FCA Retirement Outcomes Review: Investment pathways and other proposed changes to rules and guidance

Response from Nest Corporation to consultation to FCA consultation CP19/5

About us

Nest is a critical pillar of the government's auto enrolment programme, with a public service obligation to accept any employer wishing to use the scheme to discharge their auto enrolment duties.

Since we were set up in 2010 we have delivered a high quality, low cost pension scheme open to all which has not only delivered on its mission, but helped to drive up standards and best practice across the industry. Now with over 7.8 million members, Nest is playing a critical role in helping people save for their retirement - many of them low to moderate earners who may be saving for the first time and moving jobs frequently.

Nest now occupies a place in the market as a major Master Trust, a sector that has grown following the introduction of auto enrolment, and that we believe has great potential for delivering pensions to mass market consumers for many years to come, leveraging scale to offer low cost, modernised services in the context of strong Trustee governance.

Response

As an occupational pension scheme regulated by the Pensions Regulator, Nest falls outside of the scope of the Retirement Outcomes Review. For that reason we are not commenting in detail on the design and regulation of the investment pathways proposed for retail providers.

We are responding in order to reiterate our strong view that providers need to consider the complexity of choices faced by consumers at and throughout retirement in the round, and ensure suitable pathways exist for those without the means, willingness or capacity to make those decisions in an informed way (e.g. through repeated, paid-for advice). We support the concept of investment pathways and would see these as one aspect of broader required support, including where appropriate the setting of sustainable drawdown rates and provision of longevity insurance on behalf of the consumer. This argument applies equally to providers in the retail (contract) or occupational (trust-based) environment.

As the FCA notes, following the freedom and choice reforms consumers face a much more complex set of decisions about how to access their pensions savings as they transition towards retirement. Many consumers are opting for drawdown products, which can be complex in their structure and in any event require repeated decision making by the consumer. And they are not always taking advice: perhaps unsurprisingly, the proportion of consumers accessing non-advised drawdown products has increased from 5 per cent before the introduction of the pension freedoms to 30 per cent today – and we would expect that figure to rise.[1]

There is significant evidence that those consumers who do not take financial advice are not equipped to make the decisions required of them in drawdown. Indeed, there is a significant body of evidence that advice, guidance and financial education is not enough to help consumers make good retirement decisions at all. Consumer choices in the pensions industry tend not to be based on rational decision-making but rather subject to behavioural biases which can lead to sub-optimal outcomes. These behavioural biases mean that advice and guidance do not necessarily improve outcomes for consumers. Academic research has shown that interventions aimed at improving financial literacy have a negligible effect on behaviour[2], and that additional information can actually increase confusion in financial decision-making[3]. As noted in the consultation, there is very low awareness amongst drawdown customers about where their money is invested, and too great a volume of assets sitting in cash. Investment pathways should help to remedy this to an extent, particularly by limiting detriment where members leave funds invested for long periods that would otherwise have sat in cash.

But we also know that there is hazard to the unadvised consumer in decisions made about how and when to withdraw their money in order to support a sustainable income in retirement. Whilst many DC customers retiring today may not be using their pot as their main source of retirement income, this is set to change as a new generation of automatically enrolled savers retire with pots of a size that is appropriate as either a sole or supplementary income, in addition to the state pension. Evidence from Australia suggests that in this scenario the risk to the consumer can be one of under- rather than over-consumption. Unable to judge what drawdown rate constitutes a sustainable income, Australian consumers have tended to keep large proportions of their savings invested, for fear of running out of money.[4]

The FCA will be familiar with NEST's retirement blueprint, in which we proposed a guided retirement pathway involving not only a governed investment approach but also the paying out by the scheme of an income at a sustainable rate; and the purchase of a later life annuity or equivalent.

As the DC market grows and consolidates at pace, we believe it is contingent on both the FCA and the TPR to consider whether the delivery of more comprehensive guided pathways of this kind should be expected as features of any good scheme. There is a weight of evidence from both the UK and abroad that this type of product will help both deliver on savers' expectations of what a 'pension' should provide, and limit detriment to them. As an industry we should not wait for a larger body of evidence of consumer detriment before acting to design products that work in the context of both the pension freedoms and the new mass DC market.

[1] In the period October 2017 to March 2018 31% drawdown sales were made to non-advised consumers. (p.5 FCA Data bulleting, September 2018)

[2] Fernandes, Lynch, Netemeyer, (2014). Available online at: http://pubsonline.informs.org/doi/abs/10.1287/mnsc.2013.1849

[3] Lacko and Pappalardo, (2004). Available online at: https://www.ftc.gov/reports/effect-mortgage-broker-compensation-disclosures-consumers-competition-controlled-experiment

[4] Wu, Asher, Meyricke and Thorp (2017) find evidence of under-consumption in retirement in Australia, even when precautionary saving and bequest motives are set aside. Available online here: https://www.cepar.edu.au/publications/working-papers/age-pensioner-profiles-longitudinal-study-income-assets-and-decumulation. A 2018 report by the Institute for Fiscal Studies finds preliminary evidence of a similar effect using UK data. Available online here: https://www.ifs.org.uk/uploads/publications/bns/BN237.pdf

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