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Walk this way

Pension savers' views on the FCA's Investment Pathways

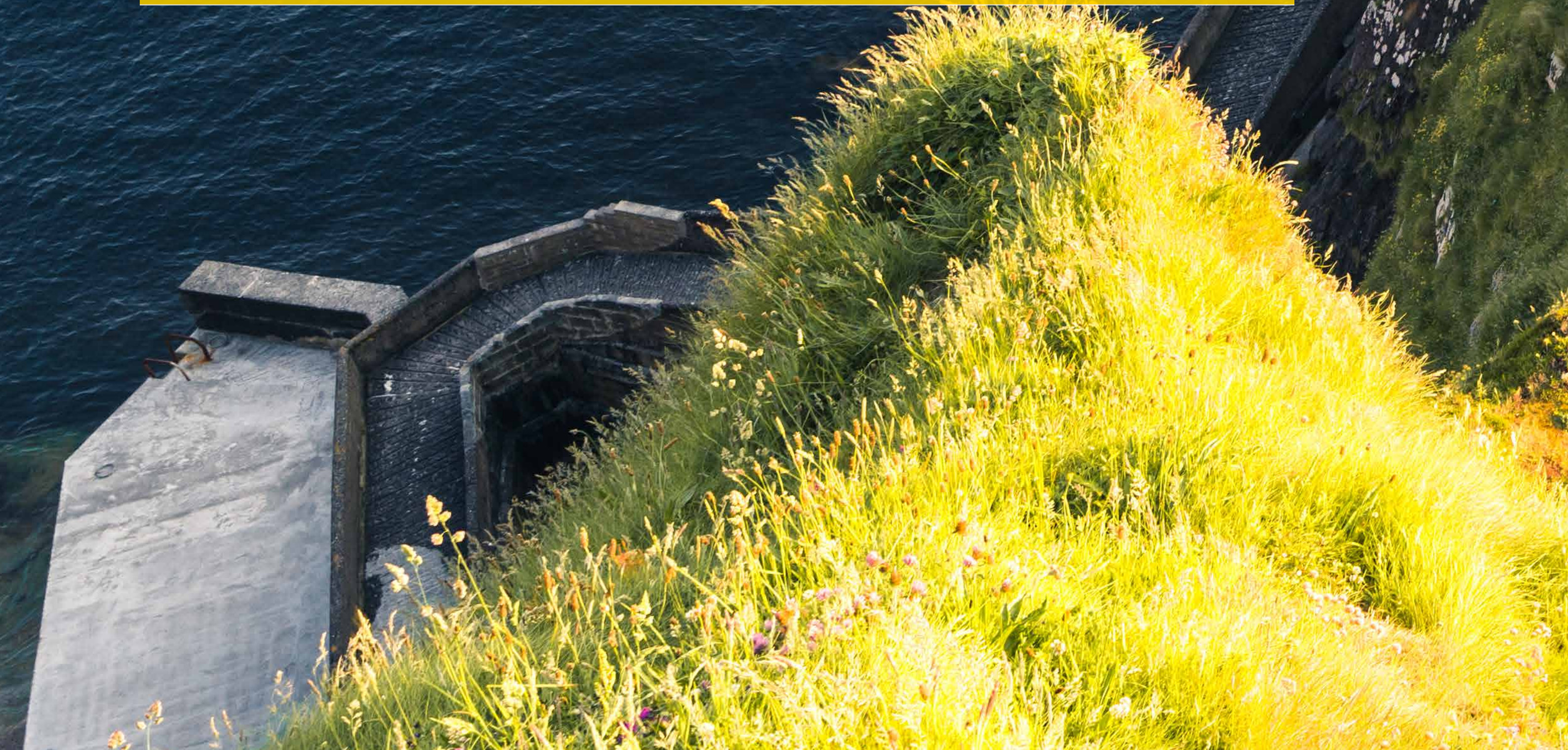
nmg CONSULTING

Legal & General INVESTMENT MANAGEMENT

As the number of retirees entering non-advised drawdown surges, we asked nearly 1,200 savers what they think of the FCA's Investment Pathways initiative.

Key findings:

- **60%** of respondents are positive about Investment Pathways, with Generation X in particular finding them useful for their retirement planning. **9 in 10** savers found an Investment Pathway option which matched their needs
- Income drawdown is the most popular Pathway, chosen by **46%** of prospective drawdown users
- However, apathy will be the biggest barrier to adoption: **33%** of prospective drawdown users will not move from their default accumulation fund unless they are prompted
- With **81%** thinking that five-year review periods are too infrequent, **60%** support providers offering annual reviews



Do you know where your pension is invested? In 2019, the Financial Conduct Authority's (FCA) Retirement Outcomes Review uncovered that for a third of all consumers entering drawdown, the answer is no.[1] Instead, many choose the 'path of least resistance' and remain in the funds they were invested in before they retired.

And Legal & General Investment Management's own research found that, in particular, non-advised savers now approaching retirement are caught in a bind. As part of neither 'Generation DB' (defined benefit) nor 'Generation DC' (defined contribution), these members are stuck in a policy and pensions gap, and now have heightened concerns about the effects of COVID-19 on their investments. This group's situation should be a wake-up call to issues that future generations of savers may face.

As the proportion of those entering non-advised drawdown is now close to 30% of the overall market and the figure for those taking advice is falling[2], we can expect an increasing number of retirees to eschew professional advice before accessing their pension pot.

Responding to the needs of non-advised savers, the FCA has developed 'Investment Pathways'. This initiative is intended to clarify the choices savers have and encourage them to take an active route through their retirement years. These include the options of staying invested and/or drawing an income, which became possible after the Pension Freedoms came into effect in 2015.

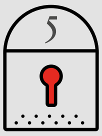
But can Investment Pathways alone solve savers' woes? LGIM and NMG Consulting investigated the reactions of nearly 1,200 non-advised existing and prospective drawdown users' to the new concept, including:

1. Who finds Investment Pathways useful: Does it meet the requirements of the scheme members most in need?
2. The detail: What do savers think of each option?
3. What can providers and the industry do to enhance and cement the concept?

In this article, we discuss our findings.

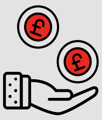
What are Investment Pathways?

Effective after 1 February 2021, Investment Pathways are four options offered by providers to savers at retirement. Each has an appropriate single-fund solution sitting behind it:



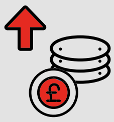
Option 1:

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

There is no minimum investment amount, and members can mix and match between different options, as well as switching in and out at different times to suit their needs after retirement.

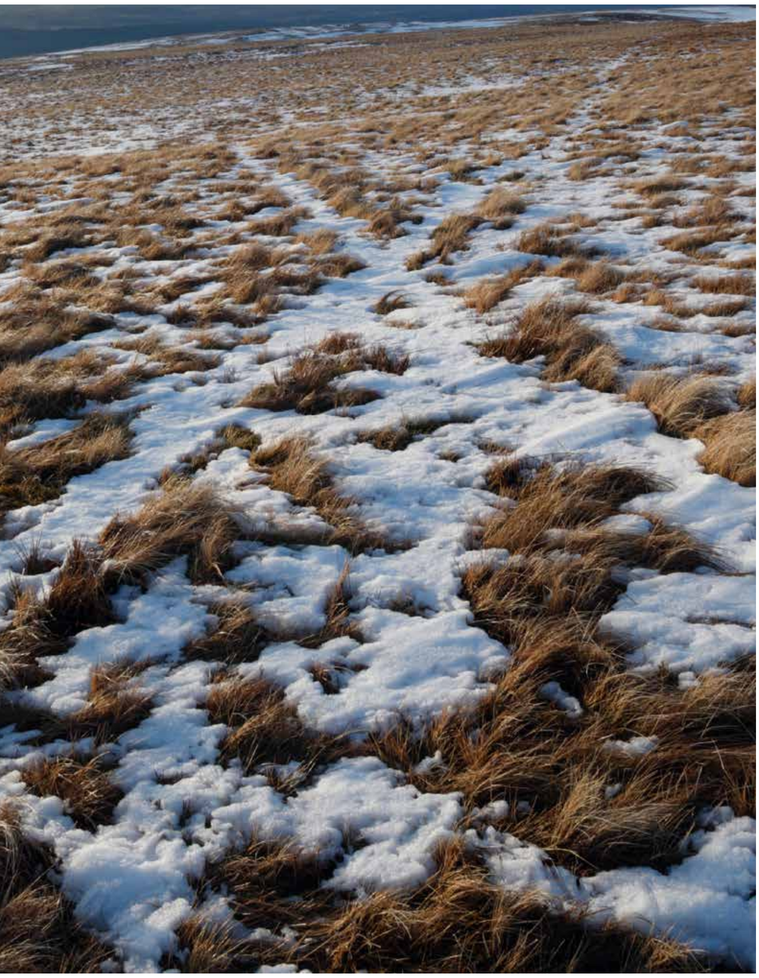
The value of an investment and any income taken from it is not guaranteed and can go down as well as up; you may not get back the amount you originally invested.

1. https://www.fca.org.uk/publications/market-studies/retirement-outcomes-review
2. Survey of 95,493 DC pension pots. https://www.fca.org.uk/data/retirement-income-market-data

Our methodology:

Legal & General Investment Management joined forces with NMG Consulting to investigate how well today's savers are equipped for non-advised drawdown five years on from Freedom and Choice. This was achieved through:

- Qualitative research of **40 one hour individual in-depth interviews** which took place in September 2020 amongst a split of non-advised consumers in drawdown and those approaching it
- Quantitative research in October 2020 amongst **1,122 non-advised consumers**:
    - **64%** pre-drawdown ('prospective drawdown users'), **36%** in drawdown ('existing drawdown users')
    - Aged **52+** for prospective drawdown savers and aged **55+** for those in drawdown
    - Pot sizes were mixed, with pots **under £10,000** excluded and a quota on **£10,000-£30,000** pot sizes



1. X marks the spot: Who found the concept the most useful?

The highlights:

- Squeezed Generation Xers feel supported by Investment Pathways: Almost 70% of retirees-to-be under age 55 found the concept useful compared to nearly 60% of those aged 65+
- Investment Pathways are relevant for both prospective drawdown users and retired savers, with 9 in 10 able to align one of the options to their needs
- After understanding the concept, 60% feel confident to make a decision on their own without using an adviser

The overall reception to Investment Pathways from both prospective retirees and those already in drawdown is warm. 60% of all respondents are positive about the broad idea. The four Investment Pathway options are relevant to the challenges retirees and the pre-retired face, with nine in 10 consumers able to align one of the options to their needs:

"It lays out all the options more clearly. Although all these options are already there they are just laying them out in a better way."

Existing drawdown customer

In particular, it is reassuring that the Investment Pathway concept appears to meet some of the requirements of the savers who are most in need of a boost. In part one of our research, we highlighted that older 'Generation Xers' (aged 50-56) have fallen through a gap in terms of pensions policy, savings and assets, issues which generations above and below them may not face. The prospective drawdown customers we surveyed, many of whom form part of this cohort, generally express lower confidence and exhibited lower knowledge levels than those already in retirement, anxieties which have been compounded by the COVID pandemic.

Prospective drawdown customers who think the Investment Pathways concept will be quite or very useful for their future pension decisions

Age:	50-54	55-64	65+
	68%	61%	58%

Source: LGIM & NMG Consulting, 2020.

So it is encouraging that nearly 70% (68%) of prospective drawdown customers aged 50-54 say they found the concept quite or very useful, a number which decreases as age rises, falling by 10% for Baby Boomers over 65. Interest in the broad Investment Pathways concept is strongest among prospective retirees with pot values of between £30,000 and £100,000, the mid-sized group which is in line with the majority of the non-advised drawdown market.

Non-advised savers give a variety of reasons as to why they find Investment Pathways useful. The most-used positive descriptors from respondents are that the language is 'simple' and 'easy to understand'. Several commented that this was the clearest explanation of retirement income choices they have seen so far, a welcome break from the challenges they associate with pensions:

"As far as pensions go, you couldn't get it put more simply. They are complex but that makes it very, very easy to understand."

Prospective drawdown customer

In our previous research, savers evinced a hesitation to make retirement income decisions, arising from a need for more information and validation of their choices. Investment Pathways help to provide this, as well as giving reinforcement for those who have some level of knowledge. Nearly 75% agreed that the concept was clear and having government and FCA backing reassures savers further.

Pathways feel simple enough for the majority of those who had not yet drawn down their pension to say they would proceed without advice. While just 12% said they feel they need formal financial advice to make a decision having seen the concept, 60% feel confident enough to make the decision alone.

However, for many savers, any more than four choices with a single fund solution attached seems too complicated:

"I think I would be quite happy making a decision. The way they have tried to simplify this makes me feel more confident. I would want just one fund and one choice."

Prospective drawdown customer

Conversely, there is a group of more engaged and confident savers, mostly amongst the already-retired segment, for whom the concept appears too basic. Those who rate themselves as being 'very' knowledgeable or confident about their retirement planning find the concept the least useful, with just 50% and 41% respectively declaring it useful. For this group, who tend to be older, male and better financially resourced, Investment Pathways are not perceived as likely to augment their retirement planning as they are already engaged investors.

In particular, the lack of fund choice Investment Pathways offer presents a problem for these savers. Investing in just one fund is sometimes viewed as a backwards step for those who have invested their pension more widely than their provider's default funds. In fact, the single fund is an issue for a sizeable minority: a third of respondents would prefer to choose from a small shortlist of funds and a fifth would prefer a wider fund choice. These savers also raise the lack of personalisation as an issue, including how to blend the Investment Pathways with other pots to maximise their drawdown strategy.

On the face of it, the simplicity of the Investment Pathway concept helps it fulfil its promise for some of our most squeezed savers by bringing them into retirement planning, even if this very same reason makes it less attractive to the more engaged.

But what did savers think about the detail of the proposition? We cover this in the next section.

2. The detail: What did savers think of the four options?

The highlights:

- Income drawdown is the most popular option for both prospective retirees (preferred by 46%), and those already drawing down (of whom 43% favour it)
- There was some preference for this option to be labelled clearly as 'income drawdown' rather than referring to 'long-term income'
- Risk looms large for savers, with 15% describing themselves as 'very' risk averse
- Apathy will be the biggest barrier to adoption: 33% of prospective drawdown users will not move from their default accumulation fund unless they are prompted

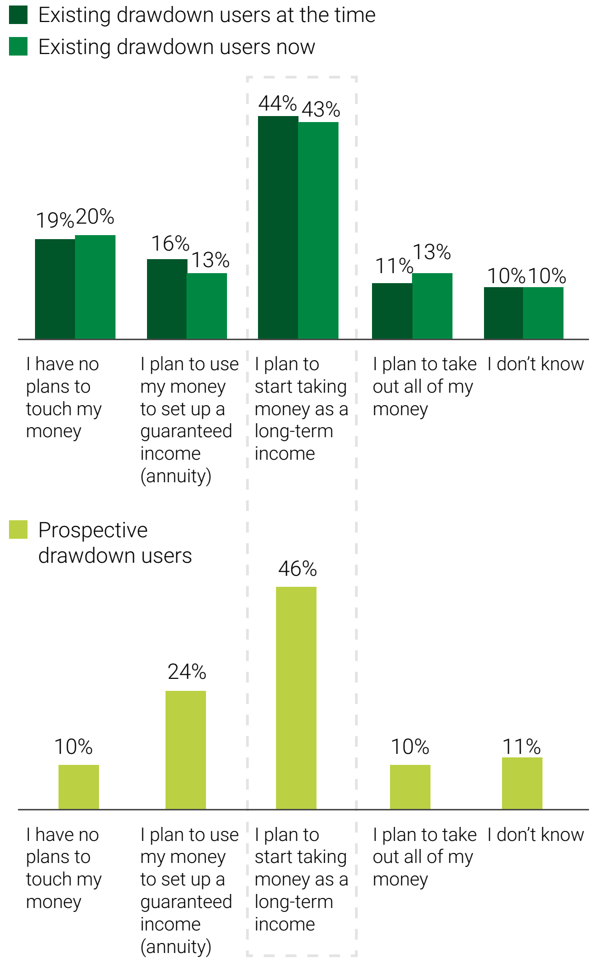
Option one (no plans to touch my money) is seen by many as the simplest option, and as the default fund for those unsure of what to do. But only 10% of the prospective drawdown group find this option appealing, a figure which doubles for the generally better-resourced retiree group.

When considering **option two** (set up a guaranteed income [annuity]), prospective retirees say they would need more information on the pros and cons of annuities before going ahead, but are markedly more likely to buy an annuity (24%) than those already in drawdown, only 13% of whom say an annuity would meet their current needs. This perhaps reflects the negative perceptions of annuities which have arisen since the Pension Freedoms, in particular for those who have already accessed their pot. These savers would have been in the run-up to retirement when annuities received particularly poor press.

Perhaps unsurprisingly in the wake of Freedom and Choice, **option three** (start taking my money as a long-term income) is the most popular option for both prospective (46%) and retired drawdown customers (43%). Respondents say that they associate this option with flexibility. There is some confusion about what is covered by this option: whether it includes both ad hoc and regular withdrawals, which led some to assume it meant regular income. In this vein, 'long-term income' is confusing to some, who queried why 'income drawdown' isn't more explicitly spelled out.

Option four (take out all my money) is seen as inappropriate for all but very small pots, with only 10% of prospective customers and 13% of current retirees finding this option appealing. Some of those who have not yet withdrawn their money remarked on the tax implications of this choice, with a few respondents who had entered withdrawal having experienced them first hand – and regretting their decision.

Income drawdown is the most popular Investment Pathway



Source: LGIM and NMG Consulting, 2020.

Thinking back to when you first drew money from your pension, which of the Pathways would have been closest to your needs at that time? And which of the Pathways is closest to your needs now? (Existing drawdown customers)

Thinking about your current situation, which of the Pathways would be closest to your current needs? (Prospective drawdown customers)

A risky business?

Governing these preferences are various different approaches. While choosing a single pathway was the most popular strategy for prospective drawdown users (38%), over a third (36%) said they would split their pot between pathways and many said they would migrate between pathways over time, prompted by the review periods.

While each solution's outcome was key for consumers, some non-advised savers are preoccupied with the perceived risk attached to each solution and 15% describe themselves as 'very' risk averse.

Respondents are lukewarm about option one (leave money invested) because, as a 'medium risk' fund solution, it is perceived to be too high for them at this stage. Similarly, option four (withdraw all money) is seen as reckless, inappropriate for the vast majority and needing to be accompanied with detailed risk information, e.g. on the possible tax implications. 65% of those choosing to purchase an annuity described themselves as 'very' risk averse and likely did so on the basis that an annuity was perceived to be lower risk than the other options.

This risk aversion is not the case for everyone. As previously mentioned, for a small group, Investment Pathways are not perceived as likely to augment their retirement planning as they were already engaged investors. In general, however, respondents are very focused on outcomes and far less comfortable discussing the investment solution sitting behind each option:

"As long as it is fairly low risk I don't really want to see what funds it is in."

Existing drawdown user

This suggests that while Investment Pathways may be helpful in putting a structure around savers' options, more guidance is required for the majority to fully understand the implications of each choice – and to move the conversation from a high-level, outcomes-based discussion towards an understanding of volatility, risk/reward and return expectations.

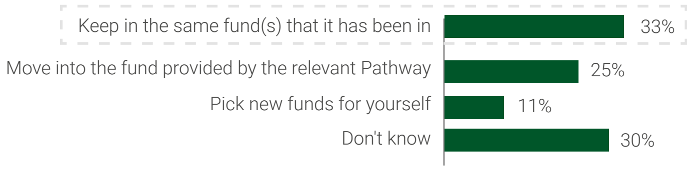
The path less travelled

It's also clear that the existence of the Investment Pathways concept alone should not mean that we treat better retirement planning as a fait accompli.

In our first report, we identified that for the majority of pension savers, default behaviours embedded during the pensions accumulation stage can lead to default behaviours during the decumulation stage. Unless investors are nudged, they are unlikely to break the habit of a (working) lifetime, and the biggest barrier to adoption of the concept will be apathy. Unfortunately, this was more pronounced amongst the generally less confident prospective drawdown group.

At the point of first access to their pension pot, one-third of those who had not yet drawn down expressed a preference for remaining invested in their accumulation fund even after the Pathway concept was explained to them, compared to just a quarter choosing Pathways.

The devil you know: Staying invested in their accumulation fund is the most popular choice for members at retirement



Source: LGIM & NMG Consulting, 2020.

At the stage where you need or want to start accessing money from your pension (either just the tax-free cash or more regular income), do you think you would prefer to: (Prospective drawdown customers)

The value of an investment and any income taken from it is not guaranteed and can go down as well as up; you may not get back the amount you originally invested.

However, popular themes and features of Investment Pathways which emerged when savers were choosing a solution give clues as to how providers can bring members on board earlier on in their savings journey. In the next section we hone in on these.

3. You'll never walk alone: Enhancing the Investment Pathway concept

The highlights:

- With 81% thinking that five-year review periods are too infrequent, 60% support providers offering annual reviews
- 45% find a discussion about making cash withdrawals more tax efficient useful when choosing their Investment Pathways
- Over half (51%) believe that it would be helpful to have all their funds consolidated in one solution

To promote and consolidate the Pathway concept with savers, we identified three broad areas that providers and the industry can focus on:

- Themes investors care about
- Frequency of engagement
- Type of engagement

Speaking my language

Themes investors identified as useful when choosing an Investment Pathway give a clue as to how to engage members long before retirement by leveraging topics providers know savers care about. For example, after cost, the second most useful topic for respondents when deciding is exploring the impact on their income of taking out their tax-free cash at different stages of their retirement, which appealed to 45%. We noticed an assumption that each option facilitates access to this perk. The ways it can be accessed need to be communicated clearly for each option, and savers may need reassurance that this is a benefit that is not going away:

"In my case let's say I take out the 25%, this is going to be a prompt to say - you have done this, what are you going to do next and why? If you are going to do something different you might need a different investment strategy. It is very valuable."

Prospective drawdown customer

A small but significant chunk – 17% – care about the fund's ethical stance, something we think is only likely to grow in future generations. Past performance and performance projections loomed large for less confident investors as well.

The long and winding road?

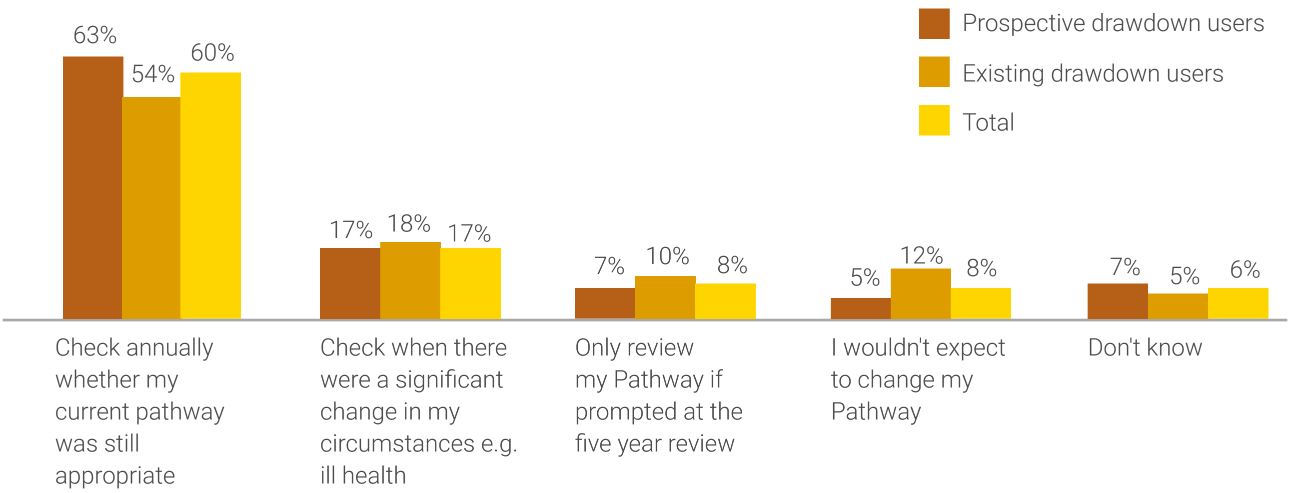
Retirement is far from a static or monolithic stage of life, and circumstances change. Reflecting this, we observed a clear demand for frequent engagement with the provider arising from the Investment Pathway structure.

"The more advice people can get the better. It is a good idea and the way you have talked about the Pathways it sounds perfectly sensible and quite straightforward."

Existing drawdown customer

Savers welcome the opportunity to review choices embedded in the current structure. However, 81% of those surveyed flagged that the five-year period leaves too long a gap between reviews. This should be qualified with the knowledge that just 44% of prospective drawdown customers say they will actually use the solution. But with 60% saying they would prefer an annual review, a figure which rises for the prospective drawdown group, there is compelling evidence that Pathway customers – at least in theory – desire relatively frequent engagement. Annual statements could be a good prompt for providers to suggest that savers review their options, and to remind them that they can change their choices within these boundaries too.

60% want an annual review of their Investment Pathway choice



Source: LGIM & NMG Consulting, 2020.
When would you expect to review and potentially change your Pathway?

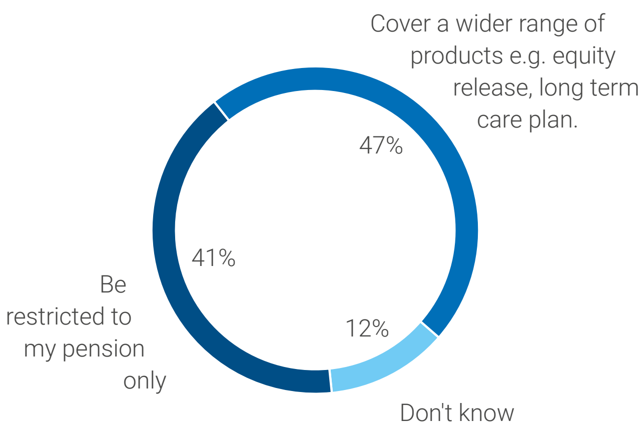
The value of an investment and any income taken from it is not guaranteed and can go down as well as up; you may not get back the amount you originally invested.

The introduction of Investment Pathways presents a real opportunity to have a discussion about all aspects of post-retirement provision and products, including investment risk.

Respondents flagged that the Pathway solution could be used to start a broader conversation about retirement planning, with 47% believing the concept could be a prompt for discussing other retirement products. Pathways are also a possible prompt for pension consolidation, with 51% believing that it would be helpful to have all their funds consolidated in one solution, reflecting a broader desire for clarity and uniformity in what can be a lengthy and disparate process. Providers may look on this as a chance to improve their members' user experience by supporting them as they join the dots of their various investments.

Nearly half of savers are keen that Investment Pathway discussions with their provider cover more than just their pension

Pathway discussions should...



Source: LGIM & NMG Consulting, 2020.

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Savers' risk aversion is an interesting (but unsurprising) divergence from the prevailing industry wisdom of recent years which we believe suggests retirees need to take more risk, not less, to generate an income after retirement. Simple online risk-modelling tools and case studies of 'people like me' can help people to understand more fully the implications of what a low-risk approach means for their individual portfolio further down the line, and perhaps get more comfortable with the presence of investment risk in order to generate an income longer term:

"I need [the description] to be more pictorial, more visual, more relatable, e.g. This is John, he is 50 he has got no kids, no commitments, these are his options."

Prospective drawdown customer

In addition, objectively positioned pros and cons of each option can help to build trust. More investment-savvy consumers require information on underlying funds, fund performance and detailed costs.

All in all, we encountered a clear appetite for more engagement, earlier, on the themes members care about. Digital tools can help bring this to life, and help to extend members' understanding beyond the four simple options to bring about a greater understanding of the risk and reward of each solution.

One small step for savers, one giant leap for pensions

Investment Pathways go a long way towards alleviating anxieties and delivering on the promise to firm up retirement options, in particular for non-advised savers who are yet to draw down. Those who previously confessed to having their head in the sand told us that this was a positive first step, a relatable and simple way to make retirement choices feel tangible, with a focus on the outcome of each decision.

The advice gap is still palpable in some non-advised savers' discomfort with risk and unwillingness to consider the investment aspects of the underlying solution. Above all, an unwillingness to engage early on leads to a reluctance after retirement.

Overcoming retirement apathy and ensuring the Investment Pathways concept is adopted fully and broadly begins long before members come to make their decumulation decisions. It starts early on in their accumulation journey and requires frequent touch points using the media savers use in their daily lives. Fortunately, we know that aspects of the retirement journey are popular with savers, such as the ability to take tax-free cash, and it's in these areas that we can pique interest earlier on. Providers should reassure members that such benefits are not only accessible but can be maximised - and give savers the tools to do so.

It's also clear that savers want their providers to stay in touch throughout their decumulation journey and give them the opportunity to review their choices frequently, so that they can shape their pathway through retirement as their needs evolve. Done well, Investment Pathways should complement other industry initiatives such as the Pensions Dashboard in providing a streamlined service to members with a single point of contact for their retirement investments: an enormous opportunity for providers who get it right.

In this way, we can turn the salutary confidence boost that Investment Pathways deliver into meaningful action which in our view delivers better retirement outcomes for savers.

Contact us

For further information about LGIM, please visit lgim.com or contact your usual LGIM representative

Important information

Past performance is not a guide to future performance. The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested.

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