Written evidence from the Financial Conduct Authority (APS0061)

We have grouped and responded to the questions posed under the headings below. We preface those responses with an overview of our remit and how we have responded to the challenges and opportunities arising from pension freedoms.

Overview

The challenge

1. The 2015 pension freedoms provided consumers with greater flexibility to decide how and when they access their pension savings.[1] Since introduction, there has been significant consumer interest in taking advantage of these flexibilities. Today only 10% of pension pots accessed for the first time are used to buy annuities and 29% enter into drawdown,[2] compared to over 90% annuities and 5% drawdown before pension freedoms.[3] In contrast to automatic enrolment which enables consumers to be passive participants, pension freedoms introduced consumer responsibility to make active decisions about how to use their pension savings. For many consumers, the choices associated with these decisions are complex and introduce new risks.

2. In line with our remit, Parliament expects us to ensure appropriate levels of consumer protection whilst also preserving the positive opportunities created by pension freedoms. We think this objective is best served by enabling choice for consumers, while creating an environment where they can access adequate support for that choice. There can be an inherent tension between these two outcomes. Many consumers need, not just information but to be guided to make decisions that are right for them.

3. Consumers now have a wide range of options to choose from when they access their pensions. This has the benefit of enabling some to consider and select how best to access their pension savings and to shop around for the best deals. This contrasts with the pre-pension freedoms landscape where most people purchased an annuity, often from their existing pension provider. Consumers have welcomed this increased flexibility.

4. However, it is also widely recognised that making an appropriate choice can be difficult for consumers, not least in a low interest rate environment, where it is more difficult to generate returns on pension savings without taking greater investment risk. An inappropriate choice (or the failure to make a choice) at crucial stages of an individual’s pension journey can have long term implications for their retirement income. We therefore support ensuring a sufficient layer of support where it is needed, to maintain an appropriate level of consumer protection.

5. We do not want to constrain choice by introducing default pension products that do not meet the needs of consumers in retirement. We are also keen to avoid ‘information overload’ leading consumers to switch off from information that is given to them, notwithstanding that it is designed to support them.

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[1] Before pension freedoms, consumers were restricted in how they could access their Defined Contribution pension savings. Upon retirement, after a tax-free cash withdrawal allowance of 25%, the remaining part of any pension savings was generally taken as an annuity. A limited form of drawdown was also available to those who were eligible.
[2] FCA retirement income market data 2019/20. Of the remainder, 56% were full cash withdrawals and 5% were where a first partial Uncrystallised Funds Pension Lump Sum (UFPLS) was taken. Of the full cash withdrawals, most were small pension pots (89% below £30,000).
[3] Based on 2013 data from the Association of British Insurers.

6. Our Retirement Outcomes Review remedies (including investment pathways) are an example of how we have considered this balance. Our review focused on consumers who do not take regulated advice ('non-advised consumers'[4]), on the basis that those taking advice already receive support. We found, many non-advised consumers did not engage with making an investment decision at all – eg leaving money in cash, with the downside of negative real returns.[5] Recognising this, we have taken steps to ensure consumers engage with these decisions and are guided to select an investment that better aligns with their objectives for retirement.

7. Since February 2021, FCA regulated firms have been required to offer investment pathways to help non-advised consumers decide how to invest their money when they access their pension savings using drawdown. If these consumers want support to make a decision, firms must present them with four objectives for how they might want to use their drawdown pot ('I have no plans to touch my money in the next 5 years', 'I plan to use my money to set up a guaranteed income (annuity) within the next 5 years', 'I plan to start taking my money as a long-term income within the next 5 years', and 'I plan to take out all my money within the next 5 years'). Underlying each of these objectives sits an investment solution, determined by their pension provider, that corresponds to the objective. While investment pathways do not provide a personal recommendation that a consumer would receive with regulated financial advice, they do support consumers to make a choice. Even if these consumers do not analyse what is "under the hood" of the investment solution, or shop around for pathway investments, our hope is that they are less likely to lose out on potential investment growth, and therefore enjoy a better income in retirement.

8. We considered that this particular group of consumers require more help than they previously had. The investment pathways choice architecture is designed to provide that help by empowering consumers to select investments.

9. We are also committed to ensuring that consumers are provided with information to equip them to make informed decisions about accessing their pension more generally. This has been a key part of our policy making to date. Since the introduction of the pension freedoms, we have placed several requirements on pension providers, to help consumers make informed decisions about which option – or options – to choose when accessing their pension savings. Our response to questions eight and nine outlines these requirements in further detail.

The key public bodies in the pensions sector

10. Various public bodies support pension savers. Each has a distinct role. But we can be most effective by acting together. So, we are collaborating closely on a range of joint workstreams, including the pensions dashboard and strengthening the nudge to guidance.

11. The Government, through HM Treasury and the Department for Work and Pensions (DWP), and with Parliamentary approval, sets the overall legislative framework for pensions.

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[4] Between October 2015 and September 2016, sales to non-advised consumers accounted for 30% of drawdown sales – FCA Retirement Outcomes Review: Final report.

[5] We estimated that 33% of non-advised drawdown consumers were wholly holding cash, with over half these consumers at risk of losing out on income in retirement by holding cash - FCA Retirement Outcomes Review: Final report.

12. Acting within this framework, the regulation of private pensions is split between The Pensions Regulator (TPR, accountable to DWP) and the FCA (accountable to HM Treasury and Parliament). TPR regulates the trustees of trust-based schemes, while the FCA regulates the providers of contract-based schemes.

13. Broadly the FCA is responsible for regulating areas of the pension savings and retirement income sector where individuals access their pension directly, which includes DC schemes. We regulate the providers of personal pensions, stakeholder personal pensions, self-invested personal pensions (SIPPs) and workplace (group) personal pensions. We also have regulatory responsibilities for firms that provide products and services for pensions that are regulated by TPR, eg advice and asset management.

14. TPR regulates the trustees of occupational pension schemes – both defined benefit (DB) and defined contribution (DC) schemes. TPR oversees the governance and administration of public service schemes. It is also responsible for implementing Automatic Enrolment and ensuring employers comply with their Automatic Enrolment responsibilities. It achieves its objectives through exercising the functions set out in pensions legislation, setting standards via codes and providing good practice guidance.

15. The Money and Pension Service (MaPS) is responsible for improving the ability of members of the public to make informed financial decisions. MaPS provides pension guidance to people at all stages of their pension journey. Pension Wise is a specific guidance service MaPS offers to consumers aged 50 and over about their options for accessing DC pensions savings.

Our future interventions

16. Our recent interventions have focused on the decumulation phase, in particular the point at which consumers access their pension savings. Our next phase of work will explore additional ways in which consumers can be supported in the run up to accessing their pension savings. As part of this, on 4 May we published our Consultation Paper on the stronger nudge to pension guidance, which also invites a wider discussion on helping consumers make informed choices (see paragraphs 26 and 27). We are also looking at decision processes as consumers build up their savings to identify whether there are other key points in the consumer journey where pension savers could benefit from policy interventions. Together with TPR, we will shortly publish a joint Call for Input on the consumer's pension journey.

17. In the accumulation phase, our focus has been on the fees and charges that consumers incur, which, particularly when compounded can have a significant effect on consumer outcomes. We are working on a joint framework with TPR, which looks at all elements of value for money – costs and charges, investment performance and service – and we expect to publish a discussion paper shortly.

Pension product options at retirement (questions 1-3)

18. Within the legislative framework set by Government, we want to see a competitive market that offers value for money products to consumers.

19. Our data indicate that many consumers have welcomed the ability to access their savings in ways they previously couldn't prior to pension freedoms. Between April 2015 and March 2020, over three million defined contribution (DC) pension pots were accessed. Most consumers who accessed their pots for the first time, did so before the age of 65 and over half of all pots accessed were fully withdrawn. These were mostly small pension pots (89% were below £30,000).[6]

20. The total numbers of annuities sold began to decline in the period leading up to the introduction of pension freedoms. Since the pension freedoms, we have seen substantial shifts away from annuities and towards taking drawdown without regulated financial advice. Demand for annuities in the future is likely to be influenced by a number of factors, including interest rates, DC pot sizes, the level of other guaranteed income to rely upon (for example from DB pensions), and the wider economic landscape. Consumers may also start to consider annuities later in retirement, with annuities becoming less expensive in their later years and with key lifestyle changes (such as leaving the workforce permanently) prompting a review of their original drawdown choice.

21. In 2018, our Retirement Outcomes Review found innovation tended to concentrate around the development of niche products that combine guaranteed income with flexi access drawdown. In these products, consumers allocate part of their investment to purchase an annuity within the plan and part remains invested, effectively using their pension pot to buy both an annuity and drawdown on one contract. These products have only emerged in a small part of the market and have generally not been available to mass market consumers.

22. The options available to consumers at the point of retirement depend in large part on the amount of pension savings accumulated. Both the investment performance, and the costs and charges incurred over the course of a consumer's accumulation journey will significantly influence this amount. Less risky and more liquid assets tend to offer lower returns. But because most pension investment horizons are long term, there is an opportunity to earn the premium that is usually offered by less liquid assets, providing risks can be suitably managed. A number of HM Treasury reports have noted that there is currently relatively limited pension investment in such long-term less liquid assets. We are therefore working closely with HM Treasury and the Bank of England to explore whether there are unintended barriers to such investment in current industry practices and/or the regulatory framework.

Support for consumers – advice and guidance (question 4)

23. Consumers face complex decisions when accessing their pension savings. In our review work, we found consumers often describe pensions as a 'minefield'.[7] Even consumers who felt confident in other aspects of their financial lives said they struggled to understand how pensions work and found it easy to put off finding out more.[8]

24. We want to address this by creating an environment where consumers are encouraged to take the right guidance to support them to make informed decisions at

[6] FCA retirement income market data 2019/20
[7] Evaluation of the Retail Distribution Review and the Financial Advice Market Review.
[8] Evaluation of the Retail Distribution Review and the Financial Advice Market Review.

the right time. Whether consumers consider that taking guidance is beneficial, may vary depending on their specific personal circumstances, level of pension savings and wealth, and financial capability.

25. Pension Wise has an important role to play in delivering guidance about accessing pension savings. Under our current rules, pension providers must signpost consumers to the Pension Wise service via a summary document when they reach the age of 50, and via their wake-up pack at 55, and every 5 years thereafter (see paragraph 40). We are also working closely with DWP and MaPS to implement a stronger nudge to pension guidance when a consumer 'applies' to access their pension savings – as required by the Financial Guidance and Claims Act 2018 (the Act). As set out above (see paragraph 16), on 4 May we consulted on proposals to implement the provisions of the Act.

26. Whilst this final nudge is a useful backstop, there has been significant debate about what else can or should be done to increase consumer uptake of Pension Wise guidance. While Parliament has chosen not to make Pension Wise guidance mandatory[9], and also recently voted against pre-booked Pension Wise appointments[10], we think there is merit in exploring further options for encouraging take-up of Pension Wise guidance beyond strict implementation of the Act. For example, the Act requires the nudge to guidance to be delivered as part of the application to access one's pension, rather than earlier in the pension savings journey. Guidance at this relatively late point in the pension journey may have limited impact if a consumer has already decided how they wish to proceed.

27. So, in our paper published on 4 May, we are asking whether a nudge to Pension Wise guidance, at an earlier point in the consumer journey, might be more effective at increasing take up, and how that might work in practice. Pension providers and other regulated firms can already do this, but we want to understand whether a regulatory impetus is required to make sure pension providers direct their consumers to pensions guidance. Building on our existing work, we also invite discussion on whether there are other regulatory interventions we can use to support pension savers more widely, to ensure they can access the right guidance at the right time. We welcome stakeholder feedback by 29 June.

28. Other organisations can also play an important role in delivering guidance: pension providers may give guidance to help inform consumer choices when accessing their individual pension pot. Employers can also be a valuable source of guidance to consumers. They can help consumers with their workplace scheme, wider retirement planning, and other financial matters. There are limitations to this set out in law, as advice can only be provided through a regulated entity, and equally investment in FCA regulated products can only be arranged by someone with appropriate permissions. We recently published a Guide with TPR on how employers and trustees can help with financial matters without needing to be FCA-regulated. Only a small proportion of consumers have access to advice, and in the absence of advice, greater availability of guidance will help consumers make better choices. While increasing take-up of pensions guidance is important, we want to do this in an effective way that enhances consumer engagement with their pension access decision, recognising that consumers have different guidance needs.

29. One area where consumers are required by law to take advice is when transferring out of a DB scheme. We have seen high levels of unsuitable advice at this point in the past– when we reviewed files from the period 2015 to 2019, we found 17% of

[9] During the passage of the Financial Guidance and Claims Act 2018.
[10] During the passage of the Pension Schemes Act 2021.

recommendations to transfer were unsuitable, and only 55% clearly suitable.[11] While we found some improvement in the quality of advice over time, with 60% of the advice we reviewed from 2018 being reviewed as suitable, the level of suitable advice overall is well below our objective for this market. We have intervened extensively to improve the rate of suitable DB transfer advice, both with individual firms and across the sector.

30. This includes interacting directly with 104 firms, resulting in 39 variations of permission and 21 asset retentions. We are currently undertaking c.30 enforcement investigations. We recently commenced High Court proceedings in one case. We have also identified nearly 60 firms who we consider need to carry out past business reviews.

31. We are also working pro-actively to encourage ex-members of the British Steel Pension Scheme (BSPS) to complain. As a group, our data show that they received particularly poor advice to transfer with only 21% of advice we reviewed being clearly suitable. In July 2020, we wrote to all former BSPS members for whom the Trustees of the scheme had contact details (more than 7,700), setting out our concerns about the quality of advice and encouraging them to make a complaint. A subsequent survey of the former members has shown a significant proportion had not considered complaining. So, we are now refining our communications strategy to ensure we are reaching these steelworkers in the most impactful way to make them aware that they could be entitled to compensation.

32. Towards the end of last year, we made further significant changes our rules to address adviser conflicts of interest, including by banning contingent charging (which removes one incentive for an advice firm to act in their own interests, rather than their client's), and other measures to improve the quality of pension transfer advice. We will monitor the effect of our interventions through our new regulatory data return.

The role of MaPS (questions 5-6)

33. MaPS has an important role to play in improving the ability of consumers to make informed financial decisions. On pensions, they offer support to pension savers throughout the consumer's pensions journey. They provide consumers guidance on a range of pension issues, rather than just one specific pension pot.

34. One such service is Pension Wise which provides very specific guidance for consumers from age 50 to help them understand the options available for accessing their DC pension(s). This service is rated highly by consumers – 94% of all appointment customers were *very* or *fairly* satisfied with the overall experience. But it should be recognised that consumers may also have other pensions guidance needs. It is important the consumers know to access the right guidance at the right time to help them make informed decisions.

35. We think dashboards, including the non-commercial MaPS dashboard, will be ultimately prove useful tools, enabling consumers to easily find information about all their pensions (occupational, workplace, personal and state) in one place, at a time of their choosing. This will provide a complete picture of the consumer's pension entitlement. We expect dashboard usage to prompt some consumers to seek out guidance and/or regulated financial advice, and it should also make it more feasible

[11] Defined Benefit (DB) transfers – further update on our work

for a range of providers to give holistic guidance or advice. Having all of their pension information in one place will put the consumer in a better-informed position from which to engage in those discussions.

36. The MaPS UK Strategy for Financial Wellbeing will inform the role of MaPS over the next 10 years. We are committed to supporting MaPS develop their guidance offering and we are currently working closely with them on a number of joint workstreams.

Investment pathways (question 7)

37. While both auto-enrolment and investment pathways represent significant interventions in the pensions market, there are fundamental differences between the two policies.

38. At the accumulation stage, a key objective is to increase pension savings. One strength of auto-enrolment is it helps ensure that even those consumers who do not wish to engage more actively with pension saving decisions do not lose on pension saving opportunities.

39. At the point which consumers access their pension savings, consumer objectives may be more varied, and they must make a number of different choices depending on how they want to live in retirement. Investment pathways are also designed to protect consumers who are reluctant or hesitant to engage with investment decisions by simplifying and prompting an active choice. Like auto-enrolment, pathways have been designed to ensure that, on average, consumers will get a better outcome than if they had been left to make decisions unsupported.

Communicating information (including costs) (questions 8-9)

40. Consumers need information to help them understand the options they have for accessing their pension savings. This is likely to be important, not only at the point of retirement, but also many years in advance of that to allow them to make informed choices. Information is given to the consumers of FCA regulated products via wake-up packs. At age 50, consumers are sent a summary document that includes key information such as pot size and generic risk warnings. This is followed by a full wake-up pack at age 55 which sets out the different options available when accessing pension savings, such as purchasing an annuity or moving into drawdown. Further wake-up packs are sent to consumers every five years thereafter until they have fully crystallised their pension pot. All wake-up packs have a clear and prominent statement signposting consumers to Pension Wise guidance.

41. When a consumer has decided in principle how to access their pension savings, firms must give them retirement risk warnings. These warnings are specific to how the consumer intends to access their pension and are designed to help them understand the implications of their decision. The consumer will also receive a Key Features Document and/or a Key Features Illustration (KFI) when entering pension drawdown, taking an Uncrystallised Funds Pension Lump Sum payment, requesting to purchase a short-term annuity, or taking a pension income for the first time. This KFI includes a one-page summary which includes the first year of charges shown in pounds and pence.

42. If a non-advised consumer wishes to go into drawdown and wants support to make an investment decision, FCA regulated firms must offer them investment pathways. All non-

advised consumers must also be given a warning if they are more than 50% invested in cash when entering pension drawdown or transferring funds already in drawdown, and on an ongoing basis when they are in pension drawdown.

43. Consumers who are in drawdown or to take an Uncrystallised Funds Pension Lump Sum payment, receive annual communications to help them consider whether they are withdrawing at a sustainable rate, and to encourage them to take advice or guidance. They will also receive information about the actual charges they have paid.

Small pots and consolidation (question 10)

44. We participated in the Small Pots Working Group and support its recommendations published in December 2020. We also welcome the subsequent formation of the Small Pots Co-ordination Group, attended by representatives from across the industry.

45. We recognise that the growth of small pots could have a significant effect on the efficiency and value of saving for retirement. Individuals could even have two or more separate pots with the same pension provider unless changes are made. We think it important to identify ways of reducing inefficiency associated with multiplying small pots.

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