Following the pathways

Duncan Ferris examines how providers have been adapting to investment pathways and what impact their introduction might have on the industry

Summary

- The introduction of pathways looks more likely to largely be used by groups who do not generally seek professional advice.
- There are indications that consumers want pathways to provide more frequent check-ins with providers.
- Investment pathways may help ensure people have a comfortable retirement, but motivating people to engage with their pensions at a younger age is key.

Investment pathways are here, having been introduced at the beginning of February with the objective of supporting defined contribution pension savers in accessing their pension when the time comes. This is achieved by giving savers the choice of picking between four retirement scenarios based on their own circumstances and aims. The concept is simple enough, but how might it influence the industry as a whole?

Advisers

If pathways promote the use of predetermined options for savers, might that be detrimental for the business of financial advisers?

Personal Investment Management & Financial Advice Association (PIMFA) senior adviser on public policy, Simon Harrington, says: "We don't think that the introduction of investment pathways will have much of an impact on the demand for advice. In our view, they are a necessary intervention in the market to support otherwise disengaged savers from making poor decisions or not making them at all.

"It is absolutely imperative that these savers are afforded a level of support which has been lacking since the introduction of pension freedoms. The primary reason why they need this protection is because they do not seek out any form of professional support and, as a result, we don't believe that the existence of pathways will act as a disincentive, or indeed an incentive, for people to seek out financial advice."

It does seem to be the case that the primary market for the pathways is the non-advised market, with research from Legal & General Investment Management (LGIM) and NMG Consulting released in February finding that the strongest interest for the pathways was seen amongst pre-drawdown savers with pot values between £30,000 and £100,000. This group was identified as the one that represented the majority of the non-advised drawdown market.

LGIM head of defined contribution, Emma Douglas, says LGIM research appeared to indicate that a majority of the non-advised market were comfortable that "they could now proceed without advice", while just 12 per cent stated that they would need "formal financial advice".

She adds: "When we actually talk to people about making these decisions, quite often what most of them want is some kind of sense check. They don't particularly want full-fat financial advice, but they do seem to want a little bit of reassurance that they are not doing something crazy or silly. It's those kind of questions that people still need answering.

"I think this shows that there are definitely going to be some people who are prepared to go it alone with investment pathways, but I do think that quite a few of them will want some form of sense check – something that we have no definition of whatsoever and is a bit more than guidance but it's not quite advice. I do think we will need to provide that."

Providers

As well as potentially impacting advisers, the changes brought by investment pathways will also bring changes for providers. They have had more time than expected to prepare for these changes, as their implementation was delayed by six months amid the Covid-19 pandemic. Despite this, some in the industry are still concerned that this time has not been beneficial.

Harrington comments: "The clarity of requirements on firms has been disappointing. Despite having no real use for them, many advice and wealth firms will at least be required to consider them. Despite the six-month delay and requests for clarity on, for example, what due consideration of the efficacy of pathways look like, none have been forthcoming."

However, Douglas was more positive about the delay, stating that it gave LGIM more time to conduct research with members to "test the concepts" of investment pathways and "start getting a feel for how people are likely to react when we offer them the pathways".

She continues: "What is good about pathways is that they set out the four options very clearly and people understand how to use them. What we did find is that the pathways talk about a five-year period and the feedback we got from the people we talked to, as part of our research, is that they felt they would want check-ins on a much more regular basis.

"Five years felt like quite a long time in some people's retirement. A lot of things can change in that period, from health and financial circumstances to a need to support relatives, as well as even things like cognitive decline and dementia."

Douglas argues that providers offering more regular check-ins would create "more confidence" among consumers. She adds: "It's not often that you find people saying that they want to spend more time with their provider but actually, in this case, they did because they wanted to be prompted to think about their circumstances."

Another issue of note for providers is that independent governance committees (IGCs) will oversee the prospective value for money offered to investors by the pathways which they are designing.

Sackers partner, Jacqui Reid, says the remit of IGCs includes looking into whether the characteristics and net performance of the pathway investments are regularly reviewed by the firm, what the charges are like and whether member communications are "fit for purpose".

She continues: "Not only have providers had to implement pathways, but they also have the IGC scrutinising what they have been doing so that the IGC can meet their requirements around pathways as well – all within the space of about a year."

More steps?

While the assessing the full results of implementing investment pathways will have to wait until a later date, with an insight into this likely to be offered by the Financial Conduct Authority's (FCA's) review of implementation in 2022.

Reid seems to indicate that this will shed light on the future of pathways, pointing out that the FCA is likely to "see how the market reacts" to their introduction before making changes.

It is still clear that pathways are just one measure in the battle to ensure that savers make sensible retirement choices, so perhaps further action might work effectively alongside them.

Douglas comments: "There is a really widespread lack of proper retirement planning. Seventeen per cent of retirees just access their pots without doing any planning at all and 41 per cent of those nearing retirement have not made any concrete plans. I think people are not really engaging with their pensions, although that is certainly not a revelation.

"However, one of the things that auto-enrolment has been brilliant at is increasing saving. But because it is automatic and relies on inaction, it has made it harder for people to actually engage with this as their own pot of money and their own retirement future."

Reid agrees, stating that members who have been in a default environment "might not have had to make any investment decisions before", adding that it must be "quite daunting" for people in this situation to suddenly make choices about what could be the largest amount of money they have ever had access to.

As an antidote to this, Douglas suggests "warming people up" to ways in which they can spend their money and enjoy their retirement during the accumulation phase, stating that "otherwise people will end up at retirement without having thought about it at all".

She concludes: "Warming people up earlier, helping them to think holistically at what they can get and using 'rules of thumb' such as the *[PLSA's]* Retirement Living Standards will give them a picture of their retirement. Starting that before people hit the moment of making the decision is important, because that is the point at which it can become completely overwhelming."

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In association with Legal & General Investment Management