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INVESTMENT
ASSOCIATION
INVESTMENT MATTERS

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Date: 15 September 2017

Dear Jonathan

RE: Retirement Outcomes Review interim report – Investment Association response

The Investment Association is a long-standing supporter of greater flexibility in the provision of retirement income, allowing pension savers access to the right product at the right time in their lives. We are committed to working with the Government and the FCA to ensure that the pension freedoms are a success for pension savers. We welcome the opportunity to respond to the FCA's interim report on the Retirement Outcomes Review and attach below our detailed response to the questions posed.

Professional support is the cornerstone of developing better retirement outcomes. This means ensuring consumers are properly supported through the provision of advice and guidance, as well as in the development of simplified pathways for the majority of consumers who currently do not take advice on planning for retirement.

The post-April 2015 retirement income market is an immature one and we think this is reflected in the FCA's findings. A strong propensity for taking DC pots fully as cash and using the proceeds to spend or pay down debt is consistent with DC pots currently being small and not forming the main source of retirement income for individuals. We expect these behaviours to change as consumers come to rely more on their DC pension savings. The market in turn will likely innovate further as consumers begin to demand products that better suit how they want to use their DC pension savings.

Some of the other behaviours found by the FCA underscore the need for better consumer journeys. The outstanding initiatives to implement FAMR may also encourage more customers to either seek financial advice or be guided in some fashion towards better outcomes. However, a considerable portion of the population does not or cannot access professional support, and will be reliant on the state pension or defaults. The findings highlight the sheer complexity that consumers face in making decisions about which products are the right ones for them. Measures to improve competition, while welcome, will not resolve this and so the question of how customers access guidance and advice cannot be overlooked when assessing how well the retirement income market is working for customers – supply-side remedies alone will not be sufficient to ensure that this market works well for all consumers.

We are strong supporters of simplifying otherwise complex investment decisions, but set out in our response why we think that retirement income requires a different starting point to the default arrangements for investment in the accumulation phase of DC saving. Defaults in the accumulation period encourage inertia saving, which while effective at growing pension pots raises questions about how to effectively engage with consumers as they approach retirement. While we support the FCA's proposal for default investment pathways if a saver has chosen drawdown as their preferred option, this does not answer the question of how to help consumers decide on the direction they should take in the first place when considering broad options (annuity, drawdown, cash or a combination).

A true default approach to the retirement income market would take account of the need for the majority of future retirees to remain invested in order to provide an income, as well as managing longevity risk over time. Determining the level of active engagement needed to deliver this, even at a very high level, is key to delivering successful outcomes.

However the question of how individuals make a choice over which product they require is resolved, we agree that IGCs can play a positive role through an extension of their 'value-for-money' assessment remit to decumulation products. The scrutiny and governance that they bring to the assessment of the provider's products, services and internal governance processes will ensure that consumers benefit from innovative, cost-effective and transparently-priced products.

We think such an approach would be preferable to a charge cap on default products. Regulators such as the OFT have pointed out that caps are an imperfect mechanism that can create unintended consequences in three respects. First, evidence from the existing DC accumulation phase charge cap suggests that it is driving a focus on low cost as a proxy for value in some parts of the market, particularly around investment. A cap of 75 bps must cover all aspects of the product, including administration and communication, with all charges borne by the saver. This may create both barriers to entry and sustainability. Second, and in consequence, it also limits product innovation. It may be difficult for a robust and diverse market in investment products to develop in the presence of a cap. Incentives to develop investment strategies for different retirement outcomes are reduced. Third, there is a risk that by capping only those products with an explicit charge and not those without an explicit charge (annuities), the market is further distorted. We would also highlight that while the accumulation phase charge cap was justified because of automatic enrolment, the same rationale does not carry through to a market in which individuals make an active choice over which product to purchase – a default investment strategy inside a retirement income product is not the same thing as a default retirement income product.

Measures to compare investment products used to generate a retirement income are welcome but should focus on more than just costs, as this risks equating value for money with lowest cost. Careful thought must be given to the design of such metrics because if not designed properly they may drive behaviours that are not optimal for the customer. For example, if such metrics were to focus on cost at a point in time rather than on the costs incurred to deliver a potential outcome, holding cash, for example, would look cheaper than remaining invested. Cash, however, offers no protection against inflation and longevity risk. Where used summary cost metrics should be supplemented with information on potential outcomes that are tailored to an individual customer's specific circumstances. This will help facilitate a better assessment of 'value for money' than a focus on cost metrics alone.

We would support more consumer testing to develop ways to help savers understand different products, and the comparisons that they may need to make. However, given the need for simplified pathways, this testing may need to focus as much on how to explain the concepts that drive an annuity pay out commitment as compared to an investment-fund income drawdown product, as well as associated issues such as the impact of inflation over a prolonged period when considering the choice between and an annuity and an investment product.

With the exception of a possible charge cap, we consider that the FCA's general approach of early intervention while giving the market time to adjust is the right one. The proposed remedies may help consumers make better-informed decisions about their needs and the available product set, while not stifling the market.

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

Yours sincerely,

Imran Razvi (by email)

Public Policy Adviser

RESPONSE TO RETIREMENT OUTCOMES MARKET STUDY INTERIM REPORT – CONSULTATION QUESTIONS

ABOUT THE INVESTMENT ASSOCIATION

The Investment Association is the trade body that represents UK investment managers, whose members collectively manage over £6.9 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 36% of European assets.

More information can be viewed on our website.

SUMMARY OF INTERIM FINDINGS

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?

1. We consider the FCA has set out a comprehensive description of the retirement income market as it exists today and as such we have no comment on the evidence base itself.

2. Some of the findings are concerning, particularly the issues around the negative public perceptions of pensions policy and the pensions industry and the effect this has on consumer decision-making. We agree that industry, regulators and government need to work together to ensure that people have confidence in the pension system and that their decisions on accessing their DC pots are not driven by their mis-trust of the system.

3. A strong propensity for taking DC pots fully as cash and using the proceeds to spend or pay down debt (figure 4 of the interim report) is consistent with DC pots currently being small and not forming the main source of retirement income for individuals. Some of the other consumer behaviours found by the FCA – lack of switching

between providers[1], struggling with the complexity of product features and charges – is also anecdotally familiar and underscores the need for customers to access financial advice, or be guided in some fashion towards better outcomes through the use of appropriate defaults.

4. While there are issues of consumer behaviour that can weaken competition, particularly low levels of switching between providers and an inability to understand and compare charges, the findings highlight the sheer complexity that unadvised consumers in particular face in making decisions about which products are the right ones for them. Measures to improve competition, while welcome, will not resolve this fundamental issue and so the question of how customers access guidance and advice cannot be overlooked[2] when assessing how well the retirement income market is working for customers. While we recognise that access to advice is being considered as part of the FAMR package and that the focus of the Retirement Outcomes Review is non-advised customers, it is important to note that supply-side remedies alone will not be sufficient to ensure that this market works well for all consumers.

5. As the FCA notes, asset managers are generally not the end product providers in this market, instead manufacturing investment and outcome-based components that sit inside drawdown products, SIPPs or other insurance-based investment products. With respect to the supply of new products, previous discussions with our members suggest that there has been some innovation in terms of new products being launched to allow consumers to access the full range of freedoms – for example, options that allow members to access cash in stages or receive a steady income stream over a fixed period of time.

6. Asset managers and insurers are also thinking about products that combine investment and insurance approaches, which complement each other in a good retirement income strategy. We set out the case for precisely these sorts of approaches in our response[3] to the NEST consultation on the 'The future of retirement'[4] and are pleased to see that NEST has subsequently taken on board these ideas in its proposed approach[5] to providing retirement income if it is permitted to do so in future. Over time we expect such combination products to emerge in the market.

7. However, the retirement income market is still immature and we are likely to see further change in terms of the suite of products on offer over time. In particular, there are two features of this market which mean that it will take some time for a wider range of products to emerge.

8. The first feature relates to the characteristics of DC plan members who are currently availing themselves of the freedoms. As the FCA notes in paragraph 3.12 and figure 24 of its interim report, DC savings are currently small and not the main source of private pension savings for most retirees. The way consumers currently access their DC pensions will likely be very different from those future cohorts who are totally reliant on DC pensions to provide them with a retirement income. It is likely that

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[1] It is our understanding that low levels of switching between providers may in part be an administrative issue associated with individuals wishing to access their tax free cash, rather than genuine inertia. In a number of instances, provider systems assume the individual is now "in drawdown" and the payment of tax free cash requires them to be switched to an in-house product in order to access the cash.

[2] In particular, more should be done to convince customers that advice does offer value for money.

[3] A response from the Investment Association to NEST's consultation on 'The future of retirement', 2015

[4] The future of retirement', NEST, 2014

[5] The future of retirement: A retirement income blueprint for NEST's members', NEST, 2015

products will adapt over time to better suit the circumstances of consumers in the market place.

9. The second feature of this market is the uncertainty surrounding how it will be regulated in future. In particular, the possibility of a charge cap being imposed on some or all retirement income products – and the associated uncertainty about the level and scope – makes it a harder decision for firms to invest to innovate. We return to discuss charge caps in our response to question three. Some asset managers also note that innovation may be dampened if the regulator has an expectation that unadvised product sales should be "for life" in order to avoid the risk that individuals run out of money.

10. When drawing conclusions from the findings of the interim report, caution should be exercised in extrapolating the behaviour of future cohorts of retirees from the behaviour of today's consumers. Since the former will retire with lower (or no) DB entitlements and larger DC accounts built up as a result of a greater number of years spent saving in a DC-dominated pension system this will inevitably have direct implications for how future cohorts use their DC pension savings; and potentially, for how the market should be regulated.

APPROACH TO DEVELOPING POTENTIAL INTERVENTIONS

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**

11. We support the FCA's general approach of early intervention while giving the market time to adjust and for the most part agree that the proposed remedies should help consumers make better-informed decisions about their needs and the available product set, while not stifling the market. We discuss our views on the FCA's proposed remedies in more detail in our answers to questions 3-6.

12. While we agree that most of the proposed remedies will not adversely affect the development of the market, we do not think this is true in relation to the proposal for a charge cap on default investment pathway products. We discuss the reasons in some detail in our answer to question three but in short we consider a charge cap to be a major structural intervention that could significantly hamper innovation and lead to consumers being denied access to certain products.

13. The experience of the DC workplace pensions market is that the charge cap on default strategies has led to a conflation of quality with low cost, with the result that some workplace pension providers compete purely on price and that in investment terms, certain asset classes, product features and management styles are now effectively priced out of the market.

14. Capping charges on a specific product type creates a significant disincentive for providers to participate in a market and we see no justification for such a major structural intervention without any evidence of a problem. We think it will be very difficult for a robust and diverse market in drawdown products to develop in the presence of a cap. Furthermore, a cap on only those products with an explicit charge and not on those that lack an explicit charge, such as annuities, risks further distorting the market.

15. We favour instead a product market characterised by transparent, competitive pricing and clear information sets, supported by purchasing and support frameworks that allow consumers access to good outcomes whether through institutional arrangements or within the more traditional retail market.

REMEDY 1: ADDITIONAL CONSUMER PROTECTIONS FOR CONSUMERS WHO BUY A DRAWDOWN PRODUCT WITHOUT ADVICE

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 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?**

16. We agree that consumers purchasing drawdown on a non-advised basis are a group that merits particular attention[6]. We are neither inherent advocates of drawdown nor critics of annuitisation – indeed, we view them as complementary approaches that can form part of a good retirement income strategy. However, it is the case that drawdown involves a more challenging and on-going set of decisions for the consumer.

17. We agree with the need for default investment pathways once a consumer has selected drawdown as the direction of travel and discuss the need for these pathways below. However, we think the Review does not answer a more fundamental question – what is the default course of action at the age the consumer has previously indicated they wish to retire, if they express no further preference?

18. This is a difficult question to answer in the post-freedoms world, given the range of options available to individuals and evolving individual expectations regarding flexibility. In our view, remaining invested until a decision on direction is made is the only possible default because it does not entail the provider making a product choice on behalf of the consumer (and hence effectively providing advice). It will also allow the pension provider multiple opportunities to contact the customer to see how they wish to access their pot as well as ensuring that the customer's options are kept open.

19. Helping consumers navigate the first order choice of how they access their pot must involve some form of engagement on the part of the provider – at a minimum some form of simplified pathway that guides people through their otherwise complex choices and helps them make a decision over which product type is most appropriate for them: e.g. is it really wise to take cash; is there a need for longevity protection?

20. It is clear how challenging this may be for individuals and we are not necessarily advocating a traditional approach to education and product type. Communications could potentially move away from product description as a starting point and look at attitudes to retirement income and risk. Decision Trees or Robo-advice could also be

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[6] Although as we noted in footnote 1 the FCA should look to understand further the extent to which customers moving to an existing provider's drawdown product is really more of a means to accessing their tax free cash.

employed to get customers thinking about what they want from their savings. Smarter communications have a significant potential role here.

Default investment pathways

21. In comparison to advised customers we think there is a greater risk of non-advised drawdown customers ending up with adverse outcomes for the reasons the FCA highlights – through poorly managed longevity risk combined with inappropriate choices on asset allocation, withdrawal rates and failure to manage investment and inflation risks. These are complex problems for which there are multiple solutions. Default investment pathways are likely to need different design features from those in accumulation, but they will become an increasingly important safety net for many and we agree that providers should look to develop these.

22. In the accumulation phase, the concept of a default arrangement has a strong logic. The accumulation phase, for all DC savers, is in essence about maximising the value of the individual's assets for retirement through a combination of regular contributions and the investment returns achieved on them for a given level of risk. The purpose of the default option in the accumulation phase is to take the asset allocation decision (and baseline contribution levels) out of the hands of individual savers. For some DC savers, their investment in the default arrangement will be due to truly inert behaviour while for others it may be an active decision to stay invested in the default. Over time, we expect that other behavioural mechanisms, possibly focusing on automatic escalation of contribution levels, may well play an additional valuable role.

23. A default investment strategy for drawdown is more complex, requiring decisions over managing investment, inflation and longevity risks as well as what constitutes a sustainable income stream[7]. Given the complexity of these decisions, we consider that investment managers will be better equipped than individuals to design and implement appropriate investment strategies to deliver the required outcomes. Nonetheless, some individual engagement over the level of income required will be needed. The default should be about taking the investment decisions out of the individual's hands, not the decisions over desired outcomes.

24. We have previously stated our view[8] that NEST should be allowed to offer decumulation products to its existing members. As well as being to the direct benefit of its members, NEST could also play a role, alongside others, in driving innovation in product development more broadly. We would recommend that the DWP in due course re-consider their decision to not extend NEST's remit to the decumulation stage for its own members.

A charge cap on default investment pathways?

25. We do not support a charge cap being put on default investment pathways. We have three key concerns. Firstly, as regulators such as the OFT have pointed out, caps are an imperfect mechanism that can create unintended consequences. It is not clear what problem a charge cap is designed to address, since the FCA has not presented any evidence showing that drawdown products come with 'excessive' charges.

26. Secondly, caps can work against product innovation, ruling out certain features and asset classes that consumers might otherwise value or benefit from. In an environment where people accessing their DC pensions are going to be subject to

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[7] One that means the individual does not run out of money before they die.

[8] Investment Association response to DWP call for evidence 'NEST: Evolving for the future', September 2016

multiple complex and intertemporal risks, a charge cap risks limiting innovation that could help to mitigate these risks, thereby placing consumers in danger of not being able to access the products that might be best for them. This could increase the risk of poor consumer outcomes.

27. A cap may also reduce competition through causing some firms to exit the market or by creating a barrier to entry for firms wishing to enter the market. This can also result in reduced innovation.

28. Third, we highlight the market distortion that can occur by capping charges only for a class of products that come with an explicit charge (investment products) while leaving products without an explicit charge (i.e. annuities) uncapped. This may distort the balance of product purchases towards products that, from a regulatory perspective, are less risky because they ensure the customer never runs out of money. Such distortions may not be in the customer's best interest if there is an alternative product available that is more suitable for them at a particular point in time.

29. While there is limited evidence on the impact of the accumulation phase charge cap on DC default investment strategies across the market, there is some evidence in parts of the market[9] that suggest an increasing dominance of the lowest cost strategies, particularly in bundled schemes aimed at smaller employers, and little allocation to alternative, and potentially higher-yielding asset classes, that are accessed by other institutional investors.

30. There is an important additional point here about the distinction between the investment needs of individuals in the accumulation phase and decumulation phase. The IA does not take a view as to whether active or passive products are superior or inferior to one another. Where we do take a view is that areas such as asset allocation and delivery of specific objectives, for example growing income or providing longevity protection, generally rely on active decisions. These decisions may or may not be highly scalable. Either way, it is a different debate and retirement income in this regard is a significantly different investment challenge to generating very long-term returns through securities markets.

31. Risk management and income generation will be a critical part of investment-based retirement income products and the danger of a cap is that such techniques are priced out. If product providers are no longer able to consider approaches that are optimal from the consumer's perspective, but only those that are allowed for by regulators, this could increase the risk of consumer detriment. It is also not without risk for government, regulators and industry over the longer term.

32. Rather than a cap we favour instead a product market characterised by transparent, competitive pricing and clear information sets, supported by purchasing and support frameworks that allow consumers access to good outcomes throughout their retirement. Clearer pricing in particular will help consumers assess the cost of products and exert pressure on providers through switching. Such forces will help keep costs reasonable as will the oversight provided by IGCs if their remit is extended to retirement income products.

Extending the role of IGCs to cover decumulation products

33. The IA has always been supportive of the emphasis on enhanced governance in DC schemes and in particular the creation of the IGC model for the contract-based

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[9] '*Master Trusts – Investment Designs: A Comprehensive Study*', Defined Contribution Investment Forum, 2017

segment of the workplace pensions market. Extending the remit of IGCs to cover value for money assessments of decumulation products, based on factors consistent with value for money assessments elsewhere, is a natural step in their evolution and one that we would support.

34. One of the most important functions that IGCs currently fulfil is their scrutiny of the investment governance processes put in place by insurers to ensure that provider-designed default strategies and self-select strategy/fund ranges are designed to meet consumers' needs and perform in line with their objectives. While outcomes in DC are inherently uncertain, a high quality investment governance process in the design and monitoring of these products will help maximise the chances of consumers achieving their desired outcomes.

35. Insurers will also apply these investment governance processes to the investment design of drawdown and other investment-based insurance products for the decumulation phase. The external scrutiny of these processes provided by the IGCs will be helpful in ensuring their quality.

36. The focus on investment governance in decumulation products must form part of the wider focus on value for money. In particular there should be a recognition that low cost and value for money are not the same thing, a distinction that has not always been made in the context of the DC accumulation market. We applaud the IGCs for their work to define value for money on grounds wider than cost and would expect to see these frameworks adapted for decumulation products. A focus on outcomes in particular will be important in this market. And while cost is not the same thing as value, we do expect it to form part of the IGC value for money judgements, thus helping to keep costs at a reasonable level for the service delivered.

37. In summary we think a focus by IGCs on the quality of investment governance processes in relation to investment-based decumulation products alongside their outcomes and costs will be a more effective way than a charge cap of helping the market for these products develop. It will ensure that consumers benefit from innovative, cost-effective and transparently-priced products.

Decision not to introduce an appropriateness test for non-advised drawdown

38. We agree with the FCA's decision not to introduce an appropriateness test for consumers moving into drawdown without taking advice at this stage. The underlying investment strategy within a drawdown product may be a packaged solution that means that the consumer understands what they have bought and actually may have bought it because it does not require managing. Equally there may be some customers who are perfectly capable and confident of taking the decisions needed to run a drawdown product without taking advice; by imposing an appropriateness test such customers will either be forced to pay for advice in order to avoid the test or they may face a restricted product set. This would not be a desirable outcome.

39. We agree that the development of default investment pathways in decumulation is a more effective way of protecting the riskiest group of non-advised drawdown customers. This group will be the least engaged with their investments and the least equipped to understand and manage the risks they face. Well governed default solutions will look after their needs. Customers who make active decisions to opt-out of the default should be left to make their own choices from a full set of decumulation products. If evidence of harm to this group emerges subsequently then the FCA can re-consider this decision in future.

REMEDY 2: ENABLING CONSUMERS TO ACCESS SOME OF THEIR SAVINGS EARLY WITHOUT HAVING TO BUY A DRAWDOWN PRODUCT

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

40. We agree that consumers moving into drawdown (or another investment product) simply to access their tax free cash is a concern. Such an outcome is not what drawdown is designed to deliver. Consumers should not be paying product and fund charges and taking on investment risk if what they want to do is access cash. Purchasing an inappropriate product is likely to be damaging for consumers and the industry and will do nothing to counter the mistrust that exists in relation to the pension system.

41. This is however a problem of consumer knowledge and access to guidance and advice rather than one of availability of products. We are aware of products that allow people to access their tax free cash and receive subsequent pay-outs without taking any investment risk. The market is already delivering these solutions. The issue then becomes one of the extent to which people outside of a default solution are informed of the existence of such products, although we question whether for most future consumers simply spreading their cash withdrawals to avoid tax will be in their best interests.

42. For consumers relying on default solutions, where people have previously expressed a desire to use their pension pot purely to access cash, such products can easily be designated as the default. However, we would caution against this becoming a generalised default over time – as more people come to rely heavily on their DC pensions for income, only investment and insurance-based approaches to generating that income will be capable of delivering. Cash should not be the default in this world.

REMEDY 3: SHOPPING AROUND REMEDIES

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 communications?**
- **Do you agree with the decision not to pursue the alternative measures we considered at this stage?**

Introducing drawdown comparison tools

43. In many markets, high rates of switching between products typically indicate a dynamic and competitive market from the viewpoint of the consumer. While this is an important feature of a well-functioning market we should not expect to see the same rates of switching between investment products as might be seen in other products.

44. Investment is an inherently long-term process. In any investment product poor timing in selling the underlying assets could destroy value for the investor. The costs of liquidating a portfolio in order to move between different products may outweigh the benefits of doing so. This feature will tend to reduce rates of switching between different investment products and so care will need to be taken in interpreting what a healthy rate of switching in this market will be.

45. Leaving aside these caveats, measures to help consumers focus on comparing different investment products are welcome. At this stage we have no particular insight on whether the market will develop such tools itself or whether intervention is required. As DC pots grow and the use of investment products to generate a retirement income becomes more popular, the Government and the FCA should keep under review developments in this area and be ready to intervene if necessary.

46. In terms of what must be disclosed charges are clearly important and we discuss these further in our response to the FCA's proposal for a summary cost metric. However, performance scenarios and projected outcomes, taking into account likely patterns of consumer usage are also needed in order to truly assess the suitability of the product and, on an ex-post basis, value for money. Given customer heterogeneity in circumstances we think these should be individually tailored rather than generic and that projections should be provided on a stochastic basis rather than a deterministic one. Deterministic projections are of limited value in a product where the range of outcomes can potentially be wide. Clearly some of this material could be challenging to interpret for consumers and just as the FCA has carried out some consumer testing with respect to the presentation of costs, it should do so with respect to outcomes.

47. The need to compare projected outcomes also highlights a need to be clearer about what is covered under the term 'drawdown'. Does this label cover pure decumulation, whereby assets are sold to generate income and capital is actually run down? Or does it cover the generation of a retirement income through the investment of assets for income, with capital left intact? These two approaches are very different but could both be used to generate a retirement income. Their differing implications for the treatment of the investor's capital highlight the need to focus on product features, risks and potential outcomes alongside charges.

Mandating the use of a summary cost metric in customer communications

48. Charges affect the net outcome from an investment product and their level should clearly be part of the decision-making process of customers. Given the complexity of drawdown charging structures we can see the benefit of using summary cost metrics to help consumers.

49. However, where used, summary cost metrics should be used in conjunction with disclosure of the actual charges paid and not instead of them. This will allow consumers to see the cost of the product or service they are paying for as well as the possible impact of the costs on their outcome (which on an ex-ante basis can only be shown through estimation).

50. Removing information on charges removes a key piece of information needed for consumers to compare product providers on the cost of the product or service delivered. In the forthcoming PRIIP KID for example, removal of information on charges and the use of RIY figures instead to express their estimated future impact removes a key element of comparability and accountability over product providers for the consumer.

51. We note from the experimental results of the research presented alongside the interim report that the FCA has chosen as its measure of effectiveness the extent to which a particular summary cost metric helps customers identify the lowest cost product. We think some caution is needed in interpreting the results in this way. The point of a summary cost indicator should not solely be to help consumers identify the cheapest product because this implies that lowest cost and value for money are the same thing. As the FCA says, wider factors should be considered as part of a value for money judgement. For example, higher yielding funds inherently cost more

than lower yielding funds but if the customer needs a high level of income from their assets then costs, whilst important, are not as important as meeting the end customer requirement. A summary cost indicator should be just one piece of information presented to consumers – alongside charges paid and estimations of the range of possible future outcomes from the product.

Alternative measures not being taken forward at this stage

52. We agree with the FCA that at this stage it is better to focus on the measures designed to facilitate easier comparison across drawdown products. Consumers should be empowered to shop around in the first instance rather than be actively prompted to move from their existing provider, although they first need to work out what they need from their retirement savings (and other assets) now or in the future.

REMEDY 4: HELPING CONSUMERS UNDERSTAND THEIR OPTIONS AFTER THE PENSION FREEDOMS

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?**

Exploring the feasibility of introducing tools that compare different products and options

53. There may be some merit in developing tools that help compare different products but as the FCA acknowledges different classes of products are not directly comparable, and indeed, not designed to be substitutable. Any attempts to compare these products should make clear the distinction between investment and insurance-based approaches to generating retirement income, the different roles these approaches play in a retirement income portfolio and the risks that they do and do not mitigate. Such comparison tools should inform and not seek to steer consumers to one particular product type. Helping people understand what they need to consider and the function of different products would be most helpful at this stage.

54. While the difference in outcomes from insurance and investment-based approaches can be explained relatively simply, cost comparisons are currently fraught with difficulties because it is not clear what the cost of an annuity is. In drawdown, while charge structures may be complex, product charges are expressed and disclosed on an ex-ante basis. However, the price of an annuity is implicit in the rate quoted to consumers. While the annuity rate provides a clear product outcome to the consumer, it does not represent the real cost of the product – the payment stream is not the price. Careful thought needs to be given to how different products can be compared in order to facilitate effective consumer decision making.

55. Tools should include questions about health firstly because it may influence expected life expectancy but more because of the importance of the enhanced annuity for some people, who simply do not know they exist. More should be done to communicate that when insurance companies provide annuity rates they are estimating the customer's likely point of death – this information could be useful in planning.

AREAS WHERE WE ARE NOT PROPOSING SPECIFIC REMEDIES AT THIS STAGE

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?**

Limited innovation for mass market consumers

56. We agree that the FCA should not be intervening at this stage due to concerns about levels of product innovation for mass-market customers, particularly those who do not take advice. As we have indicated in our answer to question one, this is still a highly immature market and we see some structural features which currently act to dampen innovation. Our expectation is that this will change as the market matures and a wider set of products will emerge.