Institute and Faculty of Actuaries

Retirement Outcomes Review: Terms of Reference

IFoA response to the Financial Conduct Authority

31 August 2016

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Institute
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Dear Retirement Outcomes Team

IFoA response to MS16/1 Retirement Outcomes Review: Terms of Reference

1. The Institute and Faculty of Actuaries (IFoA) agrees with the FCA that following fundamental reform of the pensions framework, it is important there is a review of whether the system remains fit-for-purpose. Given consumers have greater choice about how they manage their pension savings in retirement it is right that regulation, policy and industry adapt to provide consumers with the protections needed to help them to avoid making decisions that will leave them worse off.

2. Whilst the increase in choice is inherently complex, for those consumers able to engage, and who would benefit from doing so, we recommend engagement could be fostered through:
    a. a targeted approach to communications tailored to the individual;
    b. communications that help to build financial capability over time, making the decision-making process more manageable; and
    c. shifting the focus of communications from inputs to outcomes and focusing on goals for their retirement.

3. For those consumers not able, or willing, to engage in financial decisions, the introduction of appropriate defaults could help to prevent poor outcomes. However, robust consumer protections will need to be put in place to prevent consumers becoming tied into any potentially unsuitable products. It is important that any defaults have an effective governance structure in place.

4. The market is still responding to the pension freedoms, with many providers working on a range of platforms and tools to help consumers understand and navigate the options available to them. If policy, regulators and industry are able to engage individuals with these tools, and importantly the pensions dashboard when it is implemented, this could be a significant step in helping people to make better decisions regarding their retirement.

5. We have not answered those questions where individual firms will be better placed to do so.

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Question 1: How difficult is it for consumers to access and assess product information, such as prices and product features, and why? What are the effects of this on consumer decision-making?

6. Long-term financial planning is a complex process and comparing the value of an annuity against an income drawdown product is not easy. Nor is it straightforward to compare income drawdown products between providers as they may have different features. Having to figure out which type of product, and then which specific product, best meets their circumstances will be difficult and time-consuming for even those consumers with a good level of financial literacy. This could result in sub-optimal decision making and even inertia.

7. We suggest one way to help consumers to assess product information is by assisting them to take a phased approach to their retirement planning, so that they can build up their knowledge and experience in a manner that may be more manageable. This could work by helping the consumer to understand how they might use each type of product, independent of any specific product or provider in the first instance. This would mean that they would be able to understand the potential impact of their decisions on their overall retirement income, so that they are better able to ask providers to direct them towards their most suitable products. For example, rather than receiving quotes from the same provider for an annuity and a drawdown product, they would be able to search across a number of providers for a drawdown product, if they had identified that as being the type of product that would most suit their needs. This could have the additional benefit of encouraging and helping consumers to shop around.

8. If the FCA were to consider the phased approach as a policy option, the IFoA is working on a tool which will assist consumers in better informing themselves about retirement savings. The IFoA is currently in the consumer research phase and once we have consolidated our findings we would be happy to share them with the FCA. We are also using the modelling within this tool to complete some analysis on different decumulation strategies, for example, the impact of annuitising at different ages and drawing down different proportions of savings on retirement outcomes to help non-advised consumers consider a range of retirement income options.

Question 2: How do firms enhance or alleviate any complexity and comparison difficulties that consumers may face?

9. It is important to acknowledge that the increase in choice arising from the introduction of the pension freedoms is inherently complex and that whilst firms should do all they can to alleviate this complexity, there is a risk that consumers may well still be drawn to the easiest option. Noting this, the IFoA has recently established the *Communicating Investment Returns for the Retail Customer Working Party* to review communications to retail customers. This working party has found that there is far more consistency required in format and goal planning across the whole customer journey, including:
   - initial basic modelling tools on platform/provider websites;
   - more detailed and complex retirement modelling tools for use by the consumer or their adviser;
   - Point of Sale Illustrations; and
   - Annual Statements and ongoing Investment Performance reporting.

10. In addition, the working party's review found that the documents are often difficult for even professionals to understand and are at worst incoherent. This working party is now considering how industry can best make available all the information a customer might need to make decisions, whilst ensuring that the information is clear, unambiguous and in a format

that the consumer can understand. For example, the working party's secondary research has found that terms such as returns, gross or net, probabilities, and even percentages all seem to be misunderstood by a significant section of the population. A number of recommendation have arisen from the Working Party's research, namely that:

a. A succinct, clear and relevant explanation of projected values, both before and after costs, should be the key elements of any projected figures.
b. Values given in actual or today's monetary terms are most likely to be understood by the average consumer.

Question 3: Why has the level of consumer switching decreased since the introduction of the pension reforms?

11. The introduction of the pension freedom reforms has increased the choices available to consumers and again, we would highlight the inherent complexity in long-term financial planning. Whilst greater choice can enable people to ensure they can best meet their personal needs, if consumers are overwhelmed with choice this could have a negative impact and result in inertia.

12. We suggest that more could be done to simplify the decision-making process for consumers, which could in turn have a positive impact on engagement and the likelihood of individuals shopping around and switching. In our recent report 'Assessing adequacy of retirement income: a bottom-up approach', we suggest that one way of helping consumers to engage with their pension is to adopt an outcomes-based approach. This would start with the individual thinking about the type of retirement they aspire to and the specific needs that they might want to meet, so that they can set goals for their retirement. Applying an outcomes-based approach could aid with the transition into retirement by encouraging individuals to consider during the accumulation stage, right through to the decumulation stage, what they will need from their savings, rather than their discussions being led at the point of retirement when they are faced with a range of products.[1]

13. We suggest framing the outcomes-based approach around three tiers of Bronze, Silver and Gold, with Bronze relating to a minimum income measure and Silver and Gold focusing on financial resilience and improved quality of life. For example, an individual may wish to secure the amount they need to achieve the Bronze level for the rest of their life, but also value flexibility to access their funds should they have any unforeseen costs in retirement. In this context a consumer would perhaps benefit from a hybrid pension product. Breaking down an individual's needs, rather than starting with the product, could help to encourage people to shop around for a product or range of products that best meets their needs.

14. The *Communicating Investment Returns for the Retail Customer Working Party* found that none of the information they gathered from providers included any reference to consumer goals and what they might want from their retirement savings, instead focusing solely on numbers. The benefit of linking communications to goals, in addition to being engaging, is that this would provide an opportunity to discuss risks to the consumer in achieving their goals. We appreciate there is no regulatory barrier to information being presented this way, but we have not seen significant evidence of it in the market. If the FCA were supportive of this approach the IFoA would welcome the opportunity to work with the FCA to encourage this shift in the focus for provider's communications.

[1] IFoA (2016) Assessing adequacy of retirement income: a bottom-up approach

Question 4: What do the different non-advised customer journeys look like following the introduction of increased flexibility and choice?

15. For non-advised customers the path of least resistance may be to take their pot in a single lump sum or a series of lump sums - if a single transaction would have tax implications. Whilst this may be the best option for those with small pots, those who might benefit from an alternative journey face a potentially time consuming and difficult series of tasks and decisions. The development of clear and concise communications and tools will be instrumental in helping people to navigate their retirement income options. The current focus by Government and regulators on information, guidance and advice provides us with a great opportunity to undertake a collective review on whether the way that we communicate to members is sufficiently focused on what they need to know, as opposed to what we need to tell them to meet industry standards.

16. The terms of reference for this market study refer to the pensions dashboard as a specific tool that is already under development. If this is delivered as planned, the IFoA believes that it could enable consumers to take a holistic overview of their savings. If this were coupled with the ability to agree to a two-way interface to share this information with a pension provider, this could help industry to develop products that meet the entirety of an individual's needs, rather than just the savings that they have with them. It would also mean providers are better able to tailor their communications to their customers' overall circumstances. We suggest that non-advised customers would benefit from more targeted communications as opposed to generic communications as can sometimes be the case. Consumers could be segmented a number of ways including by financial wealth, financial capability, ability to bear different risk exposures and whether they are likely to access other guidance services or rely solely on the information sent to them by their scheme. Our members suggest the definition of a '*personal recommendation'* currently prevents providers from segmenting their consumers as targeted communications could then be considered as advice. The IFoA suggests the FCA considers further review to the definition of what constitutes a personal recommendation.

17. The IFoA also believes that the pensions dashboard could also help those with a number of small pots. These individuals will be able to assess their overall retirement income and take positive action during the saving phase that might reduce complexity at retirement, such as consolidating their pots. If individuals approach retirement with a proliferation of small pots they can expect to receive a number of different wake-up packs and sets of information on product options, adding even further complexity. This could be avoided if people are encouraged to aggregate their small pots, which the pensions dashboard could facilitate.

18. Finally, rather than overwhelming consumers with a number of decisions at the point of retirement, or at age 55 when they can access the freedoms, non-advised customers may benefit from a series of communications. This would lengthen their journey, but would enable them to take a series of more gradual steps, which builds their financial capability over time. Again, this ties in to our earlier comments that a provider could start by getting consumers to think about their retirement income needs, before they begin to try to understand the pros and cons of different products. This could help to mitigate the complexity facing non-advised customer journeys following the introduction of increased flexibility and choice.

Question 6: How does product presentation and distribution influence the customer journey? For example, what impact does combining accumulation and decumulation products and options have on consumer decision-making?

19. The IFoA believes that the FCA should remove any barriers for combining accumulation and decumulation in circumstances where it finds this to be in the consumer interest. However, if the pensions industry develops in such a way that this could result in a person transitioning from a default accumulation fund to a default decumulation strategy, then robust consumer protections should be put in place to prevent consumers becoming tied into a potentially unsuitable product, or a consumer not being aware that they have transitioned from accumulation to decumulation.

Question 7: To what extent do the changing customer journeys promote good informed decisions, or create barriers to doing so?

20. The freedom and choice framework relies on people engaging in planning for their retirement and experience suggests that a significant proportion of people are not able, or perhaps willing, to engage in this process currently. For these people, the freedom and choice framework could result in poorer outcomes. One way to overcome this barrier is the implementation of default decumulation strategies. As stated in our response to the previous question, if defaults are introduced, it is important that they do not lock someone into a potentially inappropriate product and they must have an effective governance structure.

Question 8: How have the market structure and business models evolved since the pension reforms?

21. The view of our members is that the market is still developing and will continue to do so for some time. For many current retirees, their Defined Contribution pots are not their only pension sources, with Defined Benefit arrangements remaining prevalent. Current developments include platforms for a greater range of product options and advice, and the IFoA would expect this to continue as more people reach retirement with a greater proportion of their savings in Defined Contribution arrangements.

Question 13: Are there examples of FCA regulation that act as barriers to entry or expansion? If so what are they?

22. The IFoA believes that the main regulatory barrier is the grey-area surrounding the definition of a personal recommendation, which means that providers are prevented from segmenting customers to target their communications. The current definition of personal recommendation also places restrictions on providers taking an active role in helping their customers to think through what type of retirement they want and suggesting how they might achieve that.

23. Whilst it is important that consumers are protected from receiving anything that is not advice appearing as such, the current regulatory framework has in some cases promoted a 'tick-box' approach, in circumstances that could otherwise have been an opportunity for informing the consumer and aiding their financial decision-making. The IFoA believes that there is a middle ground between increased flexibility of communications, whilst ensuring protection of consumers. The IFoA is interested in working with the FCA to find this balance.

24. We also note that there is inconsistency across providers in the risk ratings used, with for example, five, seven, 10 and 14 step scales being used. The PRIIPs requirements, which will be in place from January 2017 for other investments used for retirement, mean the risk rating of these investments will not be consistent with those used for pension products. It is likely this will make comparing pension products with other retirement investments more difficult for consumers.

Should you wish to discuss any of the points raised in further detail please contact Rebecca Deegan, Policy Manager (rebecca.deegan@actuaries.org.uk / 02076322125) in the first instance.

Yours sincerely

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