Seeking the right path

Three years on from the introduction of the Financial Conduct Authority's (FCA) Investment Pathways, *Pensions Age* asks: Are Investment Pathways working as intended and how has the industry's experience with them been so far?

In our experience, the FCA Investment Pathways have partially succeeded in preventing poor decision making for non-advised members by clearly communicating the four broad options currently available at-retirement. That said, the pathways are a blunt instrument to tackle an extremely complex problem of translating a fund value into a pension income, and as they stand they are unlikely to be suitable mass market retirement products.

We recognise that this is a global challenge for DC markets and in the absence of regulatory evolution the market is limited in how far it can go to support members through more sophisticated products and more targeted guidance in this crucial period. We are pleased to see that both limitations are being actively challenged by the industry.

Furthermore, the market has not landed on a consistent approach to implementation of the pathways – joining up pre- and post-retirement, for the most part, remains an aspiration. We are however supportive of the direction of travel to provide targeted options and we would like to see a consultation to allow for nomination of a default pathway, as we have seen proposed by the regulatory authority in Australia for the superannuation market.

Isio DC investment consultant, James Hawkins

People need support when it comes to making decisions about how to access their retirement income to make the most of their DC pension savings. The FCA's recent post-implementation review of the Investment Pathways, albeit light touch, found that the initial evidence shows that they are working as intended, and they provide a platform for further work to support member decision-making throughout retirement.

However, the FCA's analysis does not address the wider questions about member behaviour and the need for a more structured approach. We know that the 'default effect' is extremely powerful, meaning people tend to 'set and forget' when it comes to their pension choices. Ultimately, it's too early to tell whether people are making the right choices between the different Investment Pathways as their needs change or whether they are taking the path of least resistance and remaining in the Investment Pathway they chose first.

Equally, the power of the 'default effect' offers the industry an opportunity to move beyond the Investment Pathways towards a more flexible retirement income product that automatically changes as members get older. We're starting to see providers develop new products, for example the 'flex first and fix later' concept, that do not require members to make complex decisions on an ongoing basis.

LCP senior consultant, George Currie

Pension freedoms have greatly changed the way people access their DC pension pots, often requiring savers to make complex decisions. Many savers opt for drawdown without taking financial advice, running the risk of negatively impacting their retirement income.

Investment Pathways have helped to reduce this risk by allowing non-advised savers, who opt for drawdown, to choose investments and solutions that better align with their retirement objectives. It's too soon to understand the impact of pathways on savers' outcomes, but they may be too generic and don't reflect the multi-decade nature of retirement or savers' wider retirement planning. However, they're a step in the right direction as they prompt savers to think about their retirement objectives and decide which option they best suit.

There's still more to do. Take-up rates vary between providers, most likely as a result of differing approaches to communications, investment strategies and costs. Also, there remain a high number of savers not making decisions where pathways are available – this could be due to a lack of understanding given the concept is still relatively new. As providers continue to develop their pathway solutions more work could be done to ensure communications are clearer – the Consumer Duty should help with this, as customers must be provided with timely information that helps them to make informed financial decisions. We are also supportive of the FCA's ongoing advice/guidance review which could provide valuable tools to supplement the development of Investment Pathways and align approaches across the trust-and contract-based DC landscape.

Eversheds Sutherland partner and member of the SPP DC Committee, Amanda Small

At Aegon, while the numbers remain small, we're seeing a steady increase in individuals using our Investment Pathways. Presenting non-advised customers with the option of pathways is a good wake up for customers whose main aim is to access their pensions commencement lump sum. It prompts them to consider the investment choices and risks when moving into drawdown, in a way they can relate to, linked to their retirement objectives. This is positive even if they then don't select one of the four pathways – for example by remaining in their pre-retirement fund. We support this journey through a guidance service.

The most common choice is Pathway 1: I have no plans to touch my money in the next five years. This is followed by Pathway 3: I plan to start taking long-term income in the next five years. These combined cover around 70 per cent of customers choosing pathways seeking growth above security. The lowest take up by far is Pathway 2 – having a plan to set up a guaranteed income within the next five years.

Introduced in 2021, Investment Pathways are a relatively new initiative. Over time, we will be able to assess if individuals go on to behave in line with the pathway they chose. While we see pathways as broadly meeting their objectives, they don't (and were never designed to) protect against withdrawing unsustainable levels of income. We hope the DWP reflects on learnings in the contract-based world as they consider extending pension freedoms to members of trust-based schemes.

Aegon pensions director, Steven Cameron

Pathways offer a straightforward, consumer-friendly solution for individuals who may not wish to take financial advice. However, member inertia and a reluctance to make financial decisions continues to be an issue and Investment Pathways doesn't appear to have changed this, with many firms experiencing low levels of pathways take-up.

In December 2023, the FCA published a discussion paper on the Advice/Guidance Boundary Review and its proposals for closing the advice gap. In that discussion paper it speaks about introducing 'targeted support', which would allow firms to use information about the customer and their circumstances to help them make an informed decision by suggesting suitable options based on 'people like you'. The discussion paper notes that targeted support would be similar to, and look to build upon, the example of Investment Pathways, and so may face similar challenges around engagement/member inertia.

Hymans Robertson head of products, Rebecca MacDonald

It is important to note the relative immaturity of the DC market. Industry data shows that many DC pots are being accessed at a relatively early age simply to take tax-free cash. In this scenario, a customer is technically entering drawdown and must be offered Investment Pathways. However, they may still be working, subject to automatic enrolment and/or still accumulating for a later retirement.

Our experience is that the four objective-based solutions do resonate with customers when offered. Take-up is highest among customers entering regular income drawdown. The key is to keep customers engaged so they reconsider their investments when making subsequent defining decisions about their retirement income. It may be some time before pot sizes grow and emerging retirees become more reliant on DC pots for lifetime income – it is then a truer pattern of behaviour will be observed.

Fidelity continues to be extremely supportive of Investment Pathways. It's important to remember that they were introduced to prevent the poorest outcomes that were being observed in parts of the market, for example, consumers being invested wholly in cash when in drawdown. When used, they can improve outcomes for non-advised consumers, particularly those in workplace schemes who are not confident in choosing, or are not wanting to choose, their own investment funds.

Investment Pathways were not intended to replace or reduce the need for independent financial advice. Resolving access to advice and guidance therefore remains a priority for the industry.

Fidelity International head of pension products, James Carter

Written by Jack Gray