EValue

Powering financial insight

Response to CP18/17

Retirement Outcomes Review

EValue, Benyon House, Newbury Business Park, Newbury RG14 2PZ
Call us: 01635 881180 Visit: ev.uk

RESPONSE TO CP18/17 DRAWDOWN CONSULTATION

Executive Summary

EValue is pleased to respond to the FCA's Consultation Paper CP18/17 - "Retirement Outcomes Review: Proposed changes to our rules and guidance".

We agree that intervention is required to help consumers achieve better outcomes when considering or using income drawdown, including support for better investment decisions. We also agree that non-advised consumers using drawdown are particularly at risk.

Since pension freedoms were introduced in April 2015, there remains significant scope for innovation and product development aimed at making it easier for consumers to manage their drawdown plans to meet their retirement objectives and to minimise poor outcomes. Indeed, we agree with concerns that it is highly probable that many consumers will discover in later life that their drawdown plan has not served them well. Managing decumulation is considerably more complex and riskier than accumulating assets. Without further support to consumers we recognise the potential for many stories emerging in the future about elderly retirees struggling because of the failure of their drawdown strategy. Non-advised clients are particularly at risk of poor outcomes but even advised clients may experience disappointment and difficulties unless there is further innovation in the products and strategies used by advisers.

Whilst simple "investment pathways" represent a step forward, we do not believe that the FCA's proposals go far enough to address the challenges. Most importantly, in addition to choosing and managing an appropriate investment strategy for drawdown, consumers need to understand the likely different outcomes and risks whether investment risk, longevity risk or the impact of other life changes. Consumers who will depend on their drawdown income to provide an expected income requirement need to understand the interplay between the risk/reward profile of their investment and the potential outcome both in the short term and also over the likely duration of their income requirements.

This is, of course, precisely the reason why the FCA is concerned about the numbers of consumers investing their drawdown plan in cash or cash-like funds. Without easily accessible information on potential outcomes, there is a real risk that they will be misled into thinking that they are secure (or making a wise decision) by selecting the appropriate investment pathway for their objective. This, of course, may not be the case depending on how ambitious their goal is e.g. how much income they hope to be able to live on compared to the likely income supported by their assets. Understanding the effect of inflation over time is equally important.

Furthermore, because there is scope for potentially material differences in the pathways that different firms select, the possibility exists for consumers to make judgments based on the natural income or past returns for the fund designated as a pathway without taking any account of the associated risk. We are therefore concerned that the FCA's proposals may fall short of offering consumers, whether advised or not, consistent and relevant information to ensure that their expectations from drawdown are reasonable, well understood and can be managed both at outset and during drawdown.

While drawdown is complex, much can be done to help consumers understand and manage drawdown – particularly for those consumers looking to provide themselves with an income. To do this, it is necessary to enable them to explore the options that are available e.g. the interplay between:

- the type of investment,
- the level of income drawn,
- the desired or expected duration of the income, and
- the extent to which their pension pot (versus other resources) is critical support to their overall requirements for income and other goals.

The good news is that technology to support advice and guidance in this area is well established and increasingly accessible to consumers. We believe that this offers scope for the FCA to either encourage, or ultimately require, a more ambitious response by the industry. This includes much more engagement by providers with consumers on their personal choices and circumstances at the outset of drawdown and periodically thereafter during retirement. Ideally this would be personalised advice. Indeed, until the advent of pension freedom, there was a requirement for firms offering drawdown to undertake a review of the amount of income drawn every three years. Given the advances we see in technology and the increasingly lower cost of delivery, we believe it is increasingly feasible for firms to advise consumers regularly on the progress of their drawdown account, e.g. the likely sustainable income for some standard durations 5, 10, 15, 20 years etc.

Finally, duration can drive remarkably different implications for asset allocation. Therefore, investment choices appropriate to a drawdown client in their late fifties might be very different to a consumer in their early seventies.

EValue remains engaged with our clients to support better consumer engagement, guidance and advice. Further, as a contribution to improving outcomes for consumers using drawdown to provide an income and to test effective engagement, **EValue has additionally decided to make a simple modeller available to consumers (which would be free of charge)**. This modeller will enable consumers to enter their age, amount of their pension pot and how it is invested and see the likely sustainability of different income levels given different market outcomes. We aim to launch this in September and will be pleased to share any learning with the FCA as well as with our clients.

The remainder of this note sets out our thoughts on individual questions asked by the FCA.

Responses to questions

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

   EValue response: We agree that for most retirees holding their drawdown account in cash is inappropriate unless they intend to cash their pension savings over a short period of time. However, we are concerned with the concept of investment pathways for a number of reasons:

   - It is unclear what level of risk would be suitable for a retiree to take with the income pathway. In order to maximise prospective income, a high level of investment risk would be suitable. Indeed, it can be argued that it is necessary to take a significant amount of investment risk to compensate for the lack of a cross-subsidy which would be available with an annuity from early deaths.

   - An investment pathway for income does not address the major issue confronting non-advised user of drawdown, which is to understand the level of sustainable income for a required duration. This could be for life (which raises the issue of understanding life expectancy and the variability around this for an individual) or even for a simpler duration objective such as a fixed period of, say, 15 years.

   - Offering investment pathways without any indication of what a reasonable level of income might be drawn sustainably, including the impact of uncertain future inflation, runs the risk of providing a false sense of security to users of drawdown.

   We believe that consumers are best served by receiving good, personal advice or guidance. The technology exists for the industry to deliver this in a cost-effective way. Pursuing this will offer better outcomes for the consumer and mitigate the potential for future regret or hardship.

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

EValue Response: The three objectives seem to cover the main objectives that consumers have for selecting drawdown but do not recognise a wider variety of personal circumstances which might be important to individuals.

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

   EValue Response: Further to our response to Question 1 above, we believe there should be more than three pathways, particularly for different income profiles which might be required. These should also cover a reasonable range of consumer attitudes to risk. It is also important to provide an indication of the level of income that might be supported for each of these alternative pathways.

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

   EValue Response: We agree that a single investment solution should not be permitted.

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

   EValue Response: We agree that if a firm does not wish to offer all of the required pathways, it should be required to enter into an arrangement with another firm or firms to provide the pathways it does not wish to provide and also required to encourage consumers to get personalised advice.

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

   EValue Response: We think that firms should be required to offer a range of risk-profiled investment pathways so that non-advised consumers are offered some sensible choices together with an indication of the outcome they might expect. We also believe that customers should strongly be encouraged to get personalised advice.

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

   EValue Response: We see no reason why firms should not use pre-existing investment solutions, provided they meet the FCA's prescribed requirements which we believe should be to offer non-advised consumers a range of funds covering a sensible range of risk profiles and income requirements.

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

   EValue Response: We agree with the FCA's approach.

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

   EValue Response: As outlined by our summary and answer to Question 1 above, we think there should be more than three pathways.

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

    EValue Response: There is no good reason why the investment pathways should not be available to advised consumers, but it is to be hoped that advisers would be offering better and more tailored solutions which are therefore more suitable to individual consumer objectives.

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

    EValue Response: We agree.

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

    EValue Response: We agree.

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

    EValue Response: EValue would suggest that investment pathways cover a sensible range of risk levels and provide an indication of potential outcomes. If such an approach were adopted, we would agree that regular reviews (at a minimum annual) should be required.

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

    EValue Response: We agree it is important that consumers have regular access to information about the future prospects of an investment pathway to deliver their objectives e.g. the future prospects for the sustainability of the income they are drawing.

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

    EValue Response: We agree and as stated above technology exists so that costs to the industry should be minimal. Accordingly, we think that the market should respond positively to this requirement.

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

    EValue Response: No further comment.

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

    EValue Response: We see no good reason why the scope of the FCA's rules should be limited. Indeed, were the rules to be limited, we think that there is a risk that consumers with SIPPs could be seriously disadvantaged.

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

    EValue Response: No comment

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

    EValue Response: No comment

20. **How might an appropriateness test work in practice?**

    EValue Response: No comment

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

    EValue Response: If the FCA were to enhance its proposal for investment pathways so that they covered a range of risk levels and provided an indication of possible outcomes, then EValue would support making them available to non-advised consumers who have self-selected an investment strategy. Otherwise, given the wide discretion being given to firms to decide on 3 simple investment pathways to offer, there is little reason to believe that these would be more suitable for non-advised consumers than any investment strategies that they have self-selected. Furthermore, the result might cause confusion for little or no benefit.

    We agree with the FCA's objective to reduce the number of non-advised consumers who have defaulted to cash investment in their drawdown accounts but where a non-advised consumer has self-selected an investment strategy, we do not think it should be required to present the investment pathways which there is no reason to believe are more likely to be suitable.

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

    EValue Response: No comment

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

EValue Response: Decumulation is considerably more complex than pre-retirement accumulation. Pre-retirement consumers will typically want to accumulate as much money as possible and, if they are many years from retirement, can afford to take more investment risk given the longer investment horizon. As retirement approaches there may be a desire to reduce risk, particularly if an annuity is to be purchased or immediate cash requirements are a priority.

With drawdown there are numerous possibilities:

- Different levels of investment risk may be taken given the level of income required, the need for income stability and sustainability, and the level of income required to cover essential expenses
- The purchase of an annuity might be planned
- There may be planned large cash outflows
- There could be other sources of income or capital which could have a material impact on drawdown objectives e.g. DB pensions, annuities, ISAs and home equity-release.

In summary, it is not clear how an IGC, providing independent oversight, could make a judgment on the merits of an investment pathway beyond ensuring that the charges are reasonable.

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

EValue Response: This is hard to answer in abstract. If a decumulation product was very clear about the consumer objectives that it was seeking to achieve then independent oversight could accomplish more than simply ensuring that charges are reasonable.

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

EValue Response: Given the difficulty of exercising independent oversight of drawdown products, for the reasons set out in response to question 23, we do not believe that independent oversight is necessary for providers of products for advised and sophisticated consumers. Firms would need to demonstrate from their new business data that product

sales were predominately derived from advised and sophisticated investors

26. Do you have any other issues or concerns about the proposals?

EValue Response: None beyond those already stated.

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

EValue Response: Yes, we agree that a single default investment is not sufficient. Indeed, EValue strongly believes that more than 3 are required for the reasons we set out in earlier answers above and in our summary.

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

EValue Response: We agree in general. There may be some scope for special treatment for small funds where a default could be into an investment pathway suitable for someone who wishes to cash his or her pension fund tax efficiently over a short period.

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

EValue Response: We agree.

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

EValue Response: Not applicable.

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

EValue Response: An explicit warning about investment in cash would be necessary and should also be included when consumers are periodically reminded about investment pathways and/or receive ongoing advice.

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

    EValue Response: We agree with the FCA's proposal and, based on our understanding of the market, the minimal limit could sensibly be set at around £30,000.

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

    EValue Response: No further comments beyond repeating that we do not think that consumers using SIPPs should be excluded from any of the FCA's rules and, that to do so, could result in them being seriously disadvantaged.

34. **Do you agree with our proposals on 'wake-up' packs? If not, how should we change them?**

    EValue Response: We agree.

35. **Do you agree with our proposal to mandate specific retirement risk warnings alongside 'wake-up' packs? If not, how should we change it?**

    EValue Response: We agree.

36. **Do you have any further comments on our proposals for retirement risk warnings?**

    EValue Response: No further comments.

37. **Do you have any comments on our proposals for the reminder?**

    EValue Response: No further comments.

38. **Do you agree with our proposal to require firms to ask consumers questions that will help a consumer determine whether he or she is entitled to an enhanced annuity?**

    EValue Response: We agree.

39. **Do you agree with our proposal to require that firms include information about the consumer's potential eligibility for an enhanced annuity in the quote for comparison?**

    EValue Response: We agree.

40. **Do you agree with our proposal for amending the annuity information prompt requirements for income driven quotes? If not, how would you suggest we amend the information prompt to achieve our policy objective?**

    EValue Response: We agree.

41. **Do you agree that key information should be summarised on the front page of KFIs?**

    EValue Response: We agree.

42. **Do you agree that the summary information should show a one-year single charge figure expressed as a cash amount?**

    EValue Response: We agree.

43. **Do you agree that information in KFIs should be presented in real terms (that takes account of inflation)?**

    EValue Response: We agree.

44. **Do you agree that a KFI should be provided when a client is accessing drawdown as an option or variation under an existing contract or UFPLS option under an existing contract, and also the first time they take an income (where this happens later)?**

    EValue Response: We agree.

45. **Do you agree that firms should provide regular client communications for those who have withdrawn tax free cash but not taken an income?**

    EValue Response: We agree.

46. **Do you agree that firms should regularly remind consumers to consider reviewing their decisions, particularly investment choices, rather than reminding them how to obtain advice?**

EValue Response: Firms should both remind consumers to consider reviewing their decisions and remind them how to obtain advice. The industry has more options now to make relevant advice available to a wider audience and, deploying technology, to do so more efficiently.

EValue believes that the use of technology to address this is central, that such technology already exists and that consumers and advisers are increasingly open to more digitally assisted delivery models.

We would further recommend that consumers drawing income are reminded periodically to review the income they are taking. As highlighted in our summary, EValue will make a modelling tool available to consumers to use free of charge in September. We hope this might facilitate engagement and we will seek to learn how such tools might be further improved in the future.

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

EValue Response: We agree.

48. How do you consider this would best be achieved by firms?

EValue Response: The format should be informed by consumer testing.

49. What would you estimate to be the cost of these changes?

EValue Response: N/A