Institute and Faculty of Actuaries

# Retirement outcomes review: interim report

IFoA response to the Financial Conduct Authority

15 September 2017

**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.

Jonathan Pearson
Retirement Outcomes Review Team
Competition and Economics Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

15 September 2017

Dear Mr Pearson

**IFoA response to FCA Interim Report: Retirement Outcomes Review**

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to this consultation. The IFoA's Pensions Board has contributed much of the detail in this response. We have also received input from our Life Board. We have answered only the questions where we have specific comment to make.

**General Comments**

2. The IFoA welcomes the publication of this interim report. While some of the behavioural findings are interesting, the maturing DC market remains small at present; therefore, we would suggest caution in implementing remedies based on such limited evidence.

3. The distortion is due to two factors:
   - Many retirees only have small DC funds; and
   - Many retirees rely on other sources for their main retirement income.

4. The IFoA believes it is important to take appropriate steps so that future retirees are able to make the best decisions for their retirement. The current policy introduced in the last Parliament makes it easier for individuals to make decisions that lead to poor outcomes, as well as good. While that policy remains in place, the IFoA believes the biggest priority for providers and regulators is the provision of practical, understandable and helpful information to help more people attain good outcomes. Such information may have to be specifically about the impacts of tax and the Lifetime Allowance. Provision of retirement information and accessibility to suitable tools must take place for a considerable period before significant retirement decisions.

5. Pension freedoms mean that many individuals are taking on more investment and longevity risk. Previously retirees passed that risk to insurers by means of annuity purchases; however, the current economic and regulatory environment makes annuity purchase appear poor value to customers, leading to a large reduction in demand for annuities. This has contributed to insurers leaving the market. While the FCA remains committed to an open and competitive market for annuities, if customers continue to avoid annuities, the market will be small.

6. The IFoA believes that annuities still play an important role for pensioners, especially insuring against longevity. While there are periodic mentions of longevity risk in the report, the IFoA

would prefer a greater focus on it in order for the pensions industry to deliver the outcomes that consumers really need (as noted in our paper of December 2015)[1]. The potential remedies in the report do not address the issue of longevity risk. If assets perform, on average, as expected, and longevity is, on average, as expected, around half the pensioner population will exhaust their DC funds by simply surviving beyond the average life expectancy. This will not be a satisfactory outcome. We would like to work with the FCA in considering ways in which retirees can be helped to understand the specific ways in which longevity risk could be managed.

**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?**

8. We note that the data used in your assessment is dominated by relatively small amounts of money, probably held by people with other retirement arrangements. Therefore, we agree with paragraph 8.21 that it is too early to assess whether consumers are making poor choices. In this context, we are slightly surprised by your suggestion that any other views need to be supported by evidence.

9. Our main problem with the interim findings is the concentration on the choices between drawdown products rather than on the more important choice between drawdown and securing lifetime income.

**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**

10. It is of course difficult for respondents to answer this question fully in advance of the FCA publishing its promised strategy for the pensions sector.

11. Throughout the Review, there are references to consumers not fully understanding pension matters and not fully engaging with them even if they do understand. This might lead to a conclusion that the balance currently needs to be skewed towards measures aimed at protecting consumers (including protection from themselves).

**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 also 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?**

12. When individuals have control of their own decisions, there is always the risk of making a decision that leads to a poor outcome. Where the member has opted for some income, rather than full withdrawal, the key decision that may lead to a poor outcome is whether to enter into a drawdown arrangement giving rise to the greater investment and longevity risk, rather than enter into a product that provides secure lifetime income. Any subsequent investment decisions, with or without advice, could lead to a range of outcomes.

[1] https://www.actuaries.org.uk/documents/policy-summary-longevity-risk-december-2015

13. We believe that the FCA should be investing more effort in the key decision rather than in the details of default investment pathways.

14. As regards investment risk, a speculative "punt" on the equity market could lead to very high returns at which stage the customer believes the decision was correct, even if rational analysis would suggest such an approach was unwise. A customer making the same decision at a different time could have a very poor outcome. The volatile nature of investment returns, including from investment defaults, will result in this range of outcomes.

15. While the current policy remains in place, it is a challenge to regulate against poor decision-making, even if that seemingly poor decision ultimately turned out to be advantageous. Provision of default funds would provide some protection against very bad outcomes arising and could provide some assistance to customers in achieving some income from an acceptable (to providers and regulators) level of risk. We would support any work to implement suitable default investment pathways, recognising in general they will only be most suitable for the "average" customer. Naturally, they would not deal with longevity risk.

16. If investment is continuing post-retirement, we are content to have a charge cap on default funds, provided it does not inhibit innovation. In the same way, if customers regard their pension product as continuing, IGCs should oversee such products. Perhaps decumulation products should be more important for IGCs to oversee than accumulation products given the capacity for very poor outcomes.

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

17. We are slightly surprised that the possibility of separating the lump sum payment from the rest of the pension savings has been floated before discussing the subject with HMRC.

18. We believe that "de-coupling" would be a bad thing if it encourages consumers to start withdrawing pension savings without considering their overall retirement income needs. It is not clear to us that "de-coupling" is the right solution to the right problem.

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

19. Customers should be aware of the biggest factors to consider when making decisions at retirement. As we noted in our general comments, the impact of life expectancy is the most significant. Unless customers are aware of the impact of living longer than average, they are unlikely to understand the full and integrated nature of the significance of investment decisions.

20. We support the development of tools that provide information for customers. However, focussing on tools that go into significant detail about drawdown comparison might not be the correct focus.

21. The IFoA believes that communication is important for customers, but providing more information, or information that is not understood, is detrimental to customers. It is unclear that a cost metric would be beneficial to customers.

22. We also agree that the alternative measures should not be introduced. We are not certain they would provide any different outcomes.

**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?**

23. In our 2015 paper, we noted that information is crucial for individuals to understand longevity risk. While we recognise the need for appropriate warnings for customers, there is a danger that too many risk statements take away from the main point that DC assets will form the most significant part of many customers retirement income. They may also further undermine trust in pensions. These considerations are likely to more significant for vulnerable customers.

24. We recognise that to achieve greater engagement, customers must receive more positive messages about retirement saving at an earlier stage.

25. We believe engaging with customers at earlier ages (50+) about retirement decisions can only be beneficial. Developing a savings culture that sees larger DC funds will encourage individuals to give greater attention to investment and spending decisions as they near retirement.

26. Such communication may have to be addressed in terms understood by customers rather than unintelligible financial projections. The IFoA has suggested presenting a bottom-up approach so that customers can understand the financial consequences of retirement in terms they recognise.[2]

**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?**

27. The IFoA is unconvinced that the FCA would be in a position to enforce the operation of an annuity market. It might be that the only thing that has happened recently is a drop in supply that has matched the drop in demand. (Whether the drop in demand is a mistake is a separate matter.) The most effective measure to improve competition would be an increase in yields leading to an increase in demand for annuities. As already noted in a number of responses to specific questions, the FCA could highlight the benefits of the longevity insurance derived from annuities.

[2] https://www.actuaries.org.uk/documents/assessing-adequacy-retirement-income-bottom-approach

28. The DC market will continue to evolve as its significance increases. We encourage the FCA to establish principles for the operation of the market that will enable innovation to develop and allow customers to take advantage (as they see fit) of the policy implications of the 2015 changes.

29. We note the suggestion regarding the need for advice during the drawdown period. We are conscious that the need for this would be considerably lower if consumers fully understood the drawdown product that they bought and how it met their retirement income needs. A default option could reduce the need for continuing advice, particularly if customers are having to take major financial decisions when less capable of doing so.

Should you wish to discuss any of the points raised in further detail please contact Philip Doggart, Technical Policy Manager (Philip.doggart@actuaries.org.uk / 0131 240 1319) in the first instance.

Yours sincerely

Colin Wilson
**Immediate Past President, Institute and Faculty of Actuaries**