply discounts to the fund charges. Figure 17 shows the proportion of administration charges and fund charges (OCF) of the total charge across providers. We found that:

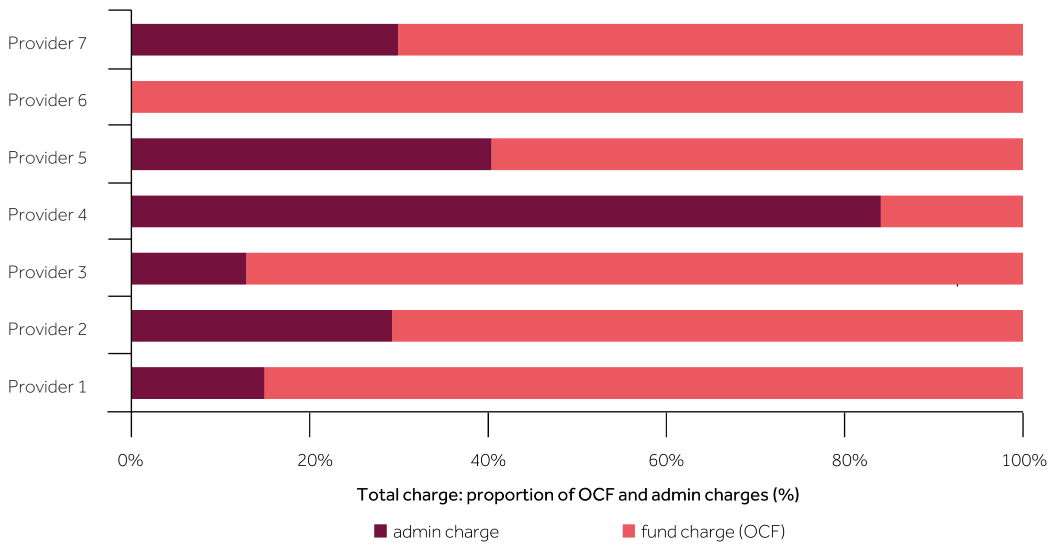
- Almost all providers use a combination of administration and fund charges.
- For most providers fund charges were a higher proportion of the overall charge than administration charges, but the opposite was true for a minority.
- Products vary between being weighted towards administration charges and fund charges. This suggests that the cheapest product in terms of administration charges will not always be the cheapest when fund charges are also considered.

4.20 A consumer trying to find the best value product needs to compute the sum of all of the charges they will pay across different providers. Consumers comparing only one headline charge would find it difficult to select the best value provider unless the figure included all charges.

4.21 This difficulty is compounded by the fact that charges are not named consistently across the market. For example, one provider may describe its main charge as a management charge while another calls it an administration charge, blurring the line between administration and fund charges.

4.22 As with previous chapters, to anonymise provider identities, we do not display provider names and randomise the order in which providers' data are reported in each figure and table presented below. In other words, 'Provider 1' will not refer to the same provider in the following figures.

Figure 17: Non-advised drawdown: proportion of administration charges and fund charges (OCF) in average total charge by provider, 1 May 2015 – 1 May 2017



Source: FCA analysis of drawdown charges and investment choices collected from 7 providers.

Note: We present average fund charges and administration charges as percentage of the average total charge by provider.

Administration charges can be complex

4.23 How a provider structures and presents charges is likely to dictate how difficult it is for consumers to understand how much they will be charged and compare providers. Charging complexity varies significantly across products for consumers who did not take advice, including the number of charges, the way they are applied and how they are presented.

4.24 The complexity of administration charges is highlighted by breaking the charges down into product charges and contingent charges. Contingent charges are paid for a certain activity, such as switching an investment, withdrawing money or getting a paper statement. Contingent charges generally account for a relatively small amount of total revenues for providers. However, SIPP providers are more likely to apply contingent charges, for example for dealing in shares which is a more natural part of their proposition than for other providers. For these providers, contingent charges can form an important part of their overall revenue from consumers.

4.25 While many products do not have any contingent charges, others have complex pricing structures with up to 44 different charges – most which are contingent. Where there are contingent charges for particular actions, these will often not be charged to consumers as many do not undertake the relevant activity. This could make it difficult for consumers to compare the total amount they will pay for some products.

Tiered charges can further complicate comparisons

4.26 Another form of complexity consumers must overcome to fully understand the charges they will pay is that they can vary depending on the value of their pot. Such tiered charging tends to take one of two forms, where:

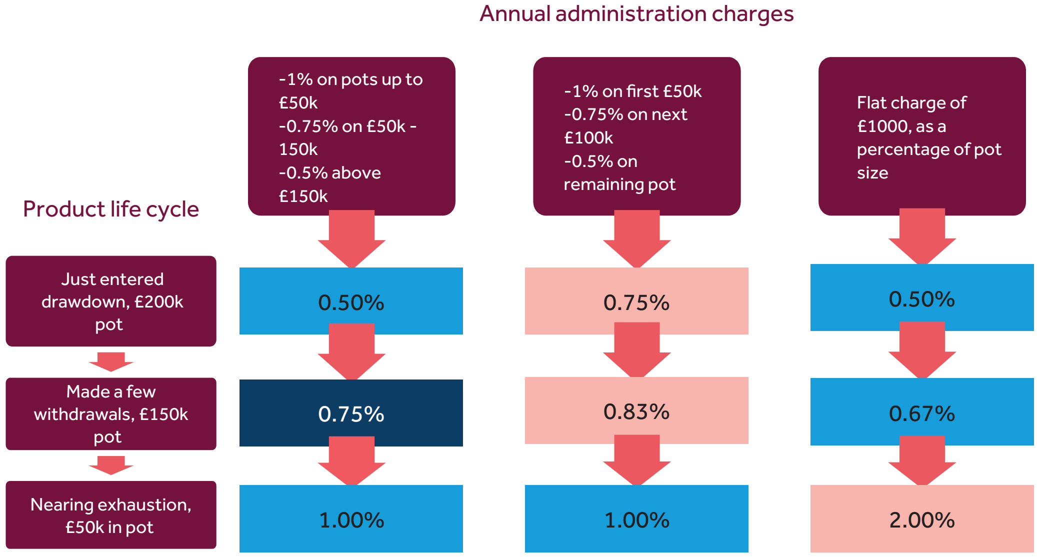
- The charge for the entire pot depends on pot size. For example, the charge could be 1% per annum on pots less than £50,000, but 0.75% for pots over £50,000 and under £150,000 and only 0.5% for pots over £150,000.
- Different parts of the pot are charged at different levels. For example, consumers are charged 1% on the first £50,000 in their pot, 0.75% on the next £100,000 and 0.5% for the pot over £150,000.

4.27 Another way in which charges can be presented differently is that some providers charge based on a percentage of the pot (typically annually) whilst others charge a set amount that does not vary by pot size, typically presented as an amount in pounds. To compare the charges requires a level of calculation from consumers, and which is cheaper may vary according to pot size, further complicating the issue.

4.28 Figure 18 looks at three example products and gives an illustration of the difficulty a consumer might have in assessing their options due to these differing charge structures.[55] The most and least expensive are highlighted at each stage. At first glance the charge structures appear similar but once the effective charges are calculated, the differences become apparent. The product that is the most expensive shortly after entering drawdown actually becomes the joint cheapest when the pot is nearly all withdrawn. Similarly the joint cheapest shortly after entering drawdown is the most expensive when nearing full withdrawal.

55 This example does not necessarily reflect charge figures seen in the market and is provided only to give an understanding of the difficulty that consumers face.

Figure 18: Illustration of the impact that different charge structures can have on comparability across the product life cycle



Note: The most and least expensive options are highlighted at each stage in pink and light blue respectively.

4.29 Another factor that can make it difficult for consumers to compare across providers is that some charges are more explicit than others. For example, if a consumer holds their pot in cash they may or may not pay administration charges and may also receive interest on the amount held. Consumers need to take both factors into account when considering the product that provides the best value. For example, a product that charged 0.5% per annum but paid interest of 1% per annum would provide better value than a product not charging a fee but providing interest of 0.25% per annum.[56]

Conclusions on barriers to switching

4.30 Building on the findings of the interim report, we have found that few consumers who do not take advice are switching provider when they enter drawdown. Further, our consumer research suggests that few are even considering switching.

4.31 For those consumers who do consider switching, there are likely to be some barriers that make this difficult. The time it takes to switch away and the associated product and fund exit fees may form barriers to switching, and our consumer research suggests that this hassle factor has an influence on some consumers. The complexity of charging structures and their lack of consistency across providers makes it difficult for consumers to compare how much they will be charged, making shopping around difficult. We found that many consumers are not aware of the charges they are paying in drawdown.

4.32 The fact that few consumers are switching provider, or even considering switching provider, suggests that providers face little competitive pressure, in particular on the charges they apply.

56 The example is illustrative only and is not intended to reflect the charging structure of any specific provider in the market.

Level of charges in non-advised drawdown

4.33 We wanted to understand whether low levels of shopping around and switching had led to high charges for consumers not taking advice or for disengaged consumers.

4.34 In a market where competition is working well, we expect consumers to shop around and select the drawdown option that better fits their needs. When consumers shop around and switch to another provider, providers will be incentivised to lower charges and improve quality to keep existing customers and attract new ones.

4.35 So far, we have seen that:

- most consumers not taking advice do not shop around and stay with their existing providers, partly because of the complexity of drawdown and charging structures
- most providers keep high proportions of their existing consumers and so may not be incentivised to compete on charges

4.36 To assess whether drawdown providers are competing on charges, we compared total charges across providers and between different types of consumers. These included, for example, consumers who took and did not take advice, and new and existing drawdown customers. Large differences in charges are not in themselves proof of weak competition. Other factors, such as the costs of providing the service, also need to be taken into account. However, given the low level of switching in drawdown, we considered that a high level of variance in charges could be the result of weak competition.

4.37 As noted in the previous chapter, we asked a sample of providers for data on the administration and fund charges paid by drawdown consumers and their investments.[57] As above, we have anonymised the provider and randomised the order in each figure.

4.38 We have combined the charges data with information on product characteristics, investment choices, and performance data from Morningstar.[58] When comparing charges across different providers, we have aimed to control for differences across providers that reflect differences in the value that consumers place on the product. While we have not been able to fully do this, we have sought to mitigate its effect by exploring the extent to which differences in charges might be driven by product quality such as, for example, product differentiation or investment performance.

4.39 In this section we present the results of our analysis of the charges paid by drawdown consumers that entered drawdown after the pension freedoms were introduced.

Charge dispersion in non-advised drawdown

4.40 We were concerned that some consumers who do not take advice are paying high charges.

4.41 Differences in charges across products can indicate that some providers are charging high prices and the market is not working in the interests of all consumers, particularly

57 We asked providers to provide these data for each customer who entered drawdown between 1 May 2015 and 1 May 2017, with an initial pot size over £10,000. More information on the data we requested can be found in annex 4.

58 Morningstar is an independent provider of investment research and analytics. It collects information in investment performance, such as returns and volatility and on investment characteristics, such as fund composition and asset class.

when so few consumers shop around. However, we know that the differences in provider charges are only part of the story. There can be differences across providers even in competitive markets, if they reflect differences in providers offering, such as a higher service level. It is also possible for consumer charges to be uniformly high, for example if all providers were charging prices above those expected in a competitive market.

4.42 We analysed the total charges across the sample of providers covered by our information request. These providers account for almost two-thirds of consumers not taking advice in drawdown.

Average total charges vary significantly across providers

4.43 We have calculated total charges including administration charges and fund charges, as a percentage of the total pot.[59]

4.44 We first focus our analysis on consumers investing in funds and other assets. We look at charges for consumers holding their entire pots in cash later in this chapter.

4.45 Figure 19 shows the total charges paid by consumers who did not take advice across providers and pot size. Our analysis confirms that there is a significant difference in charges across providers.

Figure 19: Average annual total charge by investment value (£) and provider, 1 May 2015 – 1 May 2017

Source: FCA analysis of drawdown charges and investment choices collected from 6 providers.

Note: We have calculated the total charges as the sum of annual administration charges as a percentage of the final pot size (total amount invested in funds, assets and cash) and average OCF adjusted by the value invested by each consumer in each fund/asset. We have excluded consumers in cash account.

4.46 Our data indicate that:

- Average total charges range from around 0.4% to 1.6% across providers.

59 We estimated these charges based on the actual charges they had paid over the period and used the pot size as at the snapshot date to turn this into a percentage charge. As we did not have data on actual pot size for the entire period, actual percentage charges may have varied slightly. For greater detail on how we calculated the total charges see annex 4.

- Within the segment £0-£29,999, there is less variation in average total charges with few providers charging significantly below 1%. In our data this was the most common pot size for consumers not taking advice with 40% of having a pot of £29,999 or less in May 2017.

4.47 Some of the variations in level of charges in Figure 19 reflect the different ways provider charge. For example, some providers levy charges as a percentage of the value invested. Here the percentage charge decreases with the pot size. Other providers do not charge different percentages for different pot sizes but instead levy flat fees regardless of pot size. Such charges will decrease in percentage terms as the pot size increases.

4.48 We have not collected data on the costs of providing drawdown. This means it is not possible to identify the level of charges we would expect in a market with well-functioning competition.[60] A number of stakeholders' responses to the consultation following the interim report and our information request told us that the costs of providing drawdown are higher than those of providing services in accumulation.

4.49 To understand whether some consumers were likely to be paying more for drawdown than they would in a competitive market, we used the charge cap in place for qualifying schemes for pension accumulation as a useful starting point for benchmarking the level of charges. The cap is 0.75% per annum of funds under management although we note that, in practice, providers often charge below this in accumulation.[61]

4.50 We found that at least five providers charge more than 0.75% to their drawdown consumers who do not take advice and this was independent of the value invested. While we cannot determine whether the charges are too high from this alone, the fact that other providers are offering drawdown at lower charges suggests that weak competitive pressure may be leading to higher charges than necessary for some consumers.

Total charges vary widely across providers

4.51 Although average charges help in understanding the charges consumers pay, they do not reflect the spread of charges within each provider. To understand how charges varied across individual consumers, we therefore looked at the distribution of charges within providers.

4.52 Figure 20 shows the distribution of non-advised total charges for each provider. Each box corresponds to the charge distribution of each provider and shows five summary statistics:

1. the lowest charge their customers pay
2. the lower quartile charge, this is the charge at which 25% of the provider's customers pay less and 75% pay more
3. the median charge, this is the mid-point of the distribution where half the provider's customers pay more and half pay less

60 Should we decide to progress with investment pathways, we also plan to review the charges being applied to them one year after their implementation, at which point we would expect to collect data on the cost of providing these pathways.

61 See Department for Work and Pensions' Pension charges survey 2016: https://www.gov.uk/government/publications/pension-charges-survey-2016-charges-in-defined-contribution-pension-schemes

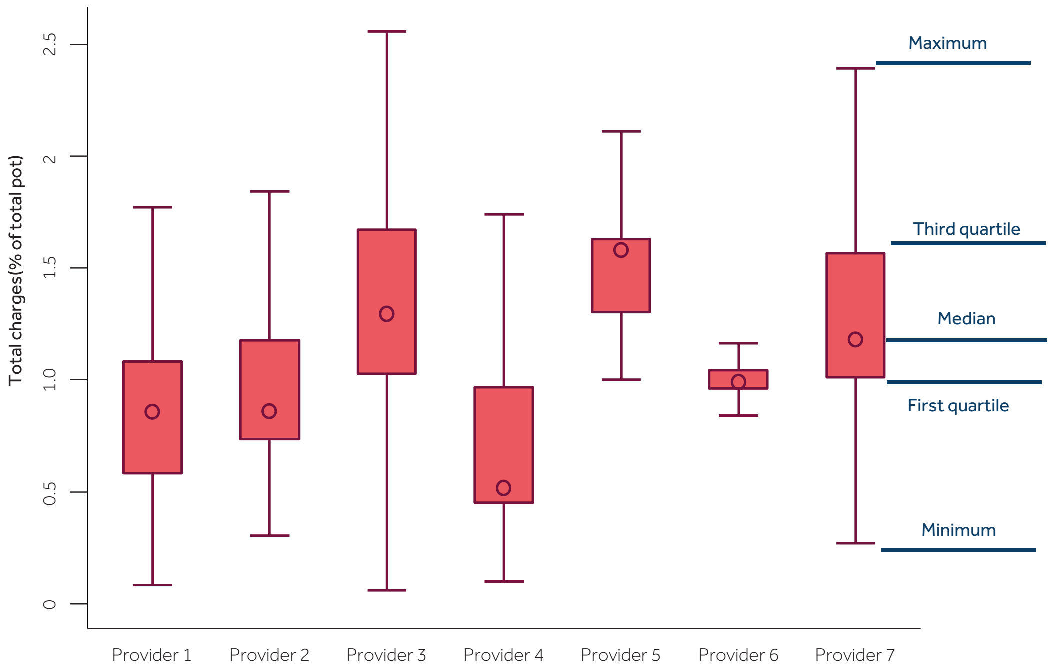
4. the upper quartile charge, this is the charge at which 75% of the provider's consumers pay less and 25% pay more

5. the maximum charge their customers pay

4.53 Our data show that:

- The median charge (the maroon circle in the boxes below) differs significantly across providers.
- Three providers have over half of their customers paying more than 1% in charges (i.e. the median charge is higher than 1%).
- The spread of charges within some providers is higher than in others. Some providers show large differences in the charges different consumers pay, while others show little difference.

Figure 20: Dispersion of non-advised total charges by provider, 1 May 2015 – 1 May 2017



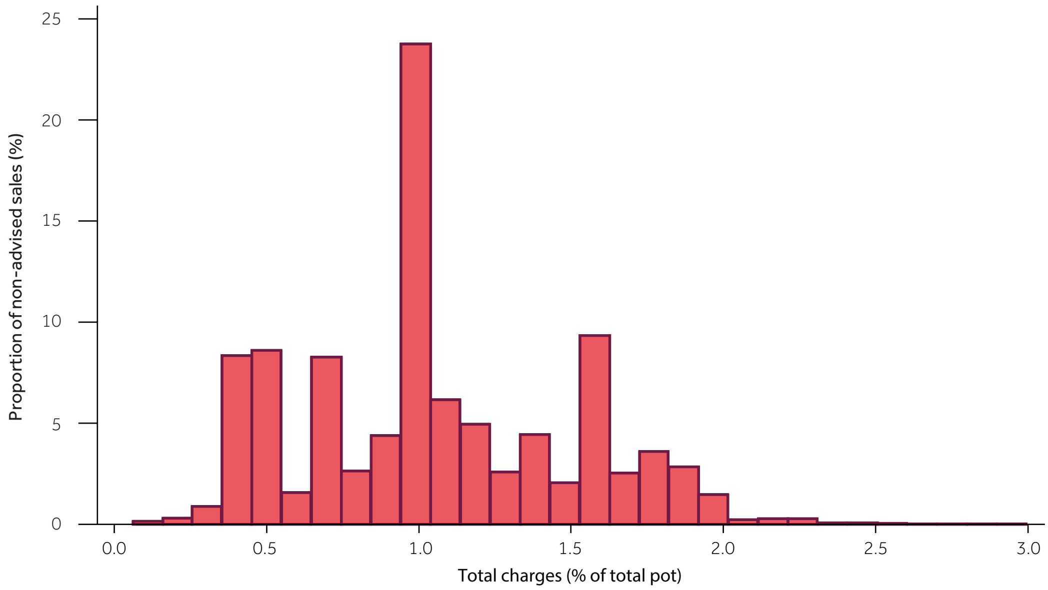
Source: FCA analysis of drawdown charges and investment choices collected from 7 providers.

Note: We have excluded consumers that are holding their money in a cash account. The provider numbers have been randomised to preserve their identity. We have excluded outliers.

Charges for consumers not taking advice are highly dispersed

4.54 Further to this analysis, we have looked at the range of charges paid by all consumers not taking advice within our sample. (Figure 21) Within the sample, a significant number of consumers are paying charges of 1.5% or more every year. For consumers with a £40,000 pension pot this amounts to around £600 a year. These consumers could save £400 a year if, by shopping around, they instead paid a charge of 0.5% per year.

Figure 21: Distribution of non-advised drawdown charges, 1 May 2015 – 1 May 2017



Source: FCA analysis of drawdown charges and investment choices collected from 7 providers.

Note: We have calculated the total charges as the sum of annual administration charges as a percentage of the final pot (total amount invested in funds, assets and cash) and average OCF adjusted by the value invested by each consumer in each fund/asset.

Note: We have excluded consumers that have not made any investment choices and are holding their pot in a cash account. We have excluded outliers.

4.55 We plotted the total charges against the total pot invested[62] to see if there is a clear relationship between total charge and pot size. Our data show that, on average charges as a percentage of the pot size decrease as the pot size increases.

4.56 Figure 22 shows that charges are dispersed but more concentrated between 0.5% and 1.5%. Few consumers with small pots pay charges higher than 2% of their total pot. This may reflect consumers being with providers charging flat fees that are a higher percentage of their pot.

62 This includes investments in cash, funds/assets including properties and any other alternative forms of investments.

Figure 22: Non-advised sales: annual total charges vs. total pot, 1 May 2015 – 1 May 2017

Source: FCA analysis of drawdown charges and investment choices collected from 7 providers.

Note: We have calculated the total charges as the sum of annual administration charges as a percentage of the final pot (total amount invested in funds, assets and cash) and average OCF adjusted by the value invested by each consumer in each fund/asset.

Note: We have excluded consumers that are mainly investing in alternative forms of investments (e.g. property). We have excluded outliers.

4.57 The differences in total charges may reflect differences in investments. We looked at the investment choice offered to consumers not taking advice.

4.58 Table 4 shows the different investment options providers offer to consumers. Depending on the type of investments consumers are investing in, the charge may vary. For example, active funds and ready-made options are likely to cost more than passive funds. Table 2 also shows the number of investments where at least one consumer who did not take advice had invested. The range of individual assets and funds where consumers are actually investing varies significantly across providers.

Table 4: Investment choices to consumers not taking advice

	Fund range offered	N. investments
Provider 1	• Same as advised • Full choice: active funds and trackers • Fund shortlist: selected active funds and trackers • Ready-made funds: 3-5 risk-targeted multi-asset funds	800-900
Provider 2	• Full choice: individual assets and funds (active funds, trackers and multi-asset funds) • Fund shortlist: active and multi-asset funds Ready-made portfolio: 3-5 multi-asset funds	400-500
Provider 3	• Same as advised • Full choice: individual assets and funds (active funds, trackers and multi-asset funds) • Fund shortlist: active funds and trackers	1,100-1,200

	Fund range offered	N. investments
Provider 4	• Same as advised • Full choice: individual assets, funds (active funds, multi-asset funds and trackers)	200-300
Provider 5	• Full choice not available • Restricted choice: active fund(s)	0-50
Provider 6	• Full choice not available • Restricted choice: active fund(s) and a cash fund	0-50

Source: FCA analysis of qualitative responses collected from 6 providers and desk research

4.59 We could not fully control for differences in types of funds. However, we compared the charges that consumers paid given the type of investment they held. This analysis showed a wide dispersion in charges even for consumers holding similar investments, such as only ready-made funds.

Consumers in cash are paying different levels of charges

4.60 This analysis excluded consumers who entered drawdown and are holding their pot in cash. We also wanted to understand the charges these consumers were paying. We are concerned that some consumers invested fully in cash may be missing out on investment growth, so would be particularly concerned if they are also paying high charges.

4.61 There are several ways that consumers might pay charges when holding cash. For example they might:

a. pay administration charges, either on-going charges or contingent charges

b. receive only a proportion of the interest earned on their money with the rest retained by the provider

c. hold a cash fund which has fund charges

4.62 Our analysis reveals that the amount consumers holding cash pay can vary significantly, although the difference in charges is less than it is for consumers not holding all their assets in cash. Most consumers are paying administration charges although some are only paying implicitly through the provider retaining interest, making it difficult to compare across providers.

Potential gains from switching

4.63 We have seen a wide variation in the total charges paid by consumers entering drawdown without advice, even within the sample of providers within the scope of our information request.[63] This showed that charges typically vary from between 0.4% to 1.6% per annum.

4.64 To understand the impact of differences in charges across providers, we estimated the potential gains consumers could get if they were to switch from a provider charging at the top of the range to one at the bottom. Not all consumers will be able to realise savings of this level, but may still be able to reduce charges by switching around.

63 Since this request covered only seven providers, it is possible that the level of dispersion across all providers in the market could be even higher.

4.65 As above in the previous chapter when considering the gains from investing compared to being in cash, we considered the difference in annual income that a consumer could expect to receive if they intended to fully withdraw their pot over 20 years. To do so, we compared the annual income consumers could withdraw over 20 years if they paid charges of 0.4% and if they paid charges of 1.6%. We assumed that all other aspects of the products would be identical, such as investment returns. We found that by switching from a higher cost provider to a lower cost provider, consumers could increase the annual income from their pot by 13%. For an individual with a pot of £100,000, this would be an extra £648 a year on top of an income of £4,922.

No clear relationship between higher charges and better performance

4.66 Our data suggest that there are substantial differences in charges across drawdown providers, even within the relatively small sample of providers we have considered. This may not indicate weak competition if it represents differences in quality across products.

4.67 When choosing the option that best suits their needs, consumers should compare both prices and quality of the available options.

4.68 It is not easy to control for product quality across providers. Many of the factors that consumers value, such as being a trusted brand or offering reliable customer service, are intangible and hard to measure. Nonetheless, we wanted to understand whether there was evidence that the wide difference in charges across providers was the result of differences in quality.

4.69 We saw no evidence of significant differences in quality across non-advised drawdown options, other than the choice of investments offered.

4.70 We wanted to understand whether there was evidence that the differences in charges could be explained by consumers getting better investment returns. We have seen from previous work on asset management that there is often no relationship between the fees of an investment fund and the performance.[64]

4.71 To build on this and to see if a similar story emerged for drawdown, we compared the charges consumers are paying with the investment returns they have received. While returns are not the only measure of quality, we might expect to see clear evidence of better performance from higher charging funds.

4.72 Our data show that most consumers (61%) who do not take advice invest in one investment.[65] Focussing on one investment makes it easier to see how returns vary with charges, so our analysis focused on these consumers.

4.73 We carried out our analysis on fund performance using the Sharpe ratio which controls for the volatility of investment returns.[66] Volatility is particularly important for drawdown consumers as they may rely on the income from their pot and so do not want its value to change too drastically.

64 See chapter 6 of the Asset Management Market Study Final Report: www.fca.org.uk/publication/market-studies/ms15-2-3.pdf

65 For greater detail, see annex 4.

66 The Sharpe ratio is a measure of performance that contrary to other performance metrics takes into account volatility: it adjusts performance for risk by scaling returns against the standard deviation of the fund's return after charges over the risk-free rate.

4.74 A higher Sharpe ratio means that a fund has performed relatively well given the amount of volatility it has incurred during the year. A Sharpe ratio of 1 or above is often considered a benchmark for an acceptable investment. This is because it reflects that the investment is performing no worse than a low-risk asset in compensating consumers for volatility with return.

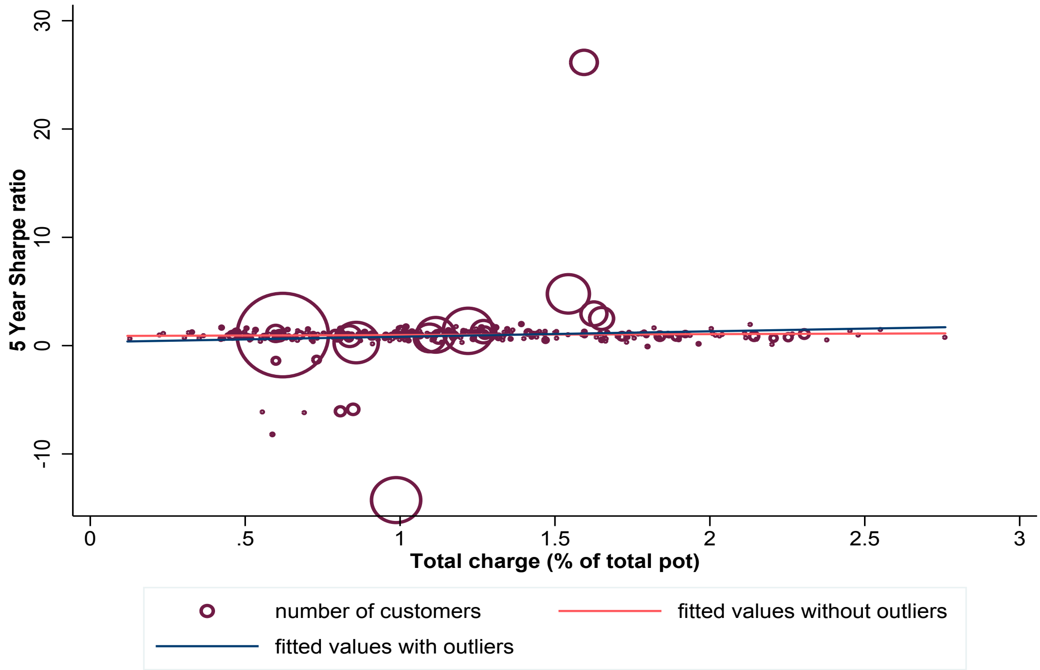
4.75 Sharpe ratios are time-period dependent so vary depending on the time period they are based on. Five years of data was the longest period for which we had data. We believe that a Sharpe ratio based on a period of five years provides an adequately long period of time to expect a pattern to emerge, but acknowledge that longer time periods might have been desirable. We have calculated Sharpe ratios net of charges.

4.76 We plotted five-year Sharpe ratios against total charges to see whether there was a clear relationship between total charges and investment performance. While the initial line of best fit was slightly upward-sloping (the blue line in Figure 23), we found that this was driven by a small number of outliers.[67] After excluding these outliers from our analysis, we found that the line of best fit was flatter (see pink line in Figure 23). Variations in total charges explain little of the variation in Sharpe ratios. Excluding outliers, for investment choices with high charges there are investments with similar Sharpe ratios and lower charges. Consistent with the findings of the FCA Asset Management Market Study[68] the evidence does not show a clear relationship between charges and performance – it is not clear that you get better returns in exchange for higher fees.

67 The line of best fit is a straight line that represents an estimate of the linear relationship between the two variables in question. Hence, if the line of best fit slopes upwards then the two variables are positively correlated and negatively correlated if the line slopes downwards.

68 Asset management market study final report, 28th June 2017, https://www.fca.org.uk/publications/market-studies/asset-management-market-study

Figure 23: Non-advised sales: 5 – Year Sharpe ratio and total charges (% of total pot), 1 May 2015 – 1 May 2017



Source: FCA analysis of drawdown charges and investment choices collected from 7 providers.

Note: We have excluded consumers with more than one investment.

4.77 So, overall, we consider that the large differences in charges between providers cannot be explained by performance.

4.78 Figure 23 also shows the number of consumers that are investing in each investment,[69] represented by the size of the bubbles.[70] Although we cannot conclude that there is a clear relationship between price and performance, our analysis shows a number of consumers investing in expensive investments with low returns. Our data suggest that:

- 30% of consumers are currently in investments with a five-Year Sharpe ratio below 1. This suggests that they may not be in the best investments.
- Some consumers are in poorly performing investments (i.e. with negative Sharpe ratios) and paying charges of around 1% per year.
- Consumers in some of the most expensive funds (OCF of 1.5% or higher) are gaining good returns – Sharpe ratios higher than 1.5 – although there are other cheaper investments offering the same returns.
- Some of the most expensive investments are multi-manager funds. Our data suggest that there are cheaper funds performing better.

Charges paid by different types of drawdown consumers

4.79 In the previous section, we saw that the charges paid by consumers not taking advice varies significantly across providers and that this is unlikely to reflect differences

69 For greater detail on the relationship between performance and fund charge by type of investment, see annex 4.
70 Unfortunately, we do not have data on some of the most popular funds because they opened less than five years ago.

in quality. We also wanted to know whether providers charged different types of consumers differently and whether some consumers were getting a worse deal than others.

4.80 We compared charges paid across providers and different groups of consumers to find out whether there are differences between:

- consumers who do or do not take advice
- for those not taking advice, consumers that switch provider when they enter drawdown and those that do not

4.81 Our comparisons showed that there is no clear evidence that consumers who do not take advice pay more than advised consumers, indeed the opposite may be the case. See annex 4 for further details of this analysis.

Conclusion on charges

4.82 We have found considerable variation between providers in consumer charges, reflecting variation in both administration charges and fund charges. Such variation does not obviously reflect differences in the cost of provision of investment performance, so we believe that such charge variation likely reflects weak competition in the drawdown market. As a result some consumers could benefit from a materially higher income from their pot by switching provider.

5 Summary of our current thinking on a package of remedies

Chapter Summary

In this chapter, we set out our current thinking on a package of remedies and how we are taking these forward.

Our package of remedies aims to help and protect consumers at each stage as they move through their retirement income consumer journey.

Our remedies aim to achieve three key objectives:

a. **protecting consumers** from poor outcomes

b. **improving consumer engagement** with their retirement income decisions

c. **promoting competition** by making the cost of drawdown clearer and more comparable for consumers

To protect consumers from poor outcomes, we are considering requiring firms not to default consumers into cash, unless the consumers make an active choice to do so. We are also considering requiring that providers introduce 'investment pathways', which give simple choice structures that help consumers make better decisions.

To improve consumer engagement, we are proposing to improve the wake up packs and risk warnings, by sending them earlier and making them clearer. We are also taking steps to improve shopping around for annuities. We will also hold a Pension TechSprint later in the year to encourage innovative solutions to some of the emerging issues, including lack of engagement and shopping around.

To promote competition, we are making Key Features Illustrations (KFIs) clearer and making charges information more prominent and comparable. We are also working with MAS and ABI to facilitate the introduction of a drawdown comparator. In addition, we are considering requiring firms to disclose actual drawdown charges annually.

Our overall package of proposed remedies

5.1 The retirement income market is still evolving after the fundamental reforms three years ago. Our package of remedies consists of rule-based interventions, guidance, coordination with other regulatory bodies and industry cooperation. It aims to effectively balance addressing the issues we have identified while allowing the market to continue to develop and innovate.

5.2 Industry practice continues to evolve, and some providers have already made changes that should address some of the issues we have identified. We believe our interventions will encourage this process, set new and clearer standards, and help ensure consistently good practice across the market.

5.3 In the executive summary we provided details of the proposed remedies based on the stages of the consumer journey in which they would aim to help and protect consumers. These are examined in detail below, both through the lens of the consumer journey and the objectives they aim to achieve.

Consumer Journey

5.4 Our package of remedies aims to help and protect consumers at each stage as they move through their retirement income choices. They aim to address the needs of the consumers before accessing their pension pot, at the first point they do so, and after they have accessed their pots.

5.5 Most of these remedies (for example the investment pathways) take effect at the point that consumers first access their pot, as we believe that is the stage consumers need more help and support, and where much of the harm occurs.

5.6 Other remedies (for example the amended wake up packs) focus on an earlier stage in the consumer journey, before they access their pots. At this stage, consumers need better information – including signposting to appropriate guidance so they can start to think about planning their retirement income before they are faced with an immediate decision.

5.7 We are also proposing remedies (for example amends to the annual statement) that focus on a later stage in the consumer journey, after consumers have accessed their pots. As circumstances can change over time, consumers need to review their decisions and manage their pensions. So we are proposing that consumers get ongoing communications to help them check that their choices continue to match their objectives.

5.8 The diagram below illustrates how the remedies we are considering will improve the consumer journey. It compares the current process and the potential future process after our remedies are implemented.

5.9 We believe that the remedies we are considering will improve the process for consumers and will get them to engage more with their pensions and make more informed choices. They will also ensure that consumers receive the support, protections and information they need to make better decisions.

Current vs future consumer journey

Current issues	Before accessing pot	When consumer accesses pot	Consumer enters drawdown
• Low consumer engagement • Lack of shopping around • Poor investment choices	**Wake-up pack** **Reminder**	**Risk warnings** **KFI** provided when consumer enters new drawdown product	**Annual statement** when taking an income (no charges info)

Our remedy package

	Before accessing pot	When consumer accesses pot	Consumer enters drawdown
Choice architecture **Protect consumers**		**Investment pathways** **No cash default**	**Annual information to allow consumers to review their investment pathways decisions**
Communications **Improve engagement**	**Wake-up pack comprising single page summary document** **Risk warnings** **Stronger reminder**	**Wake-up pack including single page summary document** **Risk warnings** **MAS factsheet** **Every five years until pot is fully crystallised** **Annuity information prompt** including for income driven quotes & enhanced annuities	
Comparison **Promote competition**		**KFI** provided to consumers entering drawdown or taking UFPLS through new or existing product, including summary document (with clearer charges info)	**Annual statement to all consumers** (including actual charges info) Further **KFI** provided where consumer starts taking income at later date
Technology **Help consumers to:** • Navigate drawdown • Make better choices		Drawdown comparison tool Techsprint	

Key: KFI - Key Features Illustration
UFPLS - Uncrystallised Funds Pension Lump Sum

Key objectives

5.10 As we outlined in our interim report and built on in our final report, our proposed remedy package aims to achieve three key objectives:

- **protecting consumers** from poor outcomes
- **improving consumer engagement** with their retirement income decisions
- **promoting competition** by making the **cost of drawdown clearer** and more comparable for consumers

5.11 Our review and these proposed remedies are primarily targeted at improving the outcomes of consumers who do not take advice, on the basis that those taking regulated advice receive support already. However, regulated advice is not affordable or appropriate for everyone, and this review focuses on those who will look to their pension provider or public sources for support and guidance around their retirement decisions.

5.12 We provide details below on the package of remedies, split under the three key objectives.

Protecting consumers from poor outcomes

5.13 As part of our Mission,[71] we set out our focus on preventing harm from occurring where possible and putting things right when they go wrong. After the introduction of pension freedoms, non-advised drawdown is effectively a new market. We want to ensure we help and do not hinder its ability to innovate and develop. However, we have found instances of potential consumer harm in this market. So we are taking action to help set this market on the right footing for the future.

Preventing consumers being defaulted into cash

5.14 Nearly a third of consumers are wholly or predominantly holding cash.[72] Some life companies' default option for consumers who did not express a view, was to place the pot in a cash account or similar investment. Similarly some platform SIPPs place a new customer in the cash account by default until the customer chooses an investment. In both cases, unless the consumer takes action, their pot will remain in cash indefinitely.

5.15 Cash may be suitable for those drawing down their pot over a short period, perhaps to bridge until the start of a DB or state pension. However the average person taking tax-free cash at 55 can reasonably expect to live to 85 or more. For someone relying on their pot for income over their entire retirement, holding their income in cash is likely to substantially reduce their income compared to investing in readily available alternatives, such as a cautious growth fund. 33% of non-advised drawdown consumers are wholly or predominantly holding cash. We estimate over half of these may be losing out on investment growth by being in cash. Some consumers could increase the expected annual income from their pot by 37% by investing in a mix of assets rather than in cash.

5.16 **We are considering making rules requiring that a providers' 'default' cannot be cash**, so a consumer will have to make an active choice to hold cash. We recognise this solution would also represent a significant change for parts of the market, in particular SIPPs. We are therefore, raising these areas for discussion in our Consultation Paper (CP) but not proposing to make rules now. We will consider the feedback received – and whether we need to refine these we have put forward in this CP – and will consult in January 2019.

5.17 For consumers already 'defaulted' into cash (or where their existing arrangement will see them defaulted into cash when they go into drawdown), we are considering proposing to introduce rules to require providers to regularly notify their customers who hold cash for significant periods of the risks of doing so. These rules will apply to consumers who stay in cash for significant periods. See the CP for further details.

71 www.fca.org.uk/publications/corporate-documents/our-mission
72 This includes direct holdings in cash and holdings in "cash-like" assets, such as money market funds or short-dated maturities.

Investment pathways

5.18 In developing responses to the challenges consumers face in drawdown we considered the protections they get when they are accumulating their pots. Qualifying workplace schemes and stakeholder pensions provide a default investment strategy in accumulation with total charges for that default capped at 0.75% and 1% respectively. This led us to consider similar defaults and charge caps in decumulation. We outlined the possibility of introducing drawdown investment pathways in our interim report.

5.19 Since the interim report, we have considered the investment options offered by providers and chosen by consumers. There is a standard common objective in accumulation – to maximise the size of the pot at the point of retirement. But there are many objectives in decumulation depending on the time period the pot will be used for and whether it is to be used for regular, ad hoc or single lump sum withdrawals.

5.20 Providers vary substantially in their range of investment options. Some providers offer a single default investment option. Others offer a variety of ready-made investment options and create a choice structure so the consumer makes an active choice. Even engaged consumers can find it hard to navigate the different options available.

5.21 This is particularly the case for consumers who go into drawdown solely because they want to access their tax-free cash. These consumers have to make a decision on what to do with the rest of their pot when they access their tax-free cash. However, these consumers generally do not focus on this decision, and so will find it even harder to make appropriate choices and navigate the options.

5.22 So, we believe that it is important that consumers are given simple choice structures that help them make better decisions. Our analysis shows that when providers have introduced similar measures, this has produced better consumer outcomes. Investment pathways are a standardised set of investment options that represent core ways in which a consumer may want to use their pot. We want to ensure that providers are offering an appropriate range of options to their customers and providing help in making their investment choice, without having to make an advised sale.

5.23 In our interim report we used the term 'default investment pathways'. We also note that the Work and Pensions Committee has recommended that the Government takes forward our proposal in the interim report to require any provider offering drawdown to offer a default drawdown solution targeted at their core customer group. Following our further work, we have moved away from that as we do not believe that a single, 'default' investment pathway is appropriate. Consumers' needs and objectives are diverse, and we believe that one single option cannot match them appropriately. We are also concerned that a single default might reinforce the lack of consumer engagement.

5.24 We think that providers should be able to offer drawdown without advice but there should be more structure around it. We found that more structured choice architecture improves the investment outcomes for consumers. To help non-advised drawdown consumers into investments that broadly meet their objectives, we are considering **mandating that providers provide ready-made drawdown investment solutions, which we refer to as 'investment pathways'**.

5.25 We suggest that investment pathways might have the following features. Investment pathways would be intended to serve as a mass-market offering. They would be designed to be broadly appropriate for consumers with fairly straightforward needs, which reflect the following standardised consumer objectives:

- I want my money to provide an income in retirement
- I want to take all my money over a short period of time
- I want to keep my money invested for a long period of time and may want to dip into it occasionally

5.26 These ideas are explored in depth in our CP. We recognise this represents a significant change for parts of the market. We are therefore, seeking further views on their design to ensure they are as effective as possible, before consulting. We will consider the feedback received – and whether we need to refine the ideas we have put forward in this CP – and will consult in January 2019.

Charges

5.27 As we have previously noted, the standard charges for non-advised drawdown vary significantly between providers and charges appear on average to be greater than for accumulation, with charges above 1% not uncommon. We believe that a lack of competitive pressure may have contributed to this.

5.28 We have identified a number of obstacles facing consumers who want to shop around and compare charges. It is not easy for consumers to compare on a like for like basis across providers because of the different ways that providers levy charges. Furthermore at the moment these consumers are not always given information at the right time and in an appropriate format. So we propose a package of remedies to increase competitive pressure and improve value for money:

a. We are taking steps to **increase the transparency of charges** both when entering drawdown and on an ongoing basis. This includes making rules requiring providers to include a one-year charge metric in pounds and pence across all relevant disclosures. This one-year charge figure will be included in the creation of a drawdown comparator currently being designed between MAS, the ABI and the FCA. These changes should help facilitate shopping around and increase competitive pressures, which in turn should lead to lower charges (see CP for further details).

b. We also believe that a requirement for independent oversight of the appropriateness, quality and charges of investment pathways may be appropriate. We are considering how a requirement for independent governance should apply and exploring this as part of our CP. This will input into our plans for consulting on investment pathways.

5.29 In our interim report we discussed the possibility of introducing a charge cap for the investment pathways. The Work and Pensions Committee subsequently recommended a charge cap for 'default decumulation pathways'. Its view was that the charge cap should be set at 0.75%, the level of the charge cap on default arrangements in qualifying workplace pension schemes used for automatic enrolment.[73]

5.30 The option of capping charges remains open, but we do not propose to take this forward this at this stage. This is because the market continues to evolve, and because

73 https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/917/91702.htm (paragraph 22)

we believe that the changes we are considering will make charges more transparent and comparable and will help some consumers to compare, shop around and switch providers if appropriate, and so increase competitive pressure.

5.31 That said, we expect to see the market deliver competitive charges for all drawdown solutions and will take action if it does not. In particular, we expect firms to challenge themselves on the level of charges they levy on investment pathways, using the charge cap on default arrangements in accumulation of 0.75% as a point of reference.

5.32 Should we decide to progress with investment pathways, we also plan to review the charges being applied to them one year after their implementation. If the evidence we gather suggests it is necessary, at that point we will be highly likely to move towards a cap.

5.33 We also note that the Work and Pensions Committee has recommended that the Government allows NEST to provide decumulation products. They also believe that this could drive better retirement outcomes by forcing other providers to offer greater value.[74] Whether or not to allow NEST to be active in decumulation is a matter for Government.

Improving consumer engagement with their retirement income decisions

5.34 We acknowledge the limitations of disclosures to consumers. We also acknowledge that the risk of 'information overload' is particularly high in this market, as the choices consumers face are very complex. These findings were reinforced by our research for the interim report which showed that many consumers do not make use of the available information.

5.35 As we committed to in our interim report, our remedy package focuses on ensuring existing information has more impact and is effective.

Earlier and clearer wake up packs and risk warnings

5.36 'Wake-up' packs are intended to help consumers make an informed decision about the various options they have to access their pension savings.

5.37 However, our work and work by the Treasury, has suggested that the current wake-up packs are largely ineffective. Consumers are deterred from engaging because of their length and complexity. Consumer testing by the Treasury has shown that introducing a one page headline document for the wake up pack produces a 10% increase in consumer engagement. This advocated the use of a 'Pension Passport', a one page pre-retirement statement, a recommendation which was also supported by the Work and Pensions Committee. We are looking to take forward the lessons learned from the pensions passport through our work on the wake-up pack.

5.38 Further, feedback to our interim report and at our stakeholder event suggests a broad industry consensus that these packs are currently issued too late to influence consumer decision-making.

5.39 So we will consult on rules **requiring that wake-up packs include a headline one page document containing key information**, including fund value, guarantees and prominent details of Pension Wise. We will require providers **to provide this to**

74 https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/917/917.pdf

consumers at age 50 and then every five years subsequently, until their entire pot is in decumulation.

5.40 We are also aware that our current rules are unclear about when providers should provide a wake-up pack to some consumers. This includes, for example, those transferring-in to a scheme from a non FCA-regulated scheme at or after age 55 and then moving straight into drawdown. We want to ensure all consumers get at least one wake-up pack before they make a retirement income decision, so we will clarify our existing rules to ensure this happens.

5.41 For risk warnings, our current rules require providers to provide risk warnings to consumers when they have made a decision in principle about how to access their pension. Recent research and feedback from respondents to the interim report shows that these risk warnings do not influence consumers' decision-making, largely because they are delivered too late in the consumer journey.

5.42 So we propose to make rules requiring that **from age 50 onwards, the wake-up pack will also include prominent risk warnings**.

Improving guidance for consumers

5.43 Consumers can look for support from a number of sources including a regulated advisor, their employer, their pension provider, or public sources including Pension Wise. The FCA's priority is to ensure that consumers get the support they need. For some this may come from regulated advice. For others, for example those with smaller pots, this may come from the information given by their provider or from free guidance from Pension Wise.

5.44 Providers are currently required to signpost consumers at various stages to Pension Wise and recommend that they seek appropriate guidance or advice to help them understand their options. The question of whether guidance – or referral to guidance – should be compulsory has been widely debated in recent months. This is particularly in light of the impending merger of Pension Wise, The Pensions Advisory Service and the Money Advice Service into a Single Financial Guidance Body (SFGB) and the passage of the Financial Guidance and Claims Bill (the Bill), which gives legal effect to the SFGB.

5.45 In our work on the ROR, we considered whether consumers should be required to seek Pension Wise guidance before accessing their pension savings (or whether providers should be required to refer consumers to Pension Wise guidance).[75] In their December 2017 report[76] on protecting pensions against scams the Work and Pensions Committee recommended a system of default guidance for consumers exercising their pension freedoms. The report explained that this recommendation was one of the Committee's priorities for the Bill.

5.46 The Bill has now become the Financial Guidance and Claims Act 2018 (the Act). The Act requires us to make rules providing that, before proceeding with an application to access or transfer a consumer's pension savings, firms must ensure that the consumer has either received appropriate pensions guidance or opted-out of receiving it.

5.47 The Act gives the FCA discretion in certain areas. For example, the Act says we may make rules specifying what constitutes appropriate pensions guidance, and

75 See paragraph 8.60 of the interim report.
76 https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/404/404.pdf

to potentially exempt some consumers, such as those with small pots. This gives us the opportunity to consider how guidance can best be delivered to maximise take-up and impact, and whether some consumers might benefit from an alternative approach. Further, the Act says we may make rules about how, and to whom, a consumer indicates they have received or opted-out of pensions guidance. Therefore, we need to consider whether the consumer should indicate their decision to opt-out to the SFGB or their pension provider.

5.48 The Act requires us to consult with the SFGB before consulting on rule changes. We will be discussing these issues with the SFGB once it is formed. In the meantime, working with Government, we will look to test various approaches in order to ensure that our rules support consumers effectively.

5.49 Once we have consulted with the SFGB we will be saying more, but our aim will be to ensure consumers get consistent, high-quality guidance.

Improving shopping around for annuities

5.50 Shopping around for the best annuity rate on the open market increases a person's retirement income by 10% on average. In May 2017 we published final rules that require providers to tell consumers how much they could gain from shopping around and switching provider before a potential annuity purchase.[77] These rules applied from March 2018. Where relevant, the disclosure provided to the consumer – **the annuity information prompt** – will show the difference between the provider's quote and the highest quote available on the market.

5.51 Following feedback to our interim report an issue has come to light that there is a potential gaming risk where providers don't provide enhanced annuities but instead factor enhancement into their standard quotes, pushing these up.

5.52 In addition, some consumers are requesting quotes on an income-basis; looking for an annuity to secure a specific income. The templates don't currently allow providers to show quotes in this way and our rules do not cover this option.

5.53 To mitigate this we propose to:

a. Provide the annuity information prompt in circumstances where income-driven quotes are provided.

b. Require providers to ask consumers basic questions about their health and lifestyle to determine whether a customer is eligible for an enhanced annuity. They must use this information when generating the quote for comparison they present in the annuity information prompt.

Giving consumers early access to their savings without having to enter drawdown

5.54 Under current tax rules, consumers can only take a lump sum tax-free from a fund still in accumulation, if the rest of the funds are assigned to provide a drawdown pension. In the interim report, we suggested that government consider de-coupling the two. This would allow consumers to access their tax-free cash without having to put the rest of their pot into drawdown or move to a product which has a drawdown option.

77 PS17/12 (www.fca.org.uk/publication/policy/ps17-12.pdf)

5.55 Many consumers see the 25% tax-free cash as a windfall. Focused on accessing their cash, they do not fully consider the options for the remaining 75% of their pension pots. In many cases they take the path of least resistance and stay with their provider without shopping around. We are concerned that this is contributing to the lack of competitive pressure on providers and means consumers are not engaging in their investment decision.

5.56 We would encourage Government to consider the merits of decoupling tax-free cash from other pension decisions. We remain of the view that decoupling has the potential to benefit many consumers. In particular, consumers who focus solely on taking the tax-free cash and do not engage with the decision about what to do with the rest of the pot, could benefit significantly from delaying that decision. Decoupling will allow their pension funds to remain in their existing accumulation scheme, and to make a better drawdown decision when it is more relevant to them and they are more likely to engage in it.

5.57 As our analysis in chapter 3 shows, in many cases consumers who have not engaged in the decision of what to do with the rest of their pot have been 'defaulted' into cash or cash-like funds, or other investments that are unlikely to suits their needs and objectives. While our package is designed to increase engagement and reduce poor outcomes that may arise from this, decoupling has the potential to further improve outcomes for consumers. However, stakeholders did raise concerns around the potential costs and the risk that it would lead to more consumers taking their tax-free cash early.

5.58 To introduce de-coupling consistently across the market requires making major changes to the pension tax regime. **We believe there is value in exploring 'de-coupling' the tax-free cash decision from the decision to take retirement income**. We recognise there are detailed policy and practical issues which the Government would need to consider. We will provide HMT with the information we gathered and our analysis of why we believe 'coupling' might lead to consumer harm to aid their consideration.

The role of technology

5.59 We believe that technology can play an important role in enabling consumers to engage with their retirement income decision. Recently research of Millennials and Baby Boomers' financial behaviour, savings habits and digital maturity[78] found that consumers of both these groups use online tools extensively when making their retirement income decisions.

5.60 We support innovations such as the Pensions Dashboard which aim to harness technology by bringing together all a consumers' pension pots into a single dashboard. This will play an important part in helping ensure they make decisions based on their whole retirement wealth, rather than on a pot by pot basis. Finally, as our case study later in this chapter shows, Australia has made extensive use of online tools to promote consumer engagement and shopping around.

5.61 So we will hold a **Pension TechSprint** later in the year. The aim of this event is to challenge tech providers and industry to come up with innovative solutions to some of the emerging issues raised in our interim report, such as a lack of engagement and shopping around.

78 http://www.tisa.uk.com/slides/666_EngagingWithBabyBoomers.pdf

Promoting competition by making the cost of drawdown clearer and more comparable

5.62 Drawdown products often have complex charging structures and consumers may struggle to assess likely charges. Charges information is also difficult to compare across providers, making shopping around hard. There is also no market wide comparison available to help consumers who do not take advice to compare charges.

5.63 These combined factors mean an engaged consumer will struggle to shop around, resulting in weak competitive pressure to offer better deals, innovate and compete on price. The package of remedies outlined below is intended to address these issues.

Clearer information when a consumer enters drawdown

5.64 When a consumer enters into a new drawdown product, our current rules require that they receive a Key Features Illustration (KFI) with information on the product, including potential investment growth and product charges. There are significant differences between providers in the format and presentation of charges information in KFIs, and information on charges is often not presented prominently.

5.65 The charges figures in the KFI illustrate the reduction in yield as a result of charges and are shown as a percentage figure. For our interim report, we tested different cost metrics to help consumer choice in the income drawdown market. This showed that using a one year charge figure in pounds and pence led to an approximately 10% increase in the number of consumers able to identify the cheapest drawdown option compared to the reduction in yield.

5.66 So we are consulting on rules requiring providers to provide a **headline one page KFI document** containing key information, **including a one-year charge figure in pounds and pence**. Our aim is that the one-year figure will provide the basis for consumers to compare costs across providers.

5.67 Currently providers are permitted to provide KFIs for drawdown in real terms or in nominal terms. As significantly more consumers are choosing drawdown since the pension freedoms, it has become more important that consumers have the ability to compare drawdown across providers. This means that there needs to be a consistent basis for drawdown illustrations, including the charges, to enable consumers to compare across providers on a like for like basis. We are therefore **proposing that all providers should present drawdown KFIs using calculations in real terms**.

5.68 Our recent thematic work[79] found that some consumers are not receiving comprehensive charges information, either when they enter into drawdown or on an ongoing basis. Our current rules require providers to disclose charges in a KFI when the consumer enters into a new contract. Some consumers are accessing drawdown using a variation of their existing contract and do not receive information on charges when they do so.

5.69 Consumers who move into drawdown but do not take a regular income also do not receive ongoing information on an annual basis. The current trigger in our rules to require providers to provide information is the consumer taking income.

79 Non-advised drawdown pension sales review: summary of findings.
https://www.fca.org.uk/publication/multi-firm-reviews/non-advised-drawdown-pension-sales-review.pdf

5.70 So we are consulting on rules that will require providers to:

a. provide the KFI when exercising drawdown options or equivalent contract variations

b. provide ongoing information on an annual basis for consumers who have entered drawdown but not taken any income

5.71 We also propose that providers **disclose actual charges in pounds and pence to consumers on an annual basis**. Pension funds are exempt from MIFID II requirements to disclose actual charges[80] so this will be a new requirement for them. So we are seeking views on this in a discussion section of our CP. We will engage with providers over the coming months on the impact of this with a view to consulting on it as part of our second CP in January 2019.

Enabling the introduction of a drawdown comparator

5.72 ABI figures for the drawdown market show that 94% of non-advised drawdown sales were made to existing customers. In the annuity market, which does have a comparator, 30% of consumers switched providers to access an annuity.[81] We believe that a drawdown comparator will play a key part in promoting shopping around and switching. This will promote competition in the market and put downward pressure on prices.

5.73 Clear and transparent charges are one of the key components by which a consumer can shop around for the best value drawdown option. However, there is currently no tool that facilitates this shopping around.

5.74 Facilitating shopping around is particularly important as drawdown is not a single point in time decision, and consumers can switch at any point. With the number and size of pots entering into drawdown expected to grow, we can also expect the number of consumers engaging in their drawdown decision to increase.

5.75 We are **working closely with the ABI and MAS to develop a new drawdown comparator**. ABI recently released their blueprint for the comparison tool in April 2018.[82] MAS are currently tendering for the development of the tool and we have worked closely together in the development of its scope.

International comparisons

5.76 Throughout our work we have sought to learn from countries that have faced similar issues to those in the UK. As part of this we have held interviews with regulators and government from Australian, Canada, Denmark, Ireland, New Zealand and the US to assess whether other countries have faced or face similar issues to those in the UK and whether there are any lessons to be learned. A particular focus has been analysing the Australian experience, which has similarities with many of the issues our Review has aimed to address. The lessons learned from this are outlined in the box below.

80 Recital 34 of MIFD II.

81 FCA analysis of ABI data, April 2015 – March 2017. Note: The sample of ABI members does not include all providers in the retirement income market but is representative of most drawdown and annuity sales. Please refer to the Retirement Outcomes Review interim report for further details.

82 https://www.abi.org.uk/news/news-articles/2018/04/abi-releases-blueprint-for-drawdown-comparison-tool/

Lessons learned from Australia

There are many similarities between the UK and Australian systems, making the lessons learned from the Australian experience invaluable when we design our interventions. Both countries use all three pillars of pensions' provision (public pensions, workplace pensions and personal pension)[83] to provide retirement income. Both also have some of the world's most developed workplace pensions systems, with consumers in both countries saving through DC schemes which have an element of compulsion.[84]

Australia and the UK also allow consumers to access their pension savings in a number of ways, including taking cash lump sums, entering drawdown and buying an annuity. The vast majority of retirement assets in Australia (94%) are held in account-based pensions which are similar to UK drawdown products.[85] This is similar to the trends we see for larger pots in the UK (£250,000 and over), with the majority choosing to enter drawdown (86%).

The key difference is that, due to higher compulsory employer contribution rates, (currently 9.5% and scheduled to increase gradually), and since Australians have been saving in these pots for longer, the average Australian DC pension savings are larger[86] than in the UK. Average pots sizes in Australia for consumers between 65 – 74 years are around $376,000 AUD[87] (approximately £200,000 GBP) compared to consumers entering drawdown in the UK whose pot sizes are around £80,000 GDP.[88] We believe that DC pension savings in the UK will continue to increase and will become the most significant source of private retirement income.

The similarities between the two systems mean that we can learn from the Australian experience. By looking at Australia we can better anticipate some of the challenges the UK pensions market might face, both as the market develops in its earlier stages, and in the longer-term. So learning from Australia's experience can help us put the market on a good footing for the future.

Lessons learned

There are a number of aspects of the Australian pensions system which were relevant to our review and which have fed into our thinking on potential remedies.

In particular we have noted the following positive characteristics in Australia, which we would like to see emerge in the UK:

- On average, Australian consumers are more engaged with their pension funds (mostly MySupers)[89] than UK consumers are with theirs. For example, Australian member engagement research reported that the level of engagement rises with

83 Workplace and private pensions are combined in Australian superannuation – employer contributions and personal contributions are made to the same account and not kept separate.

84 Mandatory employer contributions in Australia and mandatory automatic enrolment into a qualifying scheme in the UK with mandatory employer contributions, unless the employee opts out.

85 Australian Government, Financial System Inquiry: http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf

86 Although pension savings are larger in Australia than in the UK, there are still concerns in Australia around the adequacy of pension savings.

87 Australian Bureau of Statistics, Household Income and Wealth, Australia: Summary of Results, 2015–16, Superannuation of persons: http://abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6523.02015-16?OpenDocument

88 While we did not have a directly comparable figure we expect UK consumers entering drawdown in the UK to be a good reflection of when pot sizes are their largest.

89 There are multiple types of funds, but Australians typically save through their workplace into MySupers. These are simple and cost-effective default accumulation products, with a single investment option or a lifecycle investment option.

age and there were lower levels of disengagement of members aged 60 and over.[90]

- Many consumers have a number of opportunities to regularly engage with their pensions, including submitting yearly tax returns, receiving annual statements, or choosing a different fund when they change jobs. They also have many ways to get information about their funds. These include in some cases instant access to pension accounts through technologies such as the superannuation dashboard, or through online internet banking and mobile phone apps.[91]

- There are a number[92] of existing comparison sites and agencies in Australia, some are free to use and others charge for access. Most cover superannuation funds and a few compare drawdown. Newspapers and ratings agencies publish tables of best-performing funds and funds with the lowest charges. However, there are still concerns in Australia regarding definitions and consistency that would allow meaningful comparisons.

We also noted the findings of the 2014 Financial System Inquiry which mirror some of our own findings and found problems with:

- pension funds held in asset mixes that are not matched to consumers' likely patterns of withdrawals

- pensions funds not protecting against longevity risk, with a lack of risk pooling mechanisms such as deferred life annuities

- charges for MySuper (default accumulation products) may be too high and significantly affect returns and income

- switching may be low in MySuper products

The Australian Government is taking a number of steps to tackle these. They are extending tax exemptions to decumulation products with longevity insurance, such as deferred or pooled income stream products (e.g. lifetime annuities and group self–annuitisation products). The aim is to encourage consumers to buy products which protect against longevity risk.

Australia is also taking further steps to improve consumer engagement. The Australian Securities and Investments Commission (ASIC) are considering whether a guidance body should have a role in this. They are also working with trustees to review and improve upfront and ongoing disclosures. In addition, the Australian industry is taking steps to improve disclosures through their work on a Key Facts Sheet, an insurance welcome pack and standardised terminology.

90 CoreData Member Engagement Research (2016): https://www.coredata.com.au/blog/super-stop-talking-about-retirement/
91 For example, for some retail funds (where the consumers' super is with their bank) their superannuation savings balance can be accessed through a mobile app.
92 According to ASIC's MoneySmart website and the AFSA response to the Productivity Commission Superannuation Efficiency and Competitiveness issues paper (May 2016), there are 11 main comparators and major agencies which broadly involve the rating of superannuation funds.

We assessed the positive aspects we would like to see in the UK, as well as the challenges that Australia currently faces in its pensions system, when developing our proposed measures.

- In Australia many consumers who go into simple drawdown are not making the most of their retirement incomes. In response, the Australian Government is developing a framework for the Comprehensive Income Products for Retirement. This aims to balance flexibility with a regular and stable income stream. We believe investment pathways will similarly help consumers manage their pot.
- Australian consumers appear to have earlier opportunities to engage with their retirement decision. The Government announced in the 2018-19 Budget the development of 45 and 65 year checks to encourage more people to prepare for retirement, including how to build and more effectively use their superannuation. Through our remedies, we are aiming to increase consumer engagement by ensuring wake-up packs are sent earlier, are simpler, and more frequent.
- There are several ways to compare products in Australia, but there are no drawdown comparator tools in the UK. This is why we are working with MAS and ABI to introduce a drawdown comparator tool. We are learning from the Australian experience about the best way to develop this to allow for good comparison.

Measures of success

5.77 As part of our Mission,[93] we explained the importance of evaluating our significant interventions. We also set out a framework for measuring the value we add through our activities. This includes measuring our own operational efficiency, the impact of our interventions and outcomes in markets.

5.78 We have recently published a Discussion Paper (DP18/3)[94] which sets out how we intend to use post intervention impact evaluation to assess the impact our interventions have had on consumers, firms and markets. Following feedback, we will consider when and how best to measure the impact of our interventions to ensure value for money and proportionality. Where it is less cost-effective to conduct detailed analysis, we will monitor key market indicators that help show the impact of our interventions.

5.79 Our Sector Views[95] present a high-level overview of how the market is evolving and we will use the pensions and retirement income sector view to help prioritise our future areas of focus in the market.

5.80 Our proposed remedy to introduce investment pathways will be a significant intervention into the market. If we decide to implement it following consultation, we also plan to carry out a more detailed review of the impact of these pathways one year after they are implemented. This will enable us to examine, among other factors, the charges providers are applying to the pathways, so that we can ensure they offer value for money.

93 www.fca.org.uk/publications/corporate-documents/our-mission
94 https://www.fca.org.uk/publications/discussion-papers/dp18-3-ex-post-impact-evaluation-framework
95 https://www.fca.org.uk/publications/corporate-documents/sector-views

6 Next steps

6.1 Alongside this final report, we are also publishing a Consultation Paper (CP) which seeks views on our package of proposed remedies.

6.2 We ask discussion questions about some of the potential remedies in our package before we propose to make rules and consult on them:

- preventing providers from putting drawdown customers' pension funds into cash, without the consumers requesting this ('defaulting consumers into cash')
- requiring providers to provide investment pathways
- requiring providers to give all consumers information about the performance and actual charges applied to their drawdown investments on an ongoing basis

6.3 Preventing poor outcomes in the pensions and retirement income market is an important priority for the FCA. The market is still evolving, and it will be some years before most people are primarily reliant on a DC pot for their retirement income. We have identified harms and emerging issues that we are keen to address promptly, so the market is on a good footing for the future. This is why, for instance, we are asking for responses to the discussion questions within 6 weeks. For proposals we are consulting on in this CP, we will consider the feedback received and publish our finalised Handbook text in a Policy Statement in January 2019. For the areas we have raised for discussion, we will consider the feedback received – and whether we need to refine these – and will consult in January 2019.

6.4 As well as these rule changes, our package of proposed remedies also includes additional work we will carry out in the future:

- organise a 'TechSprint' to promote innovation in the market later in the year
- work with MAS and industry on introducing a drawdown comparator
- conduct further work on charges as part of our post implementation review of investment pathways, to determine whether we need to intervene

Appendix 1
Glossary of terms used in this document

Term	Description
Accumulation	The phase during which a consumer saves into a pension pot during their working career to build up a pension pot for their retirement.
Annuity	A form of insurance policy that consumers can buy with their pension pot. This will typically provide the consumer with a guaranteed income for life, or for a fixed number of years.
Association of British Insurers (ABI)	A trade association made up of insurance companies in the UK. It has a membership of around 250 companies which account for over 90% of the UK insurance market.
Automatic Enrolment	A legal requirement that every employer must automatically enrol its workers into a qualifying pension scheme subject to certain criteria. Employers have gradually enrolled all eligible workers into qualifying pension schemes between 2012 and 2018.
Blended Solutions	A combination of annuity and drawdown, where consumers can pick and choose different combinations of these to meet their different needs.
Collective Defined Contribution	A proposed scheme in which an employer pays a fixed rate of contributions and the risk is shared between the members. The provider calculates an expected benefit, but the actual benefit depends upon the funding level of the scheme and is uncertain.
Decumulation	The process of converting pension savings into a retirement income.
Default Fund Charge Cap	FCA rules require providers that operate workplace personal pension schemes used for automatic enrolment to implement a charge cap within these schemes' default funds. Similar measures have been implemented in regulations for occupational schemes for which The Pensions Regulator is responsible.
Deferred Annuity	An annuity which commences only after the end of a specified time after the final purchase premium has been paid.
Defined Ambition	A proposed scheme which gives greater certainty than a DC pension to members about the final value of a pension pot. Unlike a DB pension, employers are not liable to pay extra contribution to meet any deficits.

Term	Description
Defined Benefit	A scheme in which the benefits are defined in the scheme rules and build up regardless of the contributions paid and investment returns. The benefits are most commonly related to members' earnings at the point they leave the scheme or retire, and the length of their pensionable service. These are also known as 'final salary' or 'salary-related' scheme.
Defined Contribution	A scheme in which a member's benefits are determined by the value of the pension fund at retirement. How much is in the fund depends on how much the individual member pays in and any investment returns. Also known as a 'money purchase' scheme.
Equity Release Products	Products that allow a consumer to access the equity in their property. Typically equity release products will either be lifetime mortgages, which allow someone to borrow a proportion of their home value, or home reversion, where an individual sells a share of their property, but keeps the right to continue living in it until death.
Financial Services and Markets Act 2000 (FSMA)	The primary source of legislation governing financial services and markets in the UK.
Fintech	A term which includes any technological innovation in the financial sector, including innovations in financial literacy and education, retail banking and investment.
Guaranteed Annuity Rate (GAR)	A guaranteed annuity rate gives a policy holder the right to buy an annuity from their current provider at a guaranteed minimum rate. This rate tends to be better than the competitive rate offered on the open market.
Lifetime ISA (LISA)	A form of individual savings account for 18 to 40 year olds designed for saving towards a first home or retirement. A 25% government bonus is added to savings of up to £4,000 per year.
Master Trust	A multi-employer occupational scheme where each employer has its own division within the master arrangement.
National Employment and Savings Trust (NEST)	A trust based, defined contribution arrangement set up to support automatic enrolment. It aims to give all employers access to a low cost scheme that complies with auto-enrolment.
'Non-Advised'	Sales made by providers that do not involve any personal recommendation and leave the consumer to decide how they want to proceed.
Income Drawdown	Flexi-access income drawdown products involve investing a pension pot into a fund or funds which allow the consumer flexible access. Income drawdown providers offer a range of different investment funds, with different investment objectives, risks, and levels of charges.

Term	Description
Independent Governance Committees (IGCs)	FCA rules require providers of workplace personal pension schemes to set up and maintain independent governance committees. These committees have a duty to act solely in the interests of scheme members, assessing and, where necessary, challenging providers on the value for money of workplace personal pension schemes.
Insurance Distribution Directive (IDD)	An EU Directive designed to improve EU regulation in the insurance market by ensuring a level playing field for all providers involved in the sale of insurance products.
Hybrid Products	This is a term used to cover a number of products that offer some form of guarantee to the consumer. It includes newer structured products and variable annuities that offer guaranteed death benefit, guaranteed withdrawal benefits and guaranteed income benefits. It also includes more traditionally offered products such as with-profits and unit-linked annuities. Hybrid Products differ from blended solutions.
Key Features Illustration (KFI)	Information given to consumers who are entering a new contract. KFIs describe projected performance and the effect of charges prepared according to the rules on preparing product information (COBS 13).
Money Advice Service (MAS)	A service set up by the Government, which provides tailored and independent money guidance and advice to consumers, free of charge.
Pension dashboard	A pension dashboard gives consumers an overview of the key information on all the pension funds they have.
Pension Passport	A document that provides the consumer with key information on a specific pension fund that they have with a specific provider. Examples of the information that it could include are: policy number, pension fund size, maximum tax-free cash available, and whether any guarantees or reductions apply to that policy.
Pension Wise	A service targeted at consumers aged 50 or older who do not take individual professional advice and are starting to think about their retirement income decision. It aims to provide free, tailored and independent information to consumers about their options.
Pan European Personal Pension (PEPP)	A pan-European personal pension scheme being established through a European Regulation.
Selected Retirement Date (SRD)	The data nominated by the consumer or pension provider at which the consumer intends to retire and take benefits from their pension. Before April 2015, all accumulation pension products had an SRD but not all products have one since the pension freedoms were introduced.

Term	Description
Self-Invested Personal Pension (SIPP)	A pension 'wrapper' that holds investments until an individual retires and draws a retirement income. It allows individuals to make their own investment decisions from a range of investments approved by HM Revenue and Customs (HMRC).
Single Finance Guidance Body (SFGB)	A new body being established through the Single Guidance and Claims Act. It creates a single financial guidance body by merging three existing government-sponsored financial and pension guidance services.
Solvency II	A capital adequacy regime which applies to the insurance industry in EU member countries. Intended to better protect consumers' interests by reducing the chance of firm failure and likelihood of market disruption.
Tax-free cash (TFC)	Also known as the Pension Commencement Lump Sum, tax-free cash refers to the lump sum of money consumers can withdraw from their pension pot from age 55. Consumers can normally take up to 25% as tax-free cash though some older pensions may allow more.
The Pensions Regulator (TPR)	The UK regulator of work-based pension schemes.
Uncrystallised fund pension lump sum (UFPLS)	UFPLS is not strictly a product, but an option through which consumers can access their pension savings. UFPLS features allow consumers to take partial or full withdrawals of cash from their accumulation pension savings. When making partial withdrawals, 25% of each withdrawal is tax-free, with the remaining 75% of each withdrawal subject to tax.
Wake-up pack	Information sent to consumers before they decide which retirement income products to buy.
Zero Income Drawdown (ZID)	A term used to describe drawdown products which consumers enter into without having an arrangement for a regular income in place.

© Financial Conduct Authority 2018
25 The North Colonnade Canary Wharf London E14 5HS
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk
All rights reserved