



## Financial Conduct Authority CP21/32: Improving outcomes in non-workplace pensions

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

John Reynolds  
Financial Conduct Authority  
12 Endeavour Square  
London  
E20 1JN

The Institute and Faculty of Actuaries (IFoA) is pleased to submit feedback on CP21/32.

Within the actuarial profession we have experts in the technical detail, executives in small and large financial institutions, and practitioners working within the financial system itself. Our outlook is rooted in our Royal Charter (dating back to 1884) and in our long history of working with policymakers to effect change. We focus forwards on how we can help individuals and organisations solve financial and risk-related problems in the 21<sup>st</sup> Century.

For each of the questions in the consultation, the IFoA's Personal Finance Working Party has provided a response below, which has been based on the Working Party's collective experiences, rather than any specific research or analysis. Please contact Caolan Ward, Policy Manager, ([caolan.ward@actuaries.org.uk](mailto:caolan.ward@actuaries.org.uk)) if you have any questions about this response or need further information.

In the main we have agreed with the proposals; however, we strongly believe the FCA should also consider some means of "nudging" people into obtaining advice, even if they are invested in the default option. Particularly for people in their 30s and 40s, we believe that the upfront cost of financial advice is very likely to be significantly less than the present value of the likely difference at retirement between an unadvised (default) pension pot and an advised pension pot. However, consumers may not appreciate this point without some education and nudging.

Advice will add more value than the selection of an appropriate (tailored) investment portfolio, with recommendations on affordability and the suitability of specific pension products and providers, based on due diligence research.

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<b>Beijing</b>	14F China World Office 1 · 1 Jianwai Avenue · Beijing · China 100004 · <b>Tel:</b> +86 (10) 6535 0248
<b>Edinburgh</b>	Level 2 · Exchange Crescent · 7 Conference Square · Edinburgh · EH3 8RA · <b>Tel:</b> +44 (0) 131 240 1300
<b>Hong Kong</b>	1803 Tower One · Lippo Centre · 89 Queensway · Hong Kong · <b>Tel:</b> +852 2147 9418
<b>London (registered office)</b>	7th Floor · Holborn Gate · 326-330 High Holborn · London · WC1V 7PP · <b>Tel:</b> +44 (0) 20 7632 2100
<b>Oxford</b>	1st Floor · Park Central · 40/41 Park End Street · Oxford · OX1 1JD · <b>Tel:</b> +44 (0) 1865 268 200
<b>Singapore</b>	163 Tras Street · #07-05 Lian Huat Building · Singapore 079024 · <b>Tel:</b> +65 6906 0889

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Advice could potentially be taken each time a contribution is made but a well-balanced investment solution is likely to continue to generate superior returns even if unaltered, so advice at the outset of contributions is key.

An increasing number of individuals are consolidating all, or the most part, of their various pension entitlements in one central pot and the issue of advice is more important when large sums are being transferred and invested. There is a risk, for example, that a consumer might receive advice on a transfer value but after making the transfer then leave the money in cash without having received ongoing advice.

**Q1 Do you agree that we should require firms to offer a single default option rather than multiple default options / investment pathways?**

In terms of outcomes, a one-size fits all default option would be expected to underperform a solution more tailored to the individual's circumstances. So, while we agree with the requirement for a single default, over multiple defaults, we favour requiring firms to offer some straightforward alternatives that sit between the default and full tailoring.

If lack of tailoring is recognised as a risk, the options are:

- offering multiple default options (as a means of generating some tailoring),
- relying on the consumer's ability to bypass the default and move into tailored risk options,
- suggesting the individual pays for advice.

If tailored options are offered by the provider, we would prefer that approach to the offer of multiple defaults. For those with low financial knowledge, who would otherwise leave their pension money on cash deposit, we believe a default option (single or multiple) is a satisfactory solution. For all others a tailored route, with or without advice, is to be preferred in terms of outcomes.

As a subsidiary point we think that there is a case to be made for the default to take precedence over cash, but we recognise the timing issues that could arise if investors were automatically invested in the stock markets immediately their contribution was received.

**Q2: Do you think there is a case for requiring firms with only legacy NWP business to make a default option available to their customers?**

We do not see an argument for consumers whose pension pots sit with legacy providers to be treated differently and to miss out on the FCA's desire for them to reconsider the suitability of how their pension savings are invested.

**Q3: Do you agree that we should require firms to offer a default option to all non-advised consumers entering into an NWP? If not, what would you propose?**

We agree.

**Q4: Do you agree that we should not require firms to offer a default option to advised consumers or consumers using discretionary investment management services for their NWP?**

We agree, although in practice this is a systems issue because the default will just not be relevant.

The definition of 'advised' consumer is important here, we feel this must be someone who confirms they are receiving formal, ongoing, investment advice for the specific NWP. This might be clear for those who are using a discretionary service, but not necessarily (e.g. if they use the discretionary service for an ISA portfolio but just set up a new NWP with the same 'adviser' without that investment service).

**Q5: Do you think we are right to exempt bespoke SIPPs? Do you see any issues with our proposed approach? If so, what would you suggest?**

We believe there is a very small risk that an individual who has bought a bespoke SIPP will be holding funds in cash or an inappropriate investment mix. There may be circumstances where cash is earmarked for an upcoming purchase, for example of a property, or the consumer appears to be too concentrated and over-exposed to higher-risk assets, but these circumstances are very unlikely to arise without the policyholder(s) receiving advice or being sophisticated investors themselves.

Perhaps there should be a requirement at the point of opening an account for policyholders to confirm whether they are receiving formal, ongoing investment advice, and, where they are not, that they are aware of the risks and classify themselves as sophisticated/experienced.

**Q6: Do you agree that the default option should be offered upfront, in menus of investment choices, and alongside decision trees or tools? If not, what would you suggest?**

Unadvised new customers will fall into two categories:

- (a) those who are not at all knowledgeable about investment and are inclined to hold their pension money in cash; and
- (b) the rest, including both (i) those with good investment knowledge and (ii) those who have little investment knowledge but who do know cash is a poor investment.

Groups (a) and (b)(ii) are likely to be confused by investment 'front ends', therefore we suggest making the 'default' more prominent.

Group (b)(i) are not confused and can be led in a straightforward manner through to tailored decision trees.

On balance we think that the default should be upfront but for the reasons outlined in the response to Q1 some wording should be employed which encourages consumers to pursue the decision trees if offered. We would expect a number of providers to be able to re-use the decision trees that they have in place for auto-enrolment customers.

Somewhere in this process the consumer should be made aware why the default is being offered. For example, cash is unlikely to beat inflation over the long term or an alternative portfolio could be too high risk (or just unbalanced) and may make the consumer uncomfortable with short-term experience. As a result, they may either stop contributing and/or switch out to cash (perhaps at an inopportune time).

**Q7: Do you agree with our proposals for how a default option would be offered?**

For consumers who would otherwise invest in cash, we believe the term 'default' is appropriate, and, indeed, we would prefer such consumers to have to make an active decision to choose cash. For others the expression Standardised Investment Strategy, or similar, is probably more helpful - especially if backed up by wording which explains that a tailored approach, or better still paying for advice, is likely to prove more beneficial.

The word 'Strategy' could probably be deleted from the label, given the likely one-off nature of the process. Perhaps 'Solution' or 'Option' would be better, although we note that 'Solution' carries more implication of a satisfactory outcome than would be warranted.

There is a risk that consumers will press the default button even if their circumstances are such that cash is an advisable option; although we expect this to be very rare.

**Q8: Do you agree that we should extend our product governance rules in PROD 4 to all manufacturers and distributors of default options?**

We do not understand the applicability of this question because a default option by its nature will be broad brush and cannot be considered as an individually-tailored solution under the PROD 4 umbrella.

**Q10: Do you agree that we should not extend the remit of IGCs/GAAs or cap the charges of default options at this time?**

We do not think that the evidence of caps on charges in investment products or in other financial areas supports the extension of the IGCs/GAAs remit to NWP. Transparency of charges is vital, as is competition in the market. One effect of caps is that they become more of a standard than a top limit.

**Q12: Do you agree with our proposals for cash warnings to be given to consumers with significant and sustained cash holdings in their NWPs?**

Yes, strongly agree.

**Q13: Do you agree that we should make cash warnings mandatory up to the proposed age limit, with guidance that providers should consider giving cash warnings beyond that age limit?**

No - the wording of cash warning is key here, and we don't agree there should only be guidance above an age limit. There are some circumstances where an individual might be advised to be in cash and nearing their selected retirement age (as opposed to nearing a set age limit) is one of these. But your paper identifies several others.

We would prefer the wording of the cash warning to be phrased to identify reasons to be in cash and to say that otherwise the default or a tailored option is to be preferred for investment. These risks are minimal in a great majority of cases, especially for younger savers where a move out of cash would make a big expected improvement to their pot outcome.

**Q14: Do you agree that we should require cash warnings for all consumers who meet the conditions, including advised consumers?**

We agree, subject to the point that if an advised consumer is in cash there is probably a good reason (and therefore the wording of the cash warning is important). It would be difficult anyway to operate a system with a button to snooze the cash balance reminders if there was a good reason for the holding.

**Q15: Do you agree that we should not at this time require providers to ensure an active decision to hold cash in an NWP?**

We agree, despite our comments in the response to Q1.

**Q16: Do you agree that we should not exempt bespoke SIPP operators from the proposed requirement to give cash warnings?**

We agree, and we would expect warnings to be required in very few cases because an investor in a bespoke SIPP is likely to be knowledgeable about investments. We note that there may be practical issues with the timing of valuations of more obscure holdings in SIPPs, such as property, which create difficulties in complying with the timing schedule of cash warnings.

**Q17: Do you agree with our proposals for the content of a cash warning?**

We agree with the principles of the content. If there is no prescription will the FCA regularly review a sample of warnings used?

For individuals close to retirement there would be an argument for a different slant on the content, but the issue would be how to word such a pre-retirement warning without straying into advice.

**Q18: Do you agree with our proposals for when the need for a cash warning would be assessed?**

This is a matter for providers to comment on, but we would refer you to Q16 in connection with bespoke SIPPs.

**Q19: Do you agree with our proposed timeframe for sending cash warnings? If not, what would you suggest?**

We would prefer 6 rather than 13 weeks between assessment and notification.

**Q20: Do you agree that we should provide guidance on the data we would expect providers to retain? Are there other data you think important?**

We think it is important in judging the effectiveness of these prescriptions to have data that measures the percentage of assets in cash before and after the warnings.

There might be some merit in attempting to see whether behaviours change, with believers in cash modifying their portfolios so the cash holding is just under 25% as a means of avoiding warnings. We recognise that valuations of the remaining 75% would make this strategy subject to the vagaries of the stock market.

**Q21: Do you agree with our proposed implementation timeline for cash warnings?**

We agree that a 12-month period seems reasonable. Some major systems changes may be needed by some providers.

**Q22: Do you have any comments on our cost benefit analysis?**

We would prefer an approach that looked separately at the costs and benefits to consumers and providers and we make some general comments on these below. We have not quantified our assertions but simply want to draw attention to the issues.

**For non-advised consumers** their only costs are their time costs for researching and completing the transaction. Their benefits emerge in the form of anticipated higher returns if they switch out of cash. It is a matter of assumption as to the likely excess returns over cash in the future. In one section of your analysis you postulate an excess return of 5% over one year. If such an excess return was assumed to continue the benefits of switching from cash for an individual some way off retirement would, of course, be very considerable by virtue of the power of compound interest.

The assumed benefits for individuals would be even higher if they adopted a tailored investment strategy, which would theoretically be expected to produce higher long term returns than a 'one size fits all' (default) strategy.

The benefits for an individual who pays for advice as they move out of cash might at first be assumed to fall between the values for a default strategy and a tailored strategy. But we believe the excess returns generated even by the default strategy would comfortably cover the cost of the advice, even if it is paid for regularly and not just at the outset. This reinforces the argument for a default strategy as an option for non-advised individuals. We have commented elsewhere in our response on the benefits of paying for advice, which is a different point.

**For providers** the costs and benefits are more complex. You have identified the main costs to providers of implementing your proposals. However, we believe there should also be benefits for them. The most significant benefit over the longer term is that aggregate funds should build up significantly more than if held in cash and the charges levied on those extra funds will be considerable. You have undertaken no projections or analysis of this benefit but we believe this new quantum of charges will comfortably cover both the initial costs of setting up the default mechanism and the ongoing costs of issuing cash notices as appropriate.