Dealing with change

Nigel Bennett discusses important regulatory changes affecting FCA-regulated pension products in 2021

While the last 12 months have been unusual, by any measure, at last there is now the prospect of a return to some sort of normality. Investors seem more confident and with an ageing populating, we are seeing record levels of demand for self-invested personal pensions (SIPPs) for those at or near retirement.

We also see that the regulator has confidence the market can deal with changes that were put on hold in 2020, which are now being rolled out.

Retirement Outcomes Review

Readers may recall the Retirement Outcomes Review, which was conducted by the Financial Conduct Authority (FCA) following the changes to the market brought about by the April 2015 Freedom and Choice Reforms. The regulator was concerned about choices made by some customers, particularly those who are not advised, with evidence that some would end up remaining in cash for the long term, without it being an active decision, and that customers displayed considerable inertia when it came to shopping around when drawing benefits from a pension such as to access drawdown. The regulator introduced what it called a package of remedies, with a 12-month implementation period from 1 August 2019, which was extended by a further six months to 1 February 2021.

Investment pathways

Non-advised customers entering drawdown need to be guided through an investment pathway process, designed to provide a nudge towards a solution that prevents money remaining uninvested for the long term, without needing a great deal of effort by the customer. These customers will need to decide:

- To choose an investment pathway solution.
- To choose their own investments, with or without financial advice.
- To remain invested in current investments.

For anyone wishing to access a pathway investment, they will need to choose a solution based around four options:

Option 1: I have no plans to touch my money in the next five years.
Option 2: I plan to use my money to set up a guaranteed income (annuity) within the next five years.
Option 3: I plan to start taking my money as a long-term income within the next five years.
Option 4: I plan to take out all my money within the next five years.

Personal pension schemes, including SIPPs, must offer these solutions, but to avoid an undue burden on smaller firms, an exemption is available where the number of customers entering drawdown is less than 500 per year, although this still requires updated processes and a referral to the Money and Pensions Service Drawdown Comparator Tool, with the potential result being a transfer to another pension scheme that offers pathway investments.

There are many criticisms of these rules, but we can see that it does address some of the main concerns about non-advised customers. We feel financial advisers are best-placed to deal with the choice of pension plan and the investments within it, it will be interesting to see how many customers select a pathway investment in the months ahead.

Cash warnings

Alongside these changes, providers will need to write to non-advised customers who have a significant proportion of their fund invested in cash or cash-like investments, once a year, to remind them of the risks and potential erosion of the value of their retirement savings due to the effects of inflation. The definition of significant is set at 50%, which we think will only affect a very small number of people. This particular change can be implemented by 1 August 2021.

Total costs disclosure for decumulation customers

Finally, one of the most contentious aspects is that providers have had to amend their annual drawdown statements to include actual charges and costs incurred by their pension plan, including adviser charges and all investment charges, expressed in monetary terms. There is a long list of potential fees that need to be covered by this, and while some firms will be able to provide this, there may be instances where the provider has to make best endeavours to estimate those charges of third parties.

As a SIPP provider with lots of customers investing in commercial property, there are many possible charges that need to be taken into account, including solicitor's fees and surveyor's fees. These changes apply to all customers in drawdown or those who have taken at least one uncrystallised funds pension lump sums payment from their pension. Firms will need additional resources to deal with this and may result in fee increases, unless this information gathering and reporting can be highly automated.

We expect these changes to generate queries, for us and advisers, inevitably from customers who may have been content that the SIPP wrapper cost is very competitive, who may see these 'total costs' as many multiples of the base cost of running the SIPP. This is perhaps the aim of the new requirements.

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