

## Retirement Outcomes Review

CP19/5: Investment pathways and other proposed changes



### Purpose of today

“In terms of SIPP operators, arguably this is the most impactful FCA consultation since the regulatory capital changes. Consequently, AMPS are keen to understand the potential impact of these proposals on SIPP operators – this will help us formulate our response to the Consultation Paper”

*AMPS Newsletter – February 2019*

Therefore, today we will:

- Present a brief overview of CP19/5;
- Consider and collate views/observations on the proposed changes for feedback to AMPS; and,
- Where applicable, consider and collate attendees’ suggested solutions

Feedback will be collated:

- On a non-attributable basis; and,
- Views/opinions/firms’ working practices will remain confidential amongst attendees

## CP19/5: an overview

### FCA Policy Aims

- Links to Retirement Outcomes Review: Final Report [MS16/1.3 – June 2018] which sought to address the risk of consumer detriment linked to pension freedoms (2015) – in broad terms this proposed enhanced communications pre-crystallization (see PS19/1 arising from CP18/17) and investment pathways
- CP19/5 is a further consultation stemming from CP18/17
- Aims to increase non-advised consumer engagement with their drawdown fund resulting in poor consumer decisions and consequential poor consumer outcomes
- FCA research indicates 1:3 consumers did not know where their drawdown funds were invested
- FCA research indicates 1:3 non-advised consumers are invested fully in cash
- Investment pathways and/or the SFGB drawdown comparator therefore provide a mechanism for non-advised consumers to invest their drawdown pot
- For consumers 'defaulted' into cash, provider warnings will stimulate consumers to make alternative investment arrangements
- To ensure a competitive drawdown market, consumers should see, in 'pounds and pence' what they have paid, including transaction costs

## FCA Policy Objectives



The FCA has three operational objectives: protecting consumers, protecting financial markets and promoting competition. CP19/5 addresses two of these.

- **Consumer protection**

*"Both our investment pathway proposals, and those to ensure consumers who invest in cash are making an active decision to do so, aim to protect consumers"*

- **Competition**

*"Our proposals to make firms tell consumers the charges they have actually paid aim to increase competitive pressure"*

The harm the FCA is trying to address includes:

- **Buying unsuitable products:** consumers lose out on potential investment growth if investing in cash and/or assets that fail to meet their needs and objectives
- **Prices too high or quality too low:** consumers pay too much in fees/charges and/or do not benefit from better products due to weak competitive pressure on firms

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## Investment pathways



### What?

- Low cost (0.75% fee cap) investment solutions that pension providers can 'offer' or 'refer' consumers to based on four FCA-prescribed investment objectives
- Investment objectives range from not wishing to touch the money for the next five years, through to wishing to take or convert into income products within five years
- Those 'offering' investment pathways will be subject to product governance requirements
- An easement exempts smaller firms from having to offer investment pathways

### When?

- Each time a non-advised consumer wholly or partially crystallises benefits; or, transfers drawdown fund to a new arrangement
- Note: certain 'standing' instructions regarding phased drawdown may fall outwith the requirements

### Who?

- This applies to 'non-advised' consumers which includes those beyond 12-months the previous advice; or, within 12-months of previous advice but have not confirmed their circumstances are unchanged

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## Cash as an active investment decision



### What?

- A requirement on personal pension providers (including SIPP operators) to ensure that, where drawdown funds are predominantly (> 50%) retained in cash or 'near cash' (money-market funds, deposits and certain investments such as NS&I and short-term local authority bonds), this is an 'active decision'
- This is achieved through the provision of written warnings to the consumer confirming the risks of keeping funds invested in cash or near-cash investments

### When?

- Each time a non-advised consumer wholly or partially crystallises benefits; or, transfers drawdown fund to a new arrangement; or, gives instructions to invest > 50% into cash-like investments
- Annually thereafter

### Who?

- This applies to 'non-advised' consumers which includes those beyond 12-months the previous advice; or, within 12-months of previous advice but have not confirmed their circumstances are unchanged

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## Actual charges information



### What?

- A requirement on personal pension providers (including SIPP operators) to provide information on the actual post-sale (ex-post) charges during the decumulation phase
- These charges to be expressed as pounds and pence (rather than %) and to include transaction costs (actual or estimated) and, if applicable, adviser charges

### When?

- Annually

### Who?

- All consumers with crystallised benefits – this includes any consumers that have withdrawn at least one UFPLS payment

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## CP19/5: the feedback

### Structure of the CP

- Chapters 1 & 2 – Summary and Wider Context
- Chapters 3 to 8 – Investment pathways
- Chapter 9 – Cash as an active investment decision
- Chapter 10 – Actual charges information
- Annex 3 – Cost benefit analysis

Our focus today is primarily on Chapters 5 to 10 along with reference to the Draft Handbook text, primarily:

- COBS 16.6: Reporting information to clients (non-MiFID provisions)
- COBS 19.10: Drawdown and investment pathways (New section)
- PROD 1, 4 and 6 (Product Intervention and Product Governance Sourcebook)
- PERG 8 Annex 1: Examples of what is and is not a personal recommendation and advice

## Investment pathways: Chapter 5

### The consumers and providers the requirements will apply to

- Investment pathways apply to 'non-advised retail clients'. Are firms clear on the definition of a non-advised retail client – see COBS 19.10.1(4) and COBS 19.10.10 – and will firms be able to readily identify such clients? ***"It will be the provider's responsibility to ensure that the consumer is categorised correctly"***
- Excluded from investment pathway requirements are consumers taking 'drip-feed drawdown', the conclusion being these consumers are engaged with the drawdown process
- Whilst pathway investments can apply to the whole SIPP arrangement (crystallised and uncrystallised pots) – CP5.17 – the clear intention is that pathway investments will apply to crystallised funds – can such investments be 'earmarked' as being crystallised funds?
- Investment pathway requirements will apply to all pension providers, including SIPP operators, subject to an exemption (see chapter 7) – the exemption recognising that statistically, SIPP providers (save for the 'mass-market' providers) are focussed on advised consumers (5/71 firms had 90% of non-advised plans that were heavily invested in cash)
- **Do you agree that all providers of drawdown to non-advised consumers should be covered by the FCA's requirements on investment pathways, including SIPP operators?**

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## Investment pathways: Chapter 6

### The choices that providers must offer consumers

- There are four investment pathway solutions to be presented to consumers at Step 4 of the process [COBS 19.10.15] – these objectives arrived through qualitative and quantitative research.
- Option 1: I have no plans to touch my money in the next 5 years
- Option 2: I plan to set up a guaranteed income (annuity) within the next 5 years
- Option 3: I plan to start taking a long-term income within the next 5 years
- Option 4: I plan to take my money within the next 5 years
- **Do you agree with the FCA's proposed 4 objectives (above), and mandating all providers to use the prescribed wording when presenting these objectives?**
- Only one 'pathway solution' can be offered for each pathway objective

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## Investment pathways: Chapter 6



### The choices that providers must offer consumers (please refer to process diagram handout or p32 of CP19/5)

- There is a five-step process – COBS 19.10.9 to COBS 19.10.25
- Step 1: determine whether the retail client is transferring in (i.e. is the client transferring-in to use a pathway solution offered by the firm – in other words a referral from elsewhere)
- Step 2: determine whether the retail client has received a personal recommendation (see previous comments in Chapter 5 slide)
- Step 3: offer use of investment pathways (the client can opt-out at this point and do their own thing, although if they do a warning must be provided per COBS 19.10.24)
- Step 4: present the four investment pathway options and ask the retail client to “select an investment pathway option that corresponds most closely to their current intentions” – if a pathway is selected then proceed to Step 5; if no investment pathway is selected, then consider representing the options and remind the retail client *inter alia* they can “shop around”
- Step 5: ‘offer’ or ‘refer’ pathway solutions; or, for pathway exempt firms, refer to the SFGB drawdown comparator – as with Step 4, certain ‘reminder’ actions are invoked in the event of the retail client not acting

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## Investment pathways: Chapter 6



### The choices that providers must offer consumers (other considerations)

- The ‘promotion’ of investment pathways must have equal prominence to any other investment choices and/or the option to remain in the existing investments
- Investment pathways are distinct from other investment solutions a provider offers and are required to be presented separately
- Remaining in existing investments will be a consumer’s “informed decision” to do so
- The act of a firm ‘offering’ or ‘referring’ in regard to investment pathways “will generally not be regulated advice”

**Do you agree with the proposed rule requirements for choice architecture and do you agree that providers can offer investment pathways without giving the consumer a personal recommendation**

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## Investment pathways: Chapter 7



### Requirements for providers on the pathway solutions

- Whilst the four pathway objectives are prescribed (see earlier slide) the investment solution and risk profile is not prescribed, however the same solution cannot be offered for all objectives
- The pathway solutions will need to be clearly labelled and the FCA expects providers ***“to carefully consider their approach when designing pathway solutions (or selecting pathway solutions designed by other pathway providers)”***

Flowing from CP18/17 was mixed feedback, including from smaller SIPP providers opposition to having to provide investment pathway solutions and from other providers opposition to having to provide four solutions – consequently:

1. Small provider easement: < 500 non-advised drawdown consumers, based on estimate of next 12-months' figures, based on prior 12-months, reviewed annually – if likely to breach 500, then 12-months preparation time
2. Larger providers: required to provide ('offer') at least two pathway solutions, meaning they can only refer consumers to other pathway provider solutions for a maximum of two of the objectives

### Views on the above proposals?

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## Investment pathways: Chapter 8



### Other key elements of the proposals (Product intervention and product governance)

- Those of manufacture investment pathways; and, those who 'distribute' (i.e. refer consumers to a pathway manufacturer) will be subject to PROD (new chapter – PROD 6)
- Manufacturers will be required to review pathway investments annually to ensure that the investment remains ***“consistent with the needs, characteristics and objectives of their identified target market”*** and ***“are being distributed to their target market”*** [PROD 6.2.1]
- Distributors must also test for compatibility (as above) along with taking into account the ***“price and complexity of the pathway investment”*** along with, if funds are being 'transferred' to another pension provider, considering the ***“financial strength”*** of the other firm and its efficiency in its dealing with retail clients [PROD 6.3.2]
- Distribution agreements should be reviewed at least two-yearly, including obligations on the distributor (A) and manufacturer (B) to take steps if consumers are ***“choosing not to transfer”*** to the manufacturer – this would include making it easier to transfer from A to B

### Views on the product governance proposals?

- Investment pathways will also be subject to Independent Governance Committee (IGC) or 'governance advisory arrangement' [COBS 19.5] – **further consultation in April**

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## Investment pathways: Chapter 8



### Other key elements of the proposals (Communication)

- Annual statement requirements: 1) short description of each pathway investment and value; 2) if split, the amount in each investment; 3) a reminder of all the other pathway options; and, 4) reminder of *inter alia* that different options/products can be selected and consumers should shop around
- Annual statement guidance: enhanced reminders where there is a fifth anniversary that the five years have elapsed and that the consumer should review their decision

### Other key elements of the proposals (Record-keeping)

- Numbers of non-advised consumers who selected investment pathways; plus, action taken where the consumer did not select the solution offered
- Numbers of non-advised consumers who self-selected or remained in their current investment
- How the provider presented and identified that choice
- For manufacturers, the product approval process for each solution and the annual review thereafter

Thoughts on the above, plus the proposed implementation timeline – 12-months (July 2020)

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## Investment in cash is an active decision: Chapter 9



### Ensuring investment in cash is an active decision

- Proposals apply to non-advised consumers - **newly crystallised or transferred-in; or, those who entered drawdown prior to the proposals coming into force** (six-months to assess the latter category); **or, a retail client who has given instructions to invest in cash** - with 51%-100% invested in cash in their drawdown pot who are required to be warned that more than half their pot is invested in cash/near-cash; that their pot is at risk of being eroded by inflation and that they could consider alternative investments
- Additional warnings *could* include *inter alia* a comparison between the interest rate received and inflation, along with a reminder about investment pathways and 'Money and Pensions Service' guidance
- Ongoing (annual) warnings to be provided to non-advised drawdown consumers
- Record-keeping: numbers of clients invested predominantly or wholly in cash at the point the requirements come into force; and, analysis of those, who as a result of receiving the warning have/have not acted

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## Actual charges information: Chapter 10

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### Actual charges information

- This requires disclosure of:

***"actual costs and charges (including transaction costs and the cost of advice) charged by the operator and other parties, which have been paid out of the retail client's: i) drawdown pension fund; or, ii) personal pension scheme [...] from which an uncrystallised funds pension lump sum payment was made"***

COBS 16.6.10R(1)(a)

- The above costs to be aggregated and totalled; and, expressed as pounds and pence
- Where transaction costs are *"unknown or difficult to identify"* then a reasonable estimate may be provided – presumably the 'difficulty' will be subject to an objective test?
- **'Transaction costs' are undefined and there is no prescribed methodology**, however maybe take a lead from COBS 19.8 'Disclosure of transaction costs...in connection with workplace schemes' where they are defined as *"costs incurred as a result of the buying, selling, lending or borrowing of investments"*
- The above takes into account 'arrival price' (AP) and 'execution price' (EP) where AP is broadly the market price (various definitions) and EP is the price at which the transaction is executed including all charges, commissions, taxes and and other payments associated with the transaction, directly or indirectly – investment firms should be able to supply this information??
- Non-standard assets and property??

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## Cost benefit analysis

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**s.3B(1)(b)** the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;

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Any other comments?

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Thank You



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