THE
INVESTMENT
ASSOCIATION
INVESTMENT MATTERS

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Dear Adam and Richard,

RE: CP19/5 Retirement Outcomes Review: Investment pathways and other proposed changes to our rules and guidance

The Investment Association[1] is a long-standing supporter of greater flexibility in the provision of retirement income. Individuals should be able to decide their income needs according to their circumstances, subject to appropriate customer protection and support frameworks. We welcome the opportunity to comment on the FCA's proposals in CP19/5.

Overall we support the direction of travel through the introduction of the investment pathways and the proposals to ensure that any investment in cash is an active decision. Given the significance and consequences of retirement income decisions, there should be no default option. The FCA's approach recognises this by seeking to engage non-advised customers in an appropriate fashion. We provide more detailed comment on the FCA's proposals below in our answers to a number of the questions posed in the consultation paper.

There are a number of additional points that we wish to raise:

1. **Independent governance of investment pathways.** In our response to CP18/17, we explained that while there may be a case for limited extension of existing IGC remits to cover investment pathways, the case for a more generalised expansion of IGCs to cover drawdown and other decumulation products was weaker given their core remit resulting from specific considerations about workplace pension provision. This view is strengthened by the FCA's proposals to extend MiFID/IDD

[1] The Investment Association is the trade body that represents UK investment managers, whose 200 members collectively manage over £7.7 trillion on behalf of clients.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs.

The UK is the second largest investment management centre in the world and manages 35% of European assets.

More information can be viewed on our website.

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product governance standards to the manufacture and distribution of investment pathways, a proposal that we support. In addition, the forthcoming value assessment requirements for authorised funds, many of which will sit inside drawdown products, will provide further robust protection for customers in relation to the design and value of pathways solutions. It is not clear that layering further governance requirements on top will provide additional benefit to customers.

Despite somewhat mixed feedback, the FCA has announced its intention to proceed with extending the IGC regime to cover the pathways and we await further detail on the FCA's plans in this area. Ahead of the formal consultation on the IGC regime, it would be helpful to have a clearer statement of the case. IGCs' core purpose of looking after the interests of auto-enrolled workplace pension savers should not be diluted by the additional requirements in respect of investment pathways oversight. The proposals may also increase regulatory costs with an undefined benefit for consumers on top of the other proposed consumer protection measures.

2. **Notice of possible future charge cap on investment pathways.** We note that the FCA has no immediate plans to impose a charge cap on pathways solutions, and reiterate our view that such a step would be a negative outcome for customer choice and outcomes. Based on the experience of the accumulation phase charge cap, the consequence of a cap on investment pathways will be a conflation between low cost and quality and a limit on providers' ability to bring a full range of their best ideas to market. A drawdown product is more complex to administer than an accumulation phase pension product. There is additional sophistication in investment terms as well. Generating a sustainable retirement income is a very different challenge to the accumulation stage where the common goal across all strategies is to maximise retirement savings over a 30-40 year time horizon. Customers should be able to benefit from the best possible investment solutions and we believe the delivery of good customer outcomes should be the starting point in designing solutions, not an arbitrary pricing point.

   This is not to minimise the importance of cost, which should clearly be a factor in customer decision making. We agree that firms should seek to price competitively and the FCA's proposals on product governance for investment pathways make very clear the expectations on firms in relation to charge levels and structures. These proposals, along with clear disclosure of charges and costs will help customers assess the cost of pathways solutions and exert pressure on providers through switching, helping keep costs reasonable. We think this approach will result in better outcomes for customers than a cap.

3. **Disclosure of costs and charges over the lifetime of DC pension products.** The IA strongly supports full transparency of all costs and charges incurred in the investment process as part of a comprehensive wider disclosure process and has supported its member firms in implementing various regulatory and client-driven requirements in this area. As a result, asset managers are already supplying enhanced information about the costs and charges of the investment vehicles that sit inside pension products. We are supportive of the extension of MiFID II style ex-post pound and pence cost and charge disclosure to pension products, although we note that some providers may face significant operational challenges in implementing the requirements where they have not previously been in scope of MiFID II.

   We do, however, have a concern about cost and charge disclosure across the lifetime of a DC pension product, where differing regulatory requirements result in a number of inconsistencies in relation to the substance and presentation of

transaction cost disclosure. This is likely to create confusion for customers. We recommend instead a consistent approach to cost and charge disclosure across the lifetime of DC pension products, reflecting that the underlying investment processes in a DC pension scheme are the same, regardless of whether they happen to be incurred in the accumulation or decumulation phase.

4. **Regulation of retirement income in the trust-based pensions market.** We support the FCA's work on the regulation of the retirement income market for retail customers in the SIPP and insured pension markets. It is vital that a robust regulatory framework is in place that helps customers achieve good outcomes from the pension freedoms and the FCA's leadership in this area is welcome. We note that there is currently no equivalent framework for the trust-based segment of the DC pensions market and we call on the DWP and TPR to develop an appropriate regime for trust-based DC schemes[2] that wish to deliver a retirement income proposition to customers. A level regulatory playing field is needed between trust and contract-based schemes, so that providers of these schemes can compete on an equal basis. From the perspective of individual pension savers, who have no say on whether they are in a trust or contract-based scheme and whose investment ability is unlikely to vary by the type of scheme they are in, a consistent regulatory architecture that helps them achieve good outcomes should be present across the market.

I hope this response is helpful and would be happy discuss it with you further.

Yours sincerely,

Imran Razvi,

Senior Policy Adviser, Pensions & Institutional Market

[2] Our expectation is that these will be authorised master trust schemes rather than single employer trusts. The latter are more likely to see their members leave the scheme on retirement and buy retirement income products in the retail market.

RESPONSE TO SELECTED CONSULTATION QUESTIONS

INVESTMENT PATHWAYS

Q1: Do you agree with our proposed rules on when a consumer must be offered investment pathways, including how consumers who enter drawdown in stages should be treated, and that those who take an UFPLS are not included?

1. We agree with the proposed rules on when non-advised customers must be offered investment pathways. Moving from an accumulation phase arrangement into a new drawdown contract or from one drawdown contract to another could involve a change in investment strategy and so offering the pathways at this point is sensible.

2. While we consider that pathways are unlikely to be suitable for advised clients (as pathways by definition will be designed for an 'average' investor, whereas advised clients seek a solution bespoke to their circumstances), we do not see any concern with requiring advisers to consider pathways in their suitability assessments for retail clients – as long as pathways are just one of a number of options and advisers are not in any way required to give greater weight to the pathways over other investment solutions.

3. The treatment of consumers who enter drawdown in stages also seems reasonable. We agree with the FCA that where a non-advised customer uses a 'drip-feed' approach to drawdown which has been previously agreed with the provider, that this implies a degree of engagement that does not require repeated contact with pathway solutions. As the FCA notes, requiring the presentation of the pathways in such cases is likely to be a barrier for customers that worsens their experience. On the other hand, where the customer has not previously engaged with the provider and moves some of their pot into drawdown, we agree that presenting the pathways could be helpful to them as the lack of prior engagement with the provider may be indicative of a lack of engagement with their investment decisions in drawdown.

4. We also agree that there is no need to apply the pathways to customers accessing their pension via UFPLS. As the FCA notes, such customers will have made a deliberate decision to keep their pension in their accumulation phase investment strategy. This will, in most cases be the default strategy, which will have been professionally designed and governed and reflective of the risk that the average scheme member has the capacity to bear at any given age; or it will be in an alternative investment strategy that an individual has actively selected for themselves on the basis that they feel it better suits their individual needs.

Q2: Do you agree with our proposal that all providers of drawdown to non-advised consumers should be covered by our requirements on investment pathways, including SIPP operators?

5. Yes, we agree with the FCA's proposal here. While many non-advised customers may be sophisticated investors, this may not be true in all cases. And as the FCA has noted, it is not easy to distinguish between the more and less experienced investors in the non-advised group. As a result, we consider the proposal to require all non-advised customers to be offered pathways, including those holding SIPPs, to be a pragmatic solution to this problem. As long as pathway implementation is not overly burdensome for firms, the extra requirements should not be a concern.

Q3: Do you agree with our proposed 4 objectives, and mandating all providers to use our prescribed wording when presenting these objectives?

6. In our response to the discussion questions in this area in CP18/17 we expressed our reservations about prescribing the pathways objectives in FCA rules on the grounds that while they currently reflect the products available in the market, they may not always do so in future. For example, should hybrid investment/insurance products or deferred annuities emerge in the future, the current objectives may need to be updated. Nonetheless we can see the benefits of standardisation in order to aid customer comparison across providers. While proceeding with the four standardised objectives as proposed, we therefore recommend that the FCA keep them under regular review in order to ensure that they continue to reflect the product set and customer choices in future.

7. We also suggested in our response to CP18/17 that the pathways objectives would benefit from some brief explanations alongside to further enhance customer understanding of what the objectives entailed. We are pleased to see that following customer testing, the FCA will permit providers to provide additional information alongside the pathways to further aid customer understanding. We agree that the FCA should work with providers as they implement the pathways to understand what additional information will be most helpful to customers.

Q4: Do you agree that providers should only be able to offer 1 pathways solution for each investment pathway objective?

8. Yes, we agree that providers should only be able to offer one investment strategy to meet each pathway objective. This will ensure that customers do not need to get involved in investment decision-making, with the provider left to design the strategy they believe best suited to meeting each objective. The logic here is similar to the default investment strategy in the accumulation phase of DC, a feature that we strongly support.

9. If a charge cap is imposed on investment pathways, then a different policy framework is necessary. As we have indicated in our cover letter, a cap may preclude firms from bringing a full range of their best investment ideas to the design of investment strategies. In the event of a charge cap on the investment strategies of pathways in future, then we recommend firms should be allowed to provide an additional investment strategy for each pathway objective: one that is subject to a charge cap (and clearly disclosed as such) and one that is not (again, this should be clearly disclosed). This will allow firms to give customers a choice between an option that has been designed according to a regulatory cost constraint and an option that can be designed using a full range of investment options.[3]

Q5: Do you agree with our proposed rule requirements for the choice architecture, and do you agree that providers can offer investment pathways without giving the consumer a personal recommendation?

10. In our response to CP18/17 we considered the proposed choice architecture to be a reasonable way to help non-advised customers make a choice over the required objective and associated pathway. However, we also agree with the FCA that providers are best placed to integrate the pathways into their existing customer

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[3] Cost-effectiveness and value for money considerations will feature in the design of any product and we expect non-capped products to be priced fairly and competitively. However, the experience of the DC accumulation phase charge cap suggests that when a cap is in place, investment design is frequently dictated by the size of the investment budget rather than a starting point of the member outcomes that schemes are seeking to achieve. This is the fundamental problem with a cap – the starting point should always be member outcomes, not cost.

journeys and consider that the proposed rules will allow this in such a fashion that the pathways are given equal prominence alongside alternative investment solutions as well as a choice of staying in the accumulation phase asset allocation. We consider that the rules should help customers make the choice most appropriate for them.

11. The only area where we would challenge the proposals is in relation to giving non-advised customers that have actively chosen a non-pathways solution a second opportunity to use the pathways. Customers that have actively chosen an alternative solution are likely to have done so because they wanted an investment solution that better matched their specific circumstances and risk profile, rather than a pathway solution that has by definition been designed for an 'average' customer choosing a particular objective. We think those customers that have the confidence to have made their own choice should not have to be presented with the pathways for a second time. Being presented with the pathways a second time will be perceived as a barrier to making their choice and is likely to lead to a less smooth experience for the customer. We would therefore recommend that the FCA does not require such self-directed customers to be presented with the pathways a second time.

Q6: Do you agree with our proposed rule to prevent providers from offering the same pathways solution for all the objectives?

12. We support the FCA's approach to not being prescriptive on the design of pathways investment solutions or preventing firms from using existing investment solutions to deliver the pathways objectives where they are capable of doing so.

13. With regards to the rule that prevents providers from offering the same pathways solution for all objectives, we would note that an investment solution can be used to deliver multiple objectives. Investment strategies can be altered through different market environments and through time in order to meet the differing needs of investors. Accordingly, we think firms should be able to develop products that are capable of meeting multiple objectives.

Q7: Do you agree with our proposed rules on labelling of pathways solutions?

14. Yes, we agree with the proposed rules on the labelling of pathways solutions. The rules should enable customers to compare pathways solutions for each of the objectives across different providers.

Q8: Do you agree with our proposed rules requiring larger providers to provide pathways solutions for at least 2 of the 4 objectives and to refer consumers to another provider's pathways solutions for any objectives where they don't provide a pathways solution?

15. We generally agree that firms should be able to offer solutions to those pathways that they wish to and that there must be at least two pathway objectives catered for. We do not consider this to be onerous and indeed would expect that most large providers would be in a position to offer investment strategies for all four objectives.

Q9: Do you agree with our proposed easement for smaller providers, including our proposals for the operation and level of the threshold for qualifying for this easement?

16. We support the easement for smaller providers as a pragmatic approach based on the feedback received in the consultation. Based on the FCA's analysis of its retirement income data we would agree that 500 non-advised customers is an

appropriate threshold as it ensures the vast majority of cases are within scope of the pathways remedies.

Q10: Do you agree with our proposed approach to product governance for firms manufacturing pathways solutions used to provide investment pathways? Do you agree with our proposed approach for distributors?

17. We agree with the FCA's proposed approach to product governance requirements for pathways manufacturers and distributors. From our reading of the proposed rules we understand this to be extending the product governance requirements of MiFID/IDD (themselves similar) to the manufacture and distribution of investment pathways. The main impact of this will be for those firms not currently subject to the MiFID/IDD product governance requirements to be subject to them for the manufacture and distribution of investment pathway solutions. We support this approach because product governance requirements should be consistent across all investment pathway products and should not differ as a result of the status of the provider in relation to MiFID or IDD. A level playing field in this area will ensure that all investment pathway solutions are manufactured and distributed to consistent standards.

18. We also support the additional requirements on distributors that refer their customers to external pathways solutions to take account of the price, product complexity and financial strength of the receiving provider. Since the referral is arising from the provider's decision not to offer a particular pathway investment, the obligation should be on the referring provider to ensure that the options available to the transferring customer are suitable according to the dimensions set out by the FCA.

Q11: Do you agree with our proposed approach for ongoing information to consumers using investment pathways? Do we go far enough, or is there anything further that providers could do to ensure that consumers carefully consider their investment choices on a periodic basis?

19. The additional information proposed by the FCA is adequate to remind customers of the need to consider their options on an annual basis. Alongside the information on performance and charges under the newly introduced COBS 16.6.9 G(4) as well as existing requirements on income sustainability, we consider that customers should have all they need to review their pathways choices on an annual basis.

ENSURING INVESTMENT IN CASH IS AN ACTIVE DECISION

Q14: Do you agree with our proposals to ensure cash investment is an active decision?

20. Yes, we agree with the proposals to ensure that investment in cash is an active decision. Holding cash or cash-like assets as a long term investment poses a significant risk to the real value of a customer's pension savings and remaining invested with an appropriate asset allocation could earn them a better return. We recognise that some customers will not have the risk appetite to remain invested and should have the ability to hold cash if they so choose; confirming this through an active decision is the best way to reduce the harm for those customers who may end up heavily invested in cash without realising it.

21. We agree that cash and cash-like investments should be in scope. Where the risk and return profile is similar between cash and cash-like investments it makes little sense to limit the proposals only to cash. With regards to an appropriate threshold

for cash investment that triggers the warning, providers will be better placed to advise.

22. There is just one area where we would suggest that the cash warnings are unnecessary. Where consumers elect to choose pathway option 4 "I plan to take out all my money within the next 5 years" an active decision to invest in cash has already been made. Having made this choice it seems nonsensical that customers should then be given a cash warning on moving into the relevant pathway solution as well as on an annual basis. We suggest that customers choosing this pathway option should not be required to be given the cash warnings.

Q15: Do you agree with our proposals on the warning about investment in cash that the non-advised consumer will get when they enter drawdown or transfer-in funds in drawdown to a new provider?

23. Yes, we agree with the proposal both in principle and in content, with respect to the information contained in the cash warning. The proposed explanation of the impact of inflation in the cash warnings will be particularly useful in helping customers understand the risks of long term investment in cash.

Q16: Do you agree with our proposals on the ongoing warning around investment in cash?

24. We agree with the proposal as customers should be prompted to consider their decision to be predominantly invested in cash on an annual basis. Since the FCA's rules allow providers to give the cash warning as part of the annual drawdown statement we consider this adequately deals with the risk of customers receiving multiple communications that may cause them to disengage.

ACTUAL CHARGES INFORMATION

Q19: Do you agree that, in relation to their decumulation pensions, unless charges are built into the disclosed price of the product, consumers should receive information at least annually on all the actual charges they have paid, aggregated and expressed as a cash amount?

Q20: Do you agree that our rules should require disclosure of transaction costs, but not specify how transaction costs should be calculated?

25. The IA strongly supports full transparency of all costs and charges incurred in the investment process as part of a comprehensive wider disclosure process. We have done significant work in this area in recent years to help our member firms implement the requirements of MiFID II, PRIIPs, and COBS 19.8 as well as non-regulatory initiatives such as the LGPS Code of Transparency, the Institutional Disclosure Working Group and its successor body, the Cost Transparency Initiative. As a result of this work the asset management industry is now supplying the enhanced information about the costs and charges of the investment vehicles that sit inside pension products.

26. We recognise that following the FCA's recent supervisory work on costs and charges[4] there remain challenges around the clarity of some of this information, particularly in relation to the methodology used to calculate transaction costs. We have previously expressed our concerns to the FCA around the transaction cost methodology under COBS 19.8 and PRIIPs and do not raise these points again

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[4] MiFID II costs and charges disclosures review findings and Review on disclosure of costs by asset managers, FCA, February 2019.

here[5]. We remain committed to working with the FCA on these matters to ensure that the asset management industry moves to a solution that ensures customers receive reliable, clear and meaningful information.

27. Leaving aside our concerns about transaction cost methodologies, we are supportive of the extension of MiFID II style ex-post pound and pence cost and charge disclosure to pension products. We would note however there may be significant operational challenges in implementing the requirements for pension providers that have not previously been in scope of the MiFID II cost and charge disclosure requirements that apply to distributors. For this reason we suggest the FCA is pragmatic when requiring cash disclosures.

28. Beyond these general comments we do have some specific concerns about the proposals. Firstly, aggregation of charges with transaction costs can provide a misleading impression about the impact of transaction costs, by implying that the gross return is reduced by the sum of the OCF plus transaction costs. This is obviously not the case, as transaction costs are already included in the gross return achieved. We would therefore suggest an additional presentation that distinguishes between the service charge (shown as deducting from the return achieved) and transaction costs (incurred in generating the gross return). This is to avoid giving the customer the incorrect impression that transaction costs are an additional charge that further reduces the return achieved.

29. Secondly, looking across the cost and charge disclosures that will apply across the lifetime of a DC pension product, there are a number of inconsistencies that we fear will create real confusion for customers. In particular, the different cost and charge disclosure requirements and proposals across the life of a DC pension product are as follows:

    - Accumulation phase charge and transaction cost disclosure requirements in COBS 19.8 allow for disclosure to IGCs and trustees of percentage numbers with transaction costs calculated according to the slippage methodology. The FCA is currently consulting on extending these disclosures to members of contract-based schemes[6].

    - For those customers that go into drawdown the pre-sale KFI document requires disclosure of charges but excludes transaction costs. Disclosures must be in cash terms, although percentage figures are not prohibited.

    - Ex-post annual disclosure requirements for customers in drawdown or UFPLS require disclosure in cash terms of charges and transaction costs on an aggregated basis. The methodology for calculating transaction costs is not specified, with discretion given to firms here in the context of MiFID. While some firms may choose to apply slippage and therefore be consistent with COBS 19.8, other firms may choose an alternative methodology, creating an inconsistency between the presentation of transaction costs in the accumulation and decumulation phases of DC.

30. Taken together our concern is that these requirements will confuse customers in relation to the charges and costs of their DC pension products. We recommend a consistent approach to cost and charge disclosure across the lifetime of DC pension

[5] See our responses to the FCA's CP16/30 (2017) and Call for Input on PRIIPs (2018).

[6] CP19/10: Publishing and disclosing costs and charges to workplace pension scheme members and amendments to COBS 19.8, FCA, 2019

products: a common methodology for calculating transaction costs with disaggregated disclosure of costs and charges.