

# Retirement Outcomes Review

Response by Prospect to the interim findings and proposed remedies of the FCA's Retirement Outcomes Review.

**September 2017**

[www.prospect.org.uk](http://www.prospect.org.uk)

## **INTRODUCTION**

1. Prospect is an independent trade union representing over 140,000 professional staff across the private and public sectors. Our members work in a range of jobs in a variety of different areas including in aviation, agriculture, broadcasting, communications, defence, energy, heritage, industry and scientific research.
2. Prospect members working in the private sector are increasingly covered by defined contribution pension schemes. These members are directly impacted by the issues addressed by the Retirement Outcomes Review. This submission summarises the action Prospect would like the FCA to take in order to protect members of defined contribution pension schemes as they make difficult decisions about how to use their accumulated pension pot to secure a decent standard of living throughout their retirement.
3. We hope this submission is useful and is viewed as a constructive attempt to deal with the issues raised in the interim report. Prospect officials are happy to discuss any of the issues raised in more detail should that be useful.

## **SUMMARY OF PROSPECT'S POSITION**

4. Prospect welcomes the FCA's investigation of how the retirement income market is evolving since pension freedoms were introduced. It was reckless for the Coalition government to announce these freedoms with no public consultation and with little time to prepare for their implementation. Despite the popularity of the reform with consumers, it is clear that many have lost out as a result of inadequate protection.
5. The interim report highlights a number of areas where defined contribution pension scheme members are exposed to significant potential detriment and strong action is needed to protect them.
6. Prospect does not believe that competition alone can be relied upon to drive value for money for defined contribution pension scheme members accessing pension pots on retirement. Significant intervention from the FCA and other relevant bodies is required to safeguard members and prevent a major miss-selling scandal from developing.
7. Many of the FCA's potential remedies are welcome. Prospect believes that robust action from the FCA and others will be necessary to protect defined contribution pension scheme members. In particular, default pathways for defined contribution pension scheme members during the decumulation phase and appropriate charge caps for default products are absolutely essential to fixing the problems identified in this market.

## BACKGROUND

8. The 2014 Budget announcement about “freedom and choice” in pensions was not preceded by a public consultation. Representatives of pension scheme members did not have an opportunity to raise concerns about the real risks arising from this policy. While the political and fiscal benefits to government were plain to see it was less clear how pension freedoms were meant to address the real problems consumers faced in the retirement income market.
9. Before pension freedoms, most defined contribution pension scheme members used their pension pot to buy an annuity. The main problems in the annuity market were:
  - Consumers failing to shop around and instead opting for an annuity offered by their pension provider.
  - Consumers failing to take advantage of enhanced or guaranteed annuity rates.
  - Consumers failing to make adequate provision for inflation protection or for dependents.
10. Pension freedoms led to fewer people buying an annuity but it did not directly address any of the problems regulators and others had identified in the annuity market.
11. In fact consumers now face worse outcomes and greater risks because of pension freedoms:
  - Far fewer non-advised drawdown sales are a result of shopping around than annuity sales prior to pension freedoms (6% versus “over half”).
  - It is far more difficult for consumers to shop around between different drawdown products because they are less standardised than annuities and there are no comparison tables or calculators.
  - Opacity of charges for drawdown products could result in consumers being ripped off.
  - The ongoing risks associated with drawdown products (eg exhausting pot too soon) are far greater than for annuities.
  - There are potential issues with tax, means-tested benefits, creditors and even criminal fraudsters.
12. It should not be a surprise that there are these problems in the drawdown market. The problems identified with annuities had existed for a long time before the FCA reviewed that market. Similar providers in the workplace pension market had been shown by the Office of Fair Trading to deliver poor outcomes to consumers.
13. It is important to be clear: outcomes in the retirement income market are worse and risks are greater because of pension freedoms and the FCA and others must intervene to protect defined contribution pension scheme members.

## DETAILED COMMENTS

14. The questions in the consultation document are addressed below:

**Q1. Do you agree with our interim findings as set out here and throughout the report? If not, why not? Can you provide any relevant evidence to support your views?**

15. It is clear that aspects of pension freedoms are popular with consumers and that behaviours have changed significantly as a consequence of the post April 2015 rules.
16. Some consequences of pension freedoms, such as the ability of someone with other income to rely on to withdraw a small defined contribution pension pot as cash, are likely to be benign.
17. Other consequences are more serious. Consumers clearly have not been given the message that it is important to shop around when buying a drawdown product. As a result, most are likely to be losing out by failing to take advantage of the best value products available. Even those who are inclined to shop around may be defeated by the complexity of products and the opacity of charges. Clearly drawdown products result in greater risks for consumers to manage throughout their retirement than annuities.
18. Prospect believes the FCA has shown that the market is not working and that consumers are losing out as a result and that intervention is necessary to protect them.

**Q2. Do you agree with our overall approach to intervening in this market? In particular, do you have views on whether our proposed remedies strike the appropriate balance between:**

- **intervening early but also giving the market time to adjust**
- **measures aimed at protecting consumers and promoting more effective competition**

19. The FCA is not intervening early in this market. Issues with the retirement income market were identified before pension freedoms were introduced (eg it was clear that the open market option and other support was not sufficient to encourage defined contribution pension scheme members to shop around when purchasing an annuity). Pension freedoms have simply exacerbated known problems in this market (and introduced new ones).
20. While most people exercising pension freedoms are accessing relatively small pension pots there are people retiring now with significant defined contribution pension pots and they need to be protected from particularly poor outcomes.
21. It is naïve to expect that competition in this market can ever deliver adequate protection for all consumers. The annuity market prior to pension freedoms was far more competitive than the drawdown market now (much more transparent

marker, far more people shopping around) and still significant numbers of people suffered poor outcomes by failing to shop around or take advantage of enhanced or guaranteed rates. Intervention in this market is going to be necessary at some point and it should happen as soon as possible.

22. It is unclear what benefits consumers are likely to derive from potential innovation in the retirement income market. Certainly unclear potential benefits from innovation are no reason not to act to protect consumers from known detriments now.

**Q3. Do you consider we should introduce further consumer protections for consumers who buy drawdown without taking advice to ensure consumers are not at risk of choosing particularly unsuitable investment strategies?**

- **Should we explore the possibility of default investment pathways?**
- **Should a charge cap also be considered for default investment pathways?**
- **Should the role of IGCs be extended to decumulation products?**
- **Do you agree with the decision not to pursue the option of introducing an appropriateness test for non-advised drawdown at this stage?**

23. Intervention is absolutely necessary to protect consumers.

24. Prospect strongly supports additional consumer protections along the lines suggested under Remedy 1.

25. In the future, a typical defined contribution pension scheme member will have been defaulted into the scheme, paid at a default contribution rate and been invested in a default fund. It seems strange for there not to be a default pathway through the decumulation phase as well.

26. Without a default pathway consumers are faced with extremely difficult decisions about complicated products and how to manage significant risks.

27. Evidence has shown that consumers are not shopping around in order to get the best value product. It is extremely unlikely that those buying drawdown products on a non-advised basis are getting the best deal possible or minimising the charges they pay or even likely to be comfortable managing levels of withdrawal throughout their retirement.

28. An appropriate default pathway for the decumulation phase will ensure that consumers who are otherwise daunted by the retirement income market are protected from excessive fees and inappropriate choices.

29. Any default pathway must be subject to strong regulation and governance.

30. There are charge caps for default investment funds for members of pension schemes used for automatic enrolment. It is entirely appropriate, and necessary to protect consumers, for default pathways to be subject to a fair and reasonable charge cap.

31. Default pathways must be subject to appropriate governance arrangements. Trustees can perform this function for trust-based pension scheme members. IGCs appear best place to undertake this for members of contract-based schemes but this would require a review of IGCs themselves.

**Q4. Do you believe the market can deliver 'decoupling' without regulatory intervention?**

32. Decoupling is an important measure to protect consumers who are focussed on accessing cash lump sums. If providers do not quickly resolve this problem voluntarily, regulators and other appropriate bodies should intervene.

**Q5. Do you consider it proportionate for us to pursue remedies to make it easier for consumers to shop around for drawdown? In particular:**

- **Do you consider that the introduction of drawdown comparison tools should be left to the market or is more proactive intervention needed?**
- **What are your views on the benefits and costs of mandating the use of a summary cost metric in customer's communications?**
- **Do you agree with the decision not to pursue the alternative measures at this stage?**

33. A default pathway for decumulation will address the most significant issue of the consumer detriment arising as a result of failing to shop around.

34. However it is still important to make it easier for consumers to shop around to get the best possible deal.

35. If the market does not quickly introduce drawdown comparison tools then regulators and others should step in to do this.

36. A summary cost metric should be mandated in customer communications. Having a strong focus on costs is a desirable outcome. Providers are free to emphasise other issues that they consider to be important, such as fund performance and service delivery, in the communications.

37. Once a default pathway for decumulation is in place, the issue of the detriment arising from taking the path of least resistance and buying a product from the pension provider will be adequately addressed. Unless and until that happens, providers selling their own products to existing customers should have to explain in writing why it is at least as suitable as other options on the market.

**Q6. Do you agree we should act to make existing information more impactful and effective rather than introducing new disclosure? In particular what are your views and suggestions on our proposals to:**

- **Improve the effectiveness of communications sent to consumers before and when they access their pension pots?**
- **Explore the feasibility of introducing tools that compare different products and options?**

- **Raise consumer awareness of potential eligibility to purchase an enhanced annuity earlier in the consumer journey? Is there a better way of ensuring consumers are made aware?**

38. It is difficult to see how new disclosure requirements (besides a requirement to explain why a product is at least as suitable as other available options) could adequately address the consumer detriment in this market.

39. Even with the clearest and most impactful communications possible there will still be a failure to shop around or to properly understand and hence manage the risks inherent in purchasing a drawdown product.

40. Improving communications is important but it is no substitute for developing default pathways through the decumulation phase.

**Q7. Do you agree that we should not be intervening in these areas at this stage? If not:**

- **Why do you consider we should be intervening?**

- **What interventions should we be pursuing?**

41. Provider withdrawal from the open annuity market is a significant concern. In theory annuities are more appropriate products than drawdown for many consumers. The FCA should keep the competitiveness of the open annuity market under review and be prepared to intervene if there are any significant developments.

42. Innovation in the marketplace is unlikely to rectify the issues facing consumers. Pension freedoms resulted in the problems with annuities being replaced by the same (and other) problems with drawdown. Similarly any products that replace drawdown are likely to still take advantage of the weak demand side and other issues that result in consumers failing to shop around to find the best value products or even excessive levels of charges or inappropriate products. An appropriate default pathway for decumulation is necessary to address this.