Institute and Faculty of Actuaries

CP18/17 Retirement Outcomes Review: proposed changes to our rules and guidance

IFoA response to Financial Conduct Authority

9 August 2018

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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.

We strive to act in the public interest by speaking out on issues where actuaries have the expertise to provide analysis and insight on public policy issues. To fulfil the requirements of our Charter, the IFoA maintains a Public Affairs function, which represents the views of the profession to Government, policymakers, regulators and other stakeholders, in order to shape public policy.

Actuarial science is founded on mathematical and statistical techniques used in insurance, pension fund management and investment. Actuaries provide commercial, financial and prudential advice on the management of assets and liabilities, particularly over the long term, and this long term view is reflected in our approach to analysing policy developments. A rigorous examination system, programme of continuous professional development and a professional code of conduct supports high standards and reflects the significant role of the profession in society.

Institute and Faculty of Actuaries

Adam Summerfield and Richard Wilson
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

9 August 2018

Dear Mr Summerfield and Mr Wilson,

IFoA response to CP18/17 Retirement Outcomes Review: proposed changes to our rules and guidance.

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the FCA's consultation CP18/17 Retirement Outcomes Review: proposed changes to our rules and guidance.

2. The IFoA is the UK's only chartered professional body dedicated to educating, developing and regulating actuaries based both in the UK and internationally and has around 32,000 members. The consultation has been considered and reviewed by its Pensions Board who has extensive experience of pension policy and assessing pension risk.

3. The IFoA believes it is important that people are able to make informed decisions about their retirement. The Freedom and Choice reforms introduced in 2015 make it easier for individuals to make decisions that lead to poor outcomes, as well as good. The overall policy aim should be to establish a framework that enables consumers to make informed choices about the options they face. Provision of retirement information and access to suitable tools must take place for a considerable period before significant retirement decisions.

4. Developments in pension policy mean that many individuals are taking on more investment and longevity risk (often doing so unknowingly). Many are ill equipped to do so, therefore it is right that the FCA continues to monitor market developments and respond accordingly.

5. The IFoA is concerned that while the FCA has identified the harm that may arise from consumers not considering what to do with their pension fund and investing in cash by default, the consultation ignores the potential harm arising from the mismanagement of longevity risk. It seems to us that consumers not considering appropriate investments are also unlikely to have considered the prior question of how best to manage the risk of running out of money in retirement. Conversely, other consumers experience hardship because their fears of running out of money cause them to under-spend. Our principal concerns about the proposals arise from the concentration on the choices between drawdown products and the lack of consideration given to the important initial choice between drawdown and securing lifetime income (or using some hybrid product to mitigate the longevity risk).

6. The IFoA is also surprised at the overall “anti-cash” stance the FCA has adopted. While we recognise that having pension assets in cash bears the risk of value being eroded by inflation, investing is not a risk free alternative. The FCA rulebook rightly has extensive protection for retail consumers when investing because of the risks it poses. We think that the FCA seems to have over-enthusiastically adopted a “investing good – cash bad” mantra without considering the risks it is potentially imposing on consumers with a default investment strategy.

Q1: Do you agree with our current high-level thinking on the key elements of our potential remedy? If not, what would you suggest?

7. No, this solution ignores longevity risk. While support for customers making better informed investment choices in drawdown would benefit some consumers, the proposal ignores the prior choice that consumers need to consider but many will not have addressed, that of a guaranteed income vs gradual depletion of their assets. Even if a consumer chooses not to take a guaranteed income at outset, such a choice may become more attractive in later years as the benefits of longevity pooling become more material. In that scenario, being able to select a drawdown investment strategy that anticipates subsequent purchase of a guaranteed income could be an attractive option.

8. If consumers are going into drawdown in order to access their tax free cash, they are defaulting to an investment solution without considering how best to manage longevity risk. This is a potentially much greater source of consumer detriment than being invested in cash. The FCA proposed investment pathways solution reinforces the failure of the missed decision and may give consumers misplaced comfort that they have considered all that they need to. An unadvised consumer is unlikely to revisit an investment solution once a decision has been made.

9. If a consumer has actively addressed the longevity question and chosen drawdown, then the investment pathways solution may help consumers reach a better investment solution especially for those who have longer term horizons for using their pension assets.

Q2: 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?

10. It would be essential (and only fair to consumers) that they are reminded of the option of a guaranteed income for the rest of their life. This could be offered through the 3 option choice architecture proposed by the FCA for consumers. The IFoA believes many consumers would understand “an income in retirement” to be an “income for the duration of their retirement”. For consumers saying they want an income in retirement, the choice between a guaranteed income and one from drawdown and the associated risks/benefits of each should be fully outlined. Firms that do not offer annuities should be able to outsource their provision to a partner, but it should not be an excuse not to offer that pathway or explain the choice.

Q3: 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?

11. Not quite. While it would be appropriate to offer a single investment solution to those choosing to invest, IFoA thinks that for consumers choosing an income they should be offered a choice between an income for retirement and managing their funds over an uncertain time period.

Q4: 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?
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Q5: 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?

12. Firms should offer investment solutions that are suitable for delivery of the stated objective. The IFoA believes it is unlikely that a single solution would be suitable to meet the needs of such wide ranging objectives (i.e. keeping my money invested for a long period of time and to take all my money over a short period of time). Firms should be able to outsource the investment pathway but the solutions should match the objectives.

Q6: 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?

13. Yes. It is not appropriate for FCA to prescribe particular solutions but the FCA should mandate that a proper choice of the options is made to consumers as above (i.e. including provision of an option of an annuity).

Q7: 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?

14. Yes.

Q8: 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?

15. Yes. Consumers should be offered choice between making their own allocation or having support in decision making.

Q9: 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?

16. The choice architecture should encourage consumers to consider best how they want to manage the risks they face in retirement. This must include the longevity risk and whether they want a guaranteed income or to be invested. Otherwise, for consumers entering drawdown, the choice options are sensible.

Q10: Do you agree that investment pathways should also be made available to advised consumers? If not, what would you suggest?

17. Yes.

Q11: 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?

18. Yes.

Q12: 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?

19. Yes.

Q13: 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?

20. Yes.

Q14: Do you agree with the approach we are considering taking for ongoing disclosure to consumers about investment pathways? If not, what would you suggest?

21. Yes.

Q15: 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?
Q16: 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?
Q17: 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?
Q18: 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?
Q19: Would SIPP operators be able to demonstrate that their consumers are advised and/or sophisticated/high net worth investors?
Q20: How might an appropriateness test work in practice?
Q21: Should we not apply the remedy to non-advised consumers who have self-selected an investment strategy even though these consumers might benefit?
Q22: 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?

22. We have no comment on Qs15 – 22.

Q23: Do you agree that the IGC regime should be extended to investment pathways? If not, what alternative regime would you propose?

23. The IFoA agrees that IGC oversight of the investment pathways would increase the likelihood of good outcomes for consumers. The Terms of References for IGCs should be carefully considered in this regard. Simply adding a responsibility for investment pathways would fail to recognise that much risk of potential detriment occurs in the transition from accumulation to decumulation. Consideration should be given to the role of IGCs in relation to this transition.

Q24: Do you consider that a requirement for independent oversight should apply to other decumulation products (i.e. not only to investment pathways)? If so, why?

24. Yes, because of the risk of consumer harm.

Q25: 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?

25. We have no comment.

Q26: Do you have any other issues or concerns about the proposals?

26. No.

Q27: 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.

27. If the pathway offers different objectives (as suggested by the FCA), it is unlikely to be met suitably by a single solution.

Q28: 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?

28. No. Cash might be a plausible solution for a pathway where the objective was to take all the money over a short period of time especially if the choice architecture indicated that the consumer had in mind a very short timeframe.

Q29: 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?

29. No. There are plausible reasons for investing in cash and we believe it is more important to concentrate on encouraging consumers to make the right choices overall, taking all relevant considerations into account. The fact that uninformed consumers are more likely to invest in cash just emphasizes the need for information and advice, rather than necessarily a need to steer them away from cash (into possibly even less sensible options).

Q30: 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?

30. N/A

Q31: 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?

31. One warning, accompanied by an easily accessible path to investing choice architecture, would be sufficient.

Q32: 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?

32. Cooling off periods should be maintained and assets should be able to be held in cash for the duration. A limit of £30k seems appropriate.

Q33: 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?

33. We have no comment.

Q47: Do you agree that consumers should receive information on actual charges paid expressed as a cash amount?

34. Yes it would seem appropriate that protections mirror investor protection elsewhere.

Q48: How do you consider this would best be achieved by firms?

35. We think the same costs disclosure regime for other investment should apply.

Q49: What would you estimate to be the cost of these changes?

36. We have no comment.

Should you wish to discuss any of the points raised in further detail please contact Chris Hannant, Interim Head of Policy (Policy@actuaries.org.uk / 0207 632 1452) in the first instance.

Yours sincerely,

John Taylor
President- elect, Institute and Faculty of Actuaries