

Retirement Income Market Study: Revised Terms of Reference

On 14 February 2014 we launched a market study into retirement income to assess whether there are obstacles to competition working more effectively for consumers in this market. This work follows on from our [thematic review of annuities](#), the results of which were published on the same day, alongside the [financial promotions review of annuity comparison websites](#). The Government's [Budget announcement](#) on 19 March 2014 detailed some significant changes to the pension and retirement income landscape.

In light of these changes we have updated the scope of our market study, which is outlined in this document.

These terms of reference set out:

- the FCA's competition objective;
- why we decided to look into the market for retirement income;
- the scope of the products and key issues we will consider in the study;
- what could happen as a result of the study; and
- timetable, contacts and information gathering process.

Our competition objective

One of our statutory objectives is to promote effective competition in the interests of consumers. In financial services, as in other areas of the economy, the benefits of effective competition are enhanced efficiency, more innovation and lower prices. These, in turn, help to provide a broader range of better products and services that meet consumers' needs. Market studies are a key tool for examining competition issues in the markets we regulate.

We recognise that a wide range of problems in markets can prevent competition being effective. These can include supply-side constraints that make it harder for providers to enter the market and/or to expand, as well as demand-side problems, including consumer behaviour, problems with information provided to consumers, and the way firms respond to consumer behavioural patterns.

Why are we conducting this study?

We chose to review the annuities market because selecting an annuity is a one-off, potentially significant and irreversible decision that can be a source of detriment for consumers. The shift to Defined Contribution (DC) pensions and auto-enrolment, and the possible introduction of collective pension schemes means that the annuities market has become an ever more

important one. In 2012, the value of premiums paid for new annuity purchases was around £14 billion, and the value of income drawdown product sales totalled around £1.2 billion¹.

The FCA's thematic review into annuities indicated that, while shopping around for an annuity would often provide consumers with a better deal, many consumers will purchase an annuity from their existing pension provider. These consumers may therefore be missing out by not shopping around and switching to a different provider.

The thematic review concluded that identifying the root causes of the issues in this market and determining whether changes are needed required further work. We will undertake a market study of the retirement income market to assess whether competition is currently working well and in the interest of consumers. In light of the Budget changes we will also look to understand how consumers, providers, and distributors are likely to behave in the new market landscape in order to assess potential competition risks and vulnerabilities (e.g. complex and opaque product innovation). Although the true impact of the Government's reforms is likely only to be known after some years, many of the features of the market we are concerned about may persist. There are also new issues that we will need to consider; these are set out below.

What this study covers

The market study into retirement income will consider products such as annuities and income drawdown. These are products purchased by individuals with their accumulated pension pot² that provide an income during retirement. We will also be considering new financial products which might be offered to those approaching retirement. We will examine competition and choice in the context of the various options open to consumers when retiring. As part of this work we will assess the value for money associated with different at-retirement products in the future landscape.

Key facts about scope

Geographical scope: products available to UK customers by providers active in the UK.

Consumers: consumers using funds from their personal pension plans and/or their Defined Contribution occupational pension schemes to purchase an income product at retirement.

Focal products: all annuity and income drawdown products.

Related products and markets: Defined Benefit pensions, State pension, savings account/cash ISA/NS&I products, stock market-based investments, investment bonds from a life company, own/family business; and equity release products.

Types of firms: insurance companies (large and small), intermediaries (such as advisers and brokers) and providers of SIPPs.

¹ *Annuities – UK*, Mintel, August 2013

² This could originate from Defined Contribution occupational schemes or from personal pensions, including stakeholder pensions.

Types of product

The focus of this study is products that provide an income during retirement that are purchased by individuals from an accumulated DC pension pot. These products – typically annuities and income drawdown products – are currently purchased either through the open market or from the provider of the existing pension scheme. The existing pension provider might offer their own products, or another provider's product through a tied arrangement.

Retirement income products purchased using a DC pension pot can vary in relation to the amount of income they provide, the period of guarantee, the amount of investment risk taken on by the consumer, the flexibility provided by the product, and the treatment of the remaining funds on death of the product holder.

There may be a number of additional sources of funding for retirement income for these consumers. For example, some people may have also paid into a Defined Benefit (DB) pension scheme from which they will receive income during their retirement, in addition to the State pension. Consumers may also have access to funds or assets that are not related to their pension, but that can be used as a source of retirement income (for example, savings, other investments, or equity release). Although these are not our primary focus in this study, we will look at how these alternatives affect the decisions about the purchase of a retirement income product from a Defined Contribution pension pot both now and in the new at-retirement landscape. Should we identify issues in relation to these related products, we will consider what further action is needed.

Issues to be explored

The market study into retirement income will look to assess the following:

1. Competitive conditions in the current market landscape

We will examine the extent to which there are features of the current market where competition may not be working effectively and in the interests of consumers that might carry through into the new retirement landscape. This will involve examining a number of issues including product distribution, the role of advice and guidance, consumer decision-making and the effectiveness of the open market option. In trying to better understand the behaviour of consumers in the at-retirement market, we will undertake further consumer research. The good and poor practice identified through our thematic review of annuities sales practices will also feed in to this part of the market study.

2. The new market landscape

New products and business models are likely to arise in response to the changes to the retirement landscape announced by the Government in the March 2014 Budget. We will look to understand how the market is likely to develop in these respects and in relation to existing products (such as, enhanced annuities) in order to identify potential competition risks and vulnerabilities to consumers in the new landscape.

We also will continue to examine whether there are barriers to facilitating entry and expansion in the market. We will also consider the impact that the Solvency II Directive³, PRA Rules and other landscape features may have on this area.

3. Value for money of retirement income products in the existing and new market landscape

We will assess the value for money associated with consumers adopting different at-retirement strategies in the future landscape. We will use current market conditions and existing products to establish a current baseline. By assessing the value for money of different at-retirement strategies we can determine the most important factors to consumers when choosing retirement income products. This will help to provide a baseline for consumers to assess the value for money of product innovations that we expect to see in the new landscape.

4. How consumers, providers and intermediaries are likely to behave in the new market landscape

Our thematic work indicated that consumers often find it difficult in the current market to identify the best way to draw income from their accumulated pension pot. As a result, consumers may not buy the 'best' product to meet their needs, or may purchase a product that offers worse value. Consumer inertia in the retirement income market often leads to a 'default' annuity purchase with the existing pension provider. With the increased freedom of choice and number of potential options, the consumer's decision becomes more complex as the number of available options increases. The FCA is already working with the Government to develop the impartial guidance guarantee and the Government is already consulting on this. In our market study we will identify whether there are issues to address in the final version of the guidance guarantee as well as whether there are wider consumer protection issues that the FCA should also address. As part of our work, we will undertake a comparative analysis of international approaches to retirement planning in countries where annuitisation is not compulsory.

Next steps

We will continue to engage with market participants, consumer bodies and other interested stakeholders over the coming months.

We will be examining existing research and information we already hold, including information we have collected to date from market participants, with a view to publishing an interim report later this year.

Possible outcomes of a market study⁴ include:

- making policy or regulatory changes, including possible recommendations to the PRA
- making new rules, changing rules or withdrawing rules

³ Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking up and pursuit of the business of Insurance and Reinsurance (Solvency II) OJ [2009] L 335/1.

⁴ Further details of these potential outcomes are in [The FCA's approach to advancing its objectives](#), FCA, June 2013. See also: www.fca.org.uk/your-fca/documents/market-studies/how-we-carry-out-market-studies, FCA, October 2013.

- using firm-specific enforcement powers
- making proposals for further industry initiatives or enhanced industry self-regulation
- publishing guidance
- asking the CMA to consider the market
- taking no further action

How to submit views and evidence

We are asking for your views or evidence on the matters covered by the study in light of its revised scope. We are particularly interested in whether competition in the retirement income market is working in the interests of consumers and is likely to do so in the new at-retirement landscape. If not, what are the main obstacles to effective competition in this market and the risks and vulnerabilities to consumers in the new landscape?

Please send your comments to RetirementIncomeMarketStudy@fca.org.uk by **18 July 2014**.

Or in writing to:

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