Association of British Insurers

ABI | Long term Savings

Future proofing the freedoms
Supporting customer decisions about pension withdrawals

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About the ABI

The Association of British Insurers is the voice of the UK's world-leading insurance and long-term savings industry. A productive, inclusive and thriving sector, our industry employs 310,000 individuals in high-skilled lifelong careers, two-thirds of which are outside of London.

The UK insurance industry manages investments of over £1.6 trillion, contributes over £16 billion in taxes, paid to and collected for the Government and powers growth across the UK by enabling trade, risk-taking, investment and innovation. We are also a global success story, the largest in Europe and the fourth largest in the world.

Founded in 1985, the ABI represents 250 member companies providing peace of mind to households and businesses across the UK, including most household names and specialist providers.

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Executive Summary

- Current retirees are making good use of pension freedoms and concerns about unsustainable withdrawals are mitigated by most having other sources of income. But future retirees will be much less likely to have other income to rely on, and people need far more support than most are currently getting.
- Investment pathways help avoid a mismatch of investments and withdrawals, and early evidence shows they are being used as intended. But customers still need to make multi-faceted decisions about withdrawals.
- Support from providers, regulated financial advice and a new norm of using impartial guidance all have an important role to play in helping customers with those choices.
- Providers have enhanced the support they offer with more tailored communication, layered information and greater use of digital. The industry would like to go further still to support customers and prevent detriment, by adding its own choice architecture or guardrails to support customers. A change in the rules would enable them to do more.

Pension withdrawals are the key remaining challenge in helping people to navigate pension freedoms. Being able to withdraw pension income flexibly - when and how much the customer chooses - is the key benefit of pension freedoms. But deciding when and how much income to draw from a pension can be complex, and people need far more support than most are currently getting.

Concerns have been raised about the large number of people withdrawing their pension in full, or at rates that would see them run out of money in their fund in very few years. These concerns are valid but mitigated by other factors. The current cohort of retirees frequently have other income to rely on, particularly guaranteed Defined Benefit (DB) pension income. Many pots are being deliberately used as a bridge to retirement. And most pots that are fully withdrawn are worth less than £30,000, and therefore unlikely to finance a retirement alone.

Future cohorts will be less likely to have the comfort of DB incomes, but will have larger Defined Contribution (DC) pots to use to provide their retirement income. This means the stakes are higher: they will face the many challenges that come with the flexibility of the new choices: investment decisions, tax, benefits, longevity, inflation risk, uncertainty about care needs and supporting dependants. Future cohorts will need more support, which needs to be available widely and easy to access.

Investment pathways have helped address the risk of investments and withdrawal patterns being mismatched, such as holding cash for the long term or equities for the short term. Early results indicate that they are being used as intended, with less engaged customers more likely to follow pathways, and a spread of options being chosen.

Providers are taking a range of approaches to supporting customers with withdrawal decisions. Some require customers to take advice to access their products. All have improved customer communications, especially using digital channels, while ensuring they remain accessible for all customers. Combined with customer service changes as a result of Covid-19, many providers have taken the opportunity to improve their journeys and offer additional support, with more tailored communications and layered information.

Some providers go further. A number of firms have put interventions in place – which this report calls guardrails – to help their customers reach good outcomes and avoid bad ones. But rule changes and practice changes are needed to put in place more support. Part of this is prompting people to use Pension Wise guidance at an earlier age, while they are still considering their options, and we are very supportive of trialling this. But providers, schemes and employers should also be able to do more through changing the FCA's advice rules.

Pure defaults will not work in this context because they will be wrong for too many people given the rich diversity of retiring customers' circumstances and preferences. Instead, providers should be able to help customers in specific situations to prevent harm and enable better outcomes. The freedoms have given customers far more responsibility for their financial outcomes in retirement. There is also a great responsibility upon providers to support their customers to use them well, and upon policy-makers to enable providers to do this.

Introduction

2020 marked the five-year anniversary of the introduction of the pension freedoms, a policy which led to substantial changes in the way people approach and fund their retirement. Since its introduction, we have seen several interventions and initiatives across the sector to help customers navigate the new landscape. Despite these efforts, we believe more needs to be done to support customers making complex decisions, in order to prevent poor outcomes and help them to make the most of the flexibility available.

Last year the ABI published a wide-ranging report, "Five years on: Future-proofing the freedoms", providing an overview of the policy's impact, and setting out steps that need to be taken in order to prevent future harm to consumers. We were not alone in recognising this five-year milestone. Also marking the occasion, the Work and Pensions Select Committee launched an inquiry and DWP published NatCen's findings from large-scale qualitative research[1].

Since last year's report, good progress has been made across a number of areas in line with our recommendations. For example, the FCA is consulting on the 'stronger nudge', to support the Government's wider aim of a new 'norm' of Pension Wise usage. The Treasury has begun consultation on the expected increase of the Normal Minimum Pension Age, and the Pensions Regulator issued guidance recommending that employers and schemes write to scheme members about their DB pension ahead of transferring out.

Nonetheless, it is vital that government, regulators, industry and other stakeholders continue to collaborate in the best interests of current and future retirees. While it will be many years before we can determine if the pension freedoms were a successful policy intervention, most would agree that more needs to be done now to prevent future harms – especially those arising from greater reliance on DC pensions.

This report, delivered in partnership with Frontier Economics, focuses on a key issue identified in last year's report: to explore how approaches to sustainable withdrawal rates could be delivered, taking into account the risks customers face when making withdrawals without receiving advice. This report describes how providers currently help their customers navigate decisions about pension withdrawals. It also explores what more providers could do in the future with the right regulatory changes. The report comprises:

1. An introduction to the pension freedoms landscape. This covers the key steps in the customer journey and the options that are available to customers. It also reviews current trends in the retirement market and looks at the role of advice and guidance.

2. An overview of the challenges that non-advised drawdown customers can face. These include: achieving sustainable withdrawal rates, understanding investment strategies, preventing "leakages" from unexpected tax liabilities and minimising risks associated with full or partial pot withdrawals.

3. The role that providers currently play in helping their customers navigate these issues, and the regulatory challenges they face when providing support. The section includes case studies explaining how providers currently approach guidance conversations with customers and gives an overview of how the introduction of investment pathways is interacting with these conversations.

4. Further steps that providers would like to take to support customers in non-advised drawdown to prevent risks. It also makes the case for providers being able to offer guardrails and withdrawal pathways.

RESEARCH METHODOLOGY

To provide evidence to inform recommendations and to understand more about the support that providers give, the following research methods were employed:

- In-depth interviews with providers, conducted by Frontier Economics
- A review of FCA market data and literature published since the ABI's 2020 publication on the pension freedoms
- Data from providers for more detailed insights
- A survey of ABI long-term savings members on their approaches to non-advised withdrawals
- Analysis of new ABI data on investment pathways

[1] NatCen for DWP (2020), Pension Freedoms – a qualitative research study of individuals' decumulation journeys https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/929728/pension-freedoms-research-study.pdf

Chapter 1
Choice in retirement

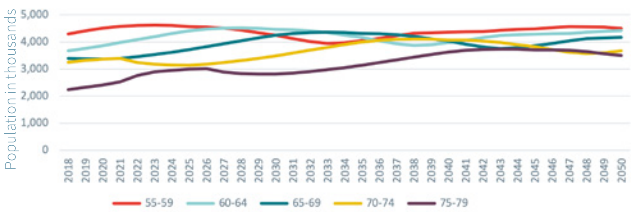
The pension freedoms gave people far greater flexibility in how they can access their pensions. Customers have more choice, but this also means that they have more responsibility for complex decisions throughout their retirement. The steps and decisions taken by those making use of the pension freedoms will be substantially different to the cohorts before 2015, and include important decisions about both how and when to access savings. This chapter provides an overview of the evolving customer journey and the current support available to help people to navigate it.

The evolving customer journeys

Retirement is not nearly as distinct as it used to be, with more people choosing to continue to work, often at reduced hours, beyond retirement age . It is at this point that pension freedoms provide arguably the greatest benefit, enabling customers to adapt to less income gradually, or to vary their income. The FCA's Financial Lives Survey in 2020 found that "the decision to access a pension is not strongly linked to retirement", given that 36% of non-retirees aged 55+ had started to take income or cash lump sums from a pension; and 28% of retirees (of all ages) had not accessed a pension[3].

The pension freedoms are available to a growing population, with historically high numbers of people reaching 55 every year, increasingly with DC pensions. The second baby boom peaked in 1964, a cohort which has just reached minimum pension age; and this wave is shifting over time so that there are many more 55-79 year olds, as illustrated in Figure 1 below.

FIGURE 1: SHIFTING WAVE OF SECOND BABY BOOMERS NOW AT PENSION AGE (POPULATION PROJECTIONS TO 2050 BY AGE BANDS, 55 - 79)



The risks around drawing DC pensions will grow over time. Many current retirees predominantly rely on the guaranteed income of a DB pension, meaning that they may be able to draw on the savings in their DC pots flexibly with less risk and greater capacity for loss.

The shift from DB to DC pensions marks a substantial transfer of risk from employers to individuals, but it is very gradual. In 2019, there were over 1m (1,058,864) active members of DB schemes, and 5.1m deferred , meaning many people still have access to DB pensions. For these people, a DC pot would not be their sole source of income – in some cases it may often only be used for large purchases or as a rainy day fund. However, DC is becoming increasingly important, meaning that trends in how people access their pension pots are likely to change substantially in the coming decades.

> "As the relative average DC pot gets larger and the reliance on DC pots increases, customer withdrawal patterns will have to change."
>
> **ABI MEMBER**

> "Today's processes are fit for today's retiring customers. Today's customers are protected by defined benefit pension wealth and property wealth. The next generation will not be. We need to protect this next generation. But that must not mean us "doing it all for them". Those days are gone. We need to nurture a culture of individual responsibility. The power must be in the hands of the individual, and we must be right behind them."
>
> **ABI MEMBER**

2 https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/ageing/articles/livinglongerhowourpopulationischangingandwhy itmatters/2018-08-13#how-many-older-people-work-and-has-this-changed
3 https://www.fca.org.uk/publication/research/financial-lives-survey-2020.pdf
2 From ONS (2019) based on 2018 figures https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationprojections/datasets/tablea21principalprojectionukpopulationinagegroups
2 https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/db-pensions-landscape-2019.ashx

Analysis by the Pensions Policy Institute has found that individuals with moderate to high levels of DC savings and no or low DB entitlement are most at risk of making decisions that can have a significant negative impact on their retirement outcomes. The PPI has also found that already half (49%) of individuals with DC, between 50 and State Pension age, have no DB entitlement.*

This report focuses on how people access their DC pension pots now, and how they can be supported at the many ‘decision points’ in the journey. Accessing a pension can be a long journey and would ideally involve many steps and planning. It is also increasingly likely that people will need to continuously monitor and modify their decisions over time. In practice, people very often give it little thought and access part or all of it as a lump sum at an early stage. NatCen’s research for DWP found that “there was little evidence of people giving detailed consideration of the length of their retirement or their needs beyond the independent phase of later life.”

New customer choices

Customers can begin decumulation at age 55 . From this point onwards, the following ways to access a DC pension will generally be available to customers. These options are described in many different ways, but an ABI guide from 2016 , described the options as follows:

1. You can keep your pension pot where it is
2. You can take your whole pension pot in one go
3. You can get a guaranteed income for life
4. You can take your pension pot as a number of lump sums
5. You can get a flexible retirement income
6. You can choose more than one option and you can mix them

Below we summarise trends in each of these access options and highlight the issues concerning ongoing withdrawal decisions.

1. You can keep your pension pot where it is

Most people are still choosing to leave their pension untouched. In the most recent ABI data available, from 2019-20, there were 6.5m untouched DC plans held by over-55s. In that context, and with hundreds of thousands of people turning 55 each year, the current propensity to access pensions is not particularly high. Among ABI data subscribers there were 458,463 pensions accessed for the first time during that period, compared to peak annuity sales of 465,524 in 2009[9].

Not touching a pension pot could either be an active or passive decision. It is important that the industry and policy-makers seek to understand the intentions and the changing age profile of the customers with these untouched pensions, because their outcomes will be determined by how those pensions are eventually accessed.

2. You can take your whole pension pot in one go

The current most frequent way to access pension savings is through full withdrawals, and almost all small pots (below £10,000) are accessed in this way[10]. Indeed, 2/3 of pots that are withdrawn in full are worth less than £10,000, and over 90% are worth less than £30,000. This suggests that comparatively smaller withdrawals are taking place to fund larger, perhaps one-off, expenditure with confidence that other long-term savings are in place. A desire to top up income (for example to meet needs after a financial shock or to fund lifestyle choices), was one of the four categories identified by NatCen as a rationale for decumulation[11] .

ABI members see full withdrawals at an early age as a key concern. This is due to the potential negative tax impact and the possibility of further detrimental decisions, such as leaving it in cash for the long-term, or falling prey to a scam. There remains little data on the wider financial circumstances of those who access their pension in full, and what they go on to do with the money.

3. You can get a guaranteed income for life

Despite sales of annuities (a guaranteed income for life) declining since pension freedoms were introduced, there have been over 400,000 annuities sold since April 2015.[12] A guaranteed income for life can provide many benefits to customers, but rates fell with the introduction of more stringent capital requirements for insurers, and extremely low long-term interest rates. Customers’ perception of how long they will live[13] may also impact uptake. Customers who do not choose this option when they first access their pension may still do so in later life, moving from drawdown to a guaranteed income. It is expected that this route will become more popular in the future and we later touch on prompts by providers to consider a guaranteed income.

* https://www.pensionspolicyinstitute.org.uk/media/3828/20210609-ppi-adequate-retirement-income-report.pdf.
[9] Notes on the data: (1) There appears to be no data on how many small pots were cashed in under the pre-2015 rules; (2) There appears to be no data on current withdrawals from occupational schemes; (3) The FCA’s data over the same period is 673,831 pensions accessed for the first time, consistent with our rule of thumb of covering 2/3 of contract-based DC data. [10] ABI Statistics, 2021. [11] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/929728/pension-freedoms-research-study.pdf
[12] FCA Retirement Income market data; available at: https://www.fca.org.uk/data/retirement-income-market-data. [13] IFS, Individual Mortality Expectations, https://www.ifs.org.uk/publications/9834

4. You can take your pension pot as a number of lump sums

The main new option introduced by the 2014/15 legislation was the uncrystallised funds pension lump sum (UFPLS), either in full or in part – though the same outcome can be achieved using drawdown. Relatively few people have taken the option of a series of taxable lump sums, only 13,854 among ABI data providers in 2019/20[14] although some drawdown customers would also access their pensions in this way. It allows gradual withdrawals to avoid paying too much tax, can maximise tax-free cash, and leave an uncrystallised pot for continued saving. This option is more evenly distributed across different pot sizes, showing it can be appropriate for anyone, depending on their wider circumstances.

Those that choose this option are likely to face ongoing decisions based on how and when they intend to access the rest of their pot, unless and until they choose to select another option.

5. You can get a flexible retirement income

Most DC retirement savings by value are accessed by taking flexible retirement income, or drawdown,[15] meaning the customer has their pension pot invested while retaining full freedom to access their savings flexibly. Drawdown provides flexibility for customers with a variety of different investment objectives and may be structured in different ways in order to achieve this. This includes drawdown with guarantees, such as fixed-rate annuities or guaranteed income embedded into drawdown.[16]

As demonstrated by Figure 1, taking a flexible income is the most common approach for pots above £30,000 but very few customers choose this option with pots less than £10,000.

All customers in drawdown will face further decisions about investments and withdrawals, and whether and when to guarantee an income.

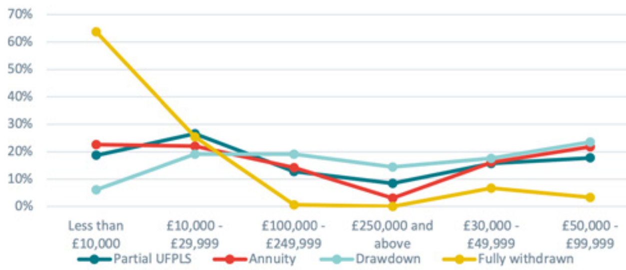
6. You can choose more than one option and you can mix them

Most of the above options can be mixed and matched. Most providers and some occupational schemes will allow benefits to be taken in part, with some taken as a taxable lump sum and some used to buy a guaranteed income.

More than one option can be chosen over time. A taxable lump sum can be followed by a flexible income, and a flexible income by a guaranteed income. This sets up more flexibility for the future, but results in customers facing a number of decision points over time, as we set out later.

FIGURE 2A: POTS OF DIFFERENT SIZES ARE ACCESSED IN DIFFERENT WAYS... (CHOICES OF THOSE WHO ACCESSED THEIR PENSION FOR THE FIRST TIME, OCT 2019 TO MAR 2020)

FIGURE 2B: ... AND EACH OPTION IS DISTRIBUTED DIFFERENTLY BY POT SIZE



Source: FCA Retirement Income Market Data

The other option: tax-free cash and no income

A major trend since pension freedoms, which was not widely foreseen at first, has been to access tax-free cash, without beginning to take an income. The fact that drawdown is the only way to do this, and it does not trigger the Money Purchase Annual Allowance, can partly explain its popularity. In its Retirement Outcomes Review (ROR), the FCA found that 56-76% of people (depending on pot size) moved into drawdown in order to access tax-free cash[17]. Research from 2020[18] found that 45% of people chose to take no income when taking their tax-free cash; 40% waited over six months and 24% waited more than a year. Our latest data from 2019/20 showed that over 300,000 plans have had a tax-free lump sum but never any income taken.

This initial decision is likely to be transitionary until they require more income and access the rest of their pot. Even though accessing their tax-free cash forces customers to make a decision about how to invest the rest of their pot, many customers did not engage with this decision and in fact did not know how their money ended up being invested. This was a major concern of the FCA's Retirement Outcomes Review; investment pathways are intended to mitigate this risk.

[14] ABI Statistics, 2021. The FCA equivalent is 31,664. [15] In terms of value. In terms of the number of pension pots being accessed, full withdrawal is more common, but it generally involves very small pots. [16] Some drawdown products incorporate multiple 'pots' that are invested differently and serve different purposes. Other products may use part of a customer's savings to purchase an annuity. [17] FCA Retirement Outcomes Review, Final Report, par. 3.15
[18] https://www.thisismoney.co.uk/money/pensions/article-7911895/Nearly-half-55s-tapping-pensions-25-tax-free-cash.html

Ongoing decisions require support

Many of the options outlined above require ongoing decisions. Although drawdown and UFPLS are simply features of a pension that allow customers to withdraw money, they can be seen as complex due to the large number of factors involved in determining a sustainable rate of withdrawal. Customers need to make a decision about the rate at which they want to access their savings, keeping in mind their retirement goals, their investments and how long they want their savings to last, and they might need to adjust this as time passes.

> "our main concern is the scale of growth we will see in this in the future as more customers enter non advised drawdown and customers who have accessed one off withdrawals to date come to rely on their pots for a retirement income"
>
> **ABI MEMBER**

In order to make such decisions, at the outset and on an ongoing basis, customers require support. Chapters 2 and 3 take a closer look at the part that providers and others can play.

The role of guidance and advice

Advice and guidance must play a pivotal role in supporting customers to choose retirement options, particularly given that some decisions are irreversible and/or can have unintended consequences. The decisions can also be complex, often requiring customers to be able to understand financial concepts, how the tax system affects them and the uncertainty of their own longevity.

Advice

To help with these decisions, customers may seek financial advice, although many choose not to do so and rely solely on guidance. As people have different levels of wealth, different levels of financial knowledge, and financial circumstances with different levels of complexity, the level of support they need will vary.

Advisers can help with financial planning, in the context of a person's wider life and financial goals, as well as helping with their ongoing investment and withdrawal decisions and 'leakage' through avoidable tax charges or from a suboptimal sequencing of their withdrawals. It means the customer has a personal recommendation that must be suitable for their circumstances.

However, advice is not cheap and customers must weigh the benefits of advice against its cost. In response to the FCA's recent evaluation of its reviews of the advice market, adviser firms said the initial customer onboarding "remains a lengthy, manual process with fixed costs of around £1,000" to advisers[19]. The cost can be seen as a deterrent to many, with ABI polling recently finding that 72% of customers would not pay for financial advice. In addition, ABI polling found that almost four times as many people wanted one off financial advice (46%) instead of the traditional model of ongoing fees (12%).

While this report considers how providers can support DC customers with more support, more widely the ABI continues to call for changes to the financial advice and guidance landscape, to ensure that advice can be available for the majority rather than the minority. We are encouraged by the FCA's approach to engaging the industry to seek examples of where streamlined advice or personalised guidance would work well. New forms of advice are also emerging, with ABI members and others investing in automated advice, especially focused on retirement decisions and often through the workplace.

While there are some remaining concerns around the advice market[20] and how it is regulated[21], those customers taking advice should be at a lower risk of poor outcomes as a result of decumulation decisions. We do not consider potential risks for advised customers further in this report.

Impartial guidance from Pension Wise

Customers who do not take advice will often seek guidance to understand their options. The Money and Pensions Service (MaPS) provides a free independent guidance service, Pension Wise, introduced alongside the pension freedoms. The ABI and its members were involved in discussions about the establishment of the service and since then have proactively signposted customers to it and explored ways of increasing uptake. MaPS recently launched MoneyHelper as its consumer-facing brand, retaining the Pension Wise name as a service from MoneyHelper.

Take-up of Pension Wise has increased to 159,000 appointments in 2019/20 (plus 45,000 self-serve journeys), from 130,000 in 2018/19 but it is still widely regarded as low: 14% of the 670,000 pots accessed in 2019/20 self-reported having used Pension Wise, and this level of usage has been broadly consistent since the service was established. This is despite consistently exceptional user feedback, with 94% very or fairly satisfied with their overall experience across all channels[22]. This has led to policy interventions to increase take-up, extending eligibility from age 55 to 50, and legislating for a 'stronger nudge' based on trials involving our members[23].

We support the implementation of the 'stronger nudge', as well as exploring further ways to prompt early engagement with the service – these are now subject to consultation by the FCA. Providers have reported that nudging to guidance is more effective when customers are considering their options, rather than when they have already made a decision. Making the process as easy as possible for customers, including automatically booking appointments for them, should also be explored.

[19] FCA (2020) Evaluation of the FAMR and RDR, https://www.fca.org.uk/publication/corporate/evaluation-of-the-impact-of-the-rdr-and-famr.pdf [20] See for example the FCA's evaluation of the RDR and FAMR reviews: https://www.fca.org.uk/publications/calls-input/evaluation-rdr-famr [21] PIMFA (2021), FCA supervision – fit for purpose? https://www.pimfa.co.uk/press-release/pimfa-on-the-future-of-uk-supervision-is-the-fca-fit-for-purpose/ [22] https://moneyandpensionsservice.org.uk/wp-content/uploads/2020/10/Pension-Wise-Service-Evaluation-report-2019-2020.pdf [23] https://moneyandpensionsservice.org.uk/wp-content/uploads/2020/07/maps-stronger-nudge-evaluation-report-july-2020.pdf

Pension Wise is primarily aimed at decisions about first access to a pension, rather than ongoing guidance about withdrawal decisions, although there is no limit on the number of appointments a person can have. It does not focus on subsequent decisions, like how much to withdraw - research by Ignition House found that "None of those who had made an online or physical appointment with Pension Wise could recall any discussion at all about how to generate a sustainable income from their pot."[24] The ABI and others have called for MaPS to introduce a similar service, focused on preparing for later life, which would include guidance on topics such as planning for social care costs and powers of attorney, as well as achieving a sustainable income.

Pension access decisions are a key example of the scenarios in which customers require additional support. We support the Work & Pensions Select Committee's call for the Money and Pensions Service to be able to go further than they currently do in terms of personalising guidance, and believe that providers should be able to do the same, especially for decisions around withdrawals which do not entail a product sale. Ignition House research found that its respondents "were looking for a personal recommendation based on their own situation which is not something Pension Wise was set up to deliver"[25]. This is not to undermine the significant positive value of Pension Wise appointments. Ignition House also identified a tendency for people to wrongly dismiss Pension Wise's ability to help with questions about pensions access which the service (and the wider MoneyHelper service) was specifically set up to answer.

The role of providers

According to the FCA's Retirement income market data from October 2019 to March 2020, 36% of all pots were accessed after taking advice and an additional 12% were accessed after receiving guidance from Pension Wise. [28] This suggests that 52% of pots were accessed with neither advice nor guidance. When considering pension pots over £30k, the share of advised access rises to 58%[27], with a further 10% receiving guidance. Among those pots that went into drawdown, 63% were advised transactions on average, with this ratio rising to 70-80% for the largest pots. But in the case of full withdrawals, only 22% of transactions were advised on average, rising to 30-40% for the largest pots.

TABLE 1. SHARE OF POTS ACCESSED FOR THE FIRST TIME OCTOBER 2019 TO MARCH 2020 THAT USED ADVICE OR PENSION WISE GUIDANCE

	Advice	Pension Wise	Provider only
All pots accessed	36%	12%	52%
>£30k pots accessed	58%	10%	32%
Pots entering drawdown	63%	10%	27%
Pots fully withdrawn	22%	14%	65%

Source: FCA Retirement income data, Frontier Economics calculations

Note: We have excluded those pension pots from this analysis that were used to purchase a guaranteed income for life.

Overall, this means that many customers will rely on support from their provider. Since providers are often a customer's first port of call, and will always be a point of contact about their pension, it is important that they can help the customer with these critical decisions, on an ongoing basis.

> "Firms have a huge role to play here and should be able to personalise information and support customers in a way that guidance bodies cannot. Making transactions effective, keeping customers on track and up to date, triggering communications and support based on behaviour. Innovation and ongoing support from providers is key."
>
> **ABI MEMBER**

The FCA also found in its Financial Lives Survey that drawdown and UFPLS providers were the most trusted providers of any product, across banking, insurance and savings, with 87% of respondents giving a trust score of 7 or more out of 10 (even though DC pension providers scored lower).

Chapter 3 gives more information on how different providers approach guidance conversations. The following chapter looks in more depth at the risks facing non-advised customers in drawdown, and the potential for poor decumulation outcomes.

[24] Ignition House (2021) [25] Ignition House (2021) for the People's Pension and State Street, 'New Choices, Big Decisions: 5 years on' https://thepeoplespension.co.uk/wp-content/uploads/New-choices-big-decisions-5-years-on.pdf [26] Available at: https://www.fca.org.uk/data/retirement-income-market-data [27] We have excluded those pension pots from this analysis that were used to purchase annuities.

Chapter 2
Challenges of non-advised withdrawal

As noted in the previous chapter, a large number of people are making decisions about a flexible retirement income without advice or guidance, resulting in the pension provider being one of the main sources of information for customers.

While the complexity of decumulation decisions can clearly pose a risk to customers, actual poor outcomes are more difficult to identify. This is because it is unclear to any outside party which outcomes are objectively bad, if they result from customers doing what they decide is best for them. Outcomes may stem from a lack of financial knowledge, the misinterpretation of certain rules, or behavioural biases, but still satisfy customers' financial needs and desires.

It is also important to consider that a person's pension savings could be spread across multiple different pots and schemes, making it difficult for the industry and regulators to fully understand and analyse decisions taken.

> "Unlike scams which crystallise immediately, or a high withdrawal triggering an excessive income tax charge, unsustainable withdrawals and under-withdrawals will have emerging impacts over potentially decades. We need better data to understand these risks."
>
> **ABI MEMBER**

This following section considers the challenges facing non-advised customers making withdrawals and their potential impact.

Challenges for non-advised customers

Non-advised customers are faced with a number of decisions when taking a flexible income and will likely need support to choose:

- appropriate investments
- if taking a lump sum, what combination of tax and taxable income to take
- whether and when to take an income
- how much to withdraw, and what a sustainable rate looks like, if that is their intention

In doing so, they will need to be aware of the impact of inflation, how their needs might evolve, product charges, and how to avoid "leakages" such as tax charges or how investments and withdrawals interact.

Depending on their circumstances, people may need to consider: how receipt of mean-tested benefits can interact with pension withdrawals; how their decisions may impact their financial dependents, now and after they die; and how financial shocks, such as Covid-19 could affect their plans. Each of these challenges is considered below.

Choosing the right investment

Withdrawal decisions need to be underpinned by an appropriate investment strategy, but entering retirement might involve the first investment decision a pension saver has ever had to make. Investments must be matched to withdrawals, balancing returns with exposure to risk. The FCA's ROR revealed concerns around many non-advised customers entering a default investment option, often in cash[28], which can lead to significant erosion by inflation. For example, someone who wants to draw down their pot over 20 years could get a 37% higher income if their pot was invested instead of held in cash[29]. Conversely, those whose money remains invested could be at risk of losses if they withdraw at the wrong time, following a fall in value.

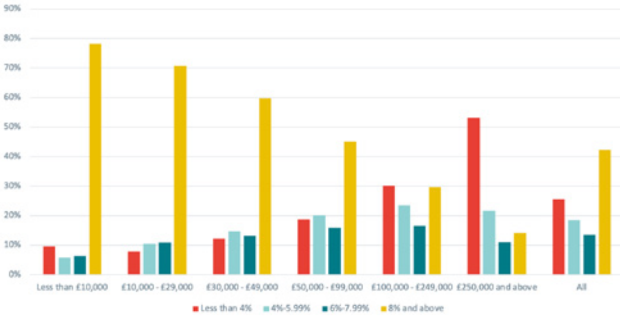
Investment pathways, introduced in February 2021, are aimed at alleviating this potential risk – these are considered in more detail in the next chapter.

Achieving sustainable withdrawal rates

Perhaps the greatest concern among stakeholders is that customers in drawdown without advice will run out of money in retirement. PPI research[30] shows that "a withdrawal rate of 3.5% ensures a 95% chance of not exhausting savings by time of death, while a withdrawal rate of 7% gives around a 50% chance of exhausting savings by average life expectancy". The FCA's retirement income market data shows that a considerable proportion of people are drawing down their pensions at a rate that means their pot will be exhausted.

The figure below shows withdrawal rates for customers by pot size.

FIGURE 3: WITHDRAWAL RATES FROM POTS WHERE PLAN HOLDERS MADE REGULAR WITHDRAWALS, BY POT SIZE



Source: FCA Retirement market income data, October 2019 to March 2020

[28] FCA Retirement Outcomes Review, Final Report, par 1.13
[29] FCA Retirement Outcomes Review, Final Report, par 1.14
[30] https://www.pensionspolicyinstitute.org.uk/media/3315/20191022-supporting-later-life-report.pdf

Overall, 56% of pots across all sizes have potentially unsustainable withdrawal rates of over 6%, and 42% over 8%. This latter falls to 35% for pots of over £30,000 and 23% for pots over £100,000. [31]

Are current unsustainable rates a concern?

No-one should assume that an unsustainable withdrawal rate is a poor outcome, especially for customers with multiple sources of income. People might want to be more active during the early part of their retirement; they might have multiple pots and aim to deplete one first before touching others. One provider told us that almost all of their customers withdrawing at 8% or more are deliberately using it as a bridging pension until State Pension age or until a Defined Benefit pension starts. The ability to make these different choices was the purpose of introducing pension freedoms – the 'appropriate' drawdown rate therefore depends on people's goals and wider financial circumstances.

On the other hand, no-one should assume there are no poor outcomes, or that customers will always be happy with decisions being made now. Future regulators and policy-makers are likely to scrutinise closely what providers have done during this period. The survey and interviews conducted by Frontier indicate that unsustainable withdrawal is an important concern for providers:

- 33% of respondents said that withdrawal behaviours are one of their top concerns.
- 55% said that this concern is equally important as other concerns related to pension freedoms.
- Two-thirds of providers also thought that this concern will grow into the future.

> "Customers are living in the moment and withdrawing amounts not thinking about full income needs in the future or all assets...
>
> These issues will be further compounded in the future as customers begin to see the impact of one-off withdrawals they are making today, plus an ageing population with impacted decision making ability."
>
> **ABI MEMBER**

Firms also noted the lack of visibility of a customer's holistic financial position is a barrier to understanding and gauging the risk.

What do we know about customers' wider circumstances?

No-one really knows how much of a problem unsustainable drawdown rates are because little is known about customers' wider circumstances. It is important to improve the data available to monitor the impacts of the policy, and to refine the size of population potentially at-risk. There is some data available on people's retirement intentions and wider financial circumstances, and we expect this to be strengthened:

- The English Longitudinal Study of Ageing (ELSA) includes questions about intentions in relation to accessing pensions. Analysis by the University of Sheffield found that "few individual characteristics are associated with plans", other than pot size[32].
- The FCA's Financial Lives survey has some data on wider product holdings – for example stating that 49% of retired adults were receiving an income from a DB pension, compared with 10% from an employer-arranged DC pension and 12% from a personally arranged DC pension[33].
- The Wealth and Assets Survey (WAS) and the Family Resources Survey (FRS) is to have drawdown-related questions added by DWP, which will help provide a clearer picture of how many people might be at risk given their wider financial circumstances. However, it will take time before this data is collected and processed to be able to provide analysis.
- Preparing for the Future is a new survey of people aged 40 to 75 asking about work and plans for retirement, also including people's expectations about their pensions or other savings in retirement, and where people go for advice and guidance on retirement planning. This is based on a feasibility study in 2019[34/35].

Changes in withdrawals over time

Unlike a guaranteed income, drawdown is not a one-off decision; this is both a benefit and a challenge of the flexibility it offers. So the data on withdrawal rates is only a snapshot, and every customer reported within it needs to make ongoing decisions about how much to take out. Reflecting this, prior to pension freedoms HMRC required a drawdown review every 3 years, and annually from age 75. The considerations are not just about sustainability:

- Insufficient withdrawals: as seen in overseas markets, customers may be very conservative in their withdrawals, and not maximise the amount that can be withdrawn sustainably. This could be part of a plan to bequeath wealth or to maximise tax efficiency; but equally, customers could be depriving themselves out of caution or fear.

[31] FCA Retirement Income Market Data. [32] Amin-Smith and Crawford (2018), Individuals' pension intentions in the new era of freedom https://www.sheffield.ac.uk/polopoly_fs/1.797621!/file/E1_Smith_Crawford.pdf [33] https://www.fca.org.uk/publication/research/financial-lives-survey-2020.pdf [34] https://natcen.ac.uk/taking-part/studies-in-field/preparing-for-the-future/about/ [35] NatCen Social Research (2019) Planning and preparing for later life: a social survey feasibility study https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/775377/planning-and-preparing-for-later-life-a-social-survey-feasibility-study.pdf

- Order and timing of investment returns: the difficulty of recovering from market falls creates the potential need to change investments or scale back withdrawals.
- Changing needs: a change of circumstances could mean that a customer's withdrawal strategy is no longer right for them. This could be as a result of a life event, such as a bereavement or inheritance.
- Uncertain costs in later life: Several studies looking at withdrawals in multiple countries have found that, in practice, "expenditure seems to decline progressively as people get older."[36] This may be deliberate, or reflect less need and desire to spend. On the other hand, some customers will face increased costs in later life – especially care costs, which for an estimated 1 in 10 people in the current system will be catastrophic at over £100,000[37].

Interaction of tax and benefits with drawdown

There is broad agreement that the tax implications of withdrawals are not fully understood by many customers. Help to navigate tax is a clear benefit of financial advice, and a risk that guidance can warn against and help customers to manage. The risk which is most relevant to this report is overpaying tax in drawdown, because withdrawals are charged tax at an emergency rate, on the assumption that that amount will be withdrawn monthly. From the perspective of a consumer seeking to make decisions about withdrawals, being charged an inaccurate tax rate is confusing and disengaging, as well as being disproportionate and inefficient. HMRC has now repaid £692m to Q1 2021 in overpaid tax, with up to 17,000 individual tax repayment claim forms processed in a quarter [38]. The ABI has proposed alternative ways to administer tax on drawdown.

Similarly, eligibility for, and levels of, means-tested benefits can be affected by pension withdrawals. The flexibility to withdraw a pension as capital in one or more lump sums can mean that claimants will not see means-tested state benefits reduced to the same extent as if they took a regular income, and may even increase. But taking it as an income can have a direct, penny for penny, impact on the level of benefits received by a claimant and their partner, giving no real increase in income. Benefit levels can also be affected if providers do not revalue the amount of the pension that remains invested. The rules are highly complex and not intuitive; it is unlikely that a pension provider will be aware of a customer's financial circumstances[39].

Risks arising following full or partial pot withdrawal

Many customers fully withdraw their savings either to spend, save or invest elsewhere. The FCA suggests that in many cases this could be driven by lack of trust in pensions/pension providers, or frequent regulatory changes[40]. Auto-enrolment is leading to the proliferation of small pots, which contributes to the likelihood of pot withdrawals, which customers may find easier than combining pots within a pension. Analysis of the ELSA by researchers for Sheffield University found that "intentions [about what to do with a pension] are strongly associated with the size of the accumulated pension fund", with people with small pots not planning to secure an income.

> "Many customers have multiple pensions, managing separately encourages mental accounting and where small pots exist they may withdraw the full amount above the amount needed. We need to help customers consider all their pots and assets together to drive better outcomes and withdrawal behaviour."
>
> **ABI MEMBER**

All of the members responding to the survey listed "Customers withdrawing pensions in full at an early age" as their first or second greatest concern in relation to withdrawals.

> "the main concern is customers cashing in their pension plans and incurring large tax bills, especially in the early years of retirement."
>
> **ABI MEMBER**

Pot withdrawals may be a risk for different reasons, as well as the tax impact. First, withdrawals may result in missed investment returns, especially if they keep their withdrawn savings in cash. Second, customers might be more likely to deplete their retirement savings too quickly as they become undifferentiated from other savings and investments.

However, nearly all (94%) of those who fully withdrew a pot larger than £10,000 without advice had other sources of retirement income[41], suggesting that they may have been planning to use the withdrawn pot for other purposes (e.g. paying off loans).

[36] Okusanya (2020) Retirement Spending Patterns: Implications for Retirement Income Sustainability summarises studies by the IFS, ILC-UK, and Morningstar, and from the USA and Australia: https://www.timelineapp.co/guides/retirement-spending-pattern-implications-for-retirement-income-sustainability.pdf [37] Housing, Communities and Local Government Committee (2018) https://publications.parliament.uk/pa/cm201719/cmselect/cmcomloc/768/768.pdf [38] From cumulative HMRC pensions newsletters. [39] https://benefitsinthefuture.com/notional-income-from-pensions-too-notional-for-some-advisers/ [40] FCA Retirement Outcomes Review, Final Report, par. 1.16 [41] FCA Retirement Outcomes Review, Final Report, par. 1.7

Gender differences and implications for financial dependants

Each of the decisions set out in this chapter could be different when taking dependants into account. The key trade-off here is withdrawing income that is deemed sufficient to cover a couple's current income versus planning to leave sufficient income to last both partners' lives (or another dependant adult's). We are not aware of any research on how such decisions are taken within couples and households and continue to believe this is a fruitful area for further exploration.

In practice, most couple households will have one partner financially dependent on the other, especially given that women age 65 and over, on average, have half the pension wealth of male counterparts[42]. The FCA's Financial Lives survey noted that women were almost twice as likely as men to say they rely mainly on the State Pension (43% vs. 26%, respectively); and single retirees were more likely to say this than those living in a couple (47% vs. 29%, respectively).

There is limited evidence of the differential impacts of retirement decisions on men and women. In 2018, Zurich found that compared to men, women taking flexible income reported lower levels of investment experience, financial confidence, and engagement, as well as smaller pot sizes[43].

While financial dependence is an important factor in retirement decisions with both partners alive, it becomes critical after the wealthier partner has died. A benefit of pension freedoms, and of drawdown in particular, is the greater flexibility and tax treatment of death benefits. But this flexibility means there are additional decisions to make, at some point during the life of the pension.

Prior to 2014/15, there was great stakeholder interest in the death benefits offered by annuities – joint life policies, guaranteed periods, and 'money back' value protection. This public attention has been absent from debate of pension freedoms. We would welcome further exploration of the evidence, customer experience and practice by providers, schemes and guidance bodies in discussing these issues.

Our focus

There are several risks for customer harm in the retirement income market. The following chapter focuses on how providers currently support non-advised customers to avoid some of these risks while taking the opportunities for flexible withdrawals, what factors should be considered in the future, how the regulatory environment impacts these risks and what could be done to mitigate them.

[42] ONS (2019) based on 2018 data: https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/pensionwealthingreatbritain/april2016tomarch2018
[43] Zurich (2018) Drawdown: is it working for consumers?

Chapter 3
Supporting customers in drawdown

Providers' position

Providers recognise that non-advised customers need extra support to understand and make choices in retirement. While slightly over half of providers responding to our survey think most customers do understand the impact of their decisions, they are all concerned that some customers may run out of retirement income, or that they may be adversely impacted by withdrawing their pensions in full at an early age. Some also raised inappropriate investment choices and poor tax outcomes as a concern.

FIGURE 4: DO PROVIDERS AGREE THAT CUSTOMERS UNDERSTAND THE IMPLICATIONS OF RETIREMENT DECISIONS?

All customers understand	0
Most customers understand	5
Some customers understand	3
Most customers do not understand	1

The existing literature on this subject also indicates that there is consumer demand, and need, for greater support. New research by Smart Pension found that "there is an expectation that the provider will play a key role in providing this support digitally." [44]

Dominic Lindley for Pension Bee found that:

"Many people have little idea about sustainable withdrawal rates and tend to overestimate the amount they can withdraw without running the risk of exhausting their DC pension fund. One third said that a sustainable withdrawal rate was 8% or higher and one in seven said that they didn't know."[45]

Ignition House for the People's Pension and State Street found that:

"Once they have taken the plunge into drawdown, our members felt that they had been left to their own devices to decide how to take their money"; and that "drawdown members overwhelmingly found the idea of a guided drawdown product very useful." [46]

Providers believe that they have a clear responsibility to help non-advised customers – more so than government or regulators. However, they face limitations in what they can do within the bounds of guidance without affecting customer relationships. As set out elsewhere in the report, these limitations include the advice boundary [47], the lack of visibility of customers' wider financial circumstances, and the fact that guidance often comes only after customers have already made up their minds.

Another important factor to consider is that, while aiming to protect customers, providers seek to make the customer experience a positive one. Customers are likely to expect smooth journeys and quick access to their funds. Attempts to restrict or obstruct customers' choices can damage this customer experience. There are a number of trade-offs involved here:

- There is a trade-off for providers between a frictionless customer experience and appropriately intervening when customers may potentially be at risk of behaviour that is not in their interests.
- Providers must sometimes deliver tough messages to customers but firms told us that they have experienced pushback from some customers when telling them what a sustainable income looks like.
- Customers rightly expect their pension provider to help them make decisions. But for front-line staff with multiple pressures, any degree of support provided entails some risk of saying the wrong thing.
- Related to this, support offered by providers may be seen by regulators and other stakeholders as an attempt to sell products or to retain the customer. It is right for providers to prompt customers to receive impartial guidance, and for regulators to require firms to encourage shopping around at key trigger points. But it is counterproductive to discourage providers from giving support themselves.

Providers seek to balance these trade-offs in order to support their customers, and take different approaches to this challenge.

Impacts of Covid-19 on approaches to guidance

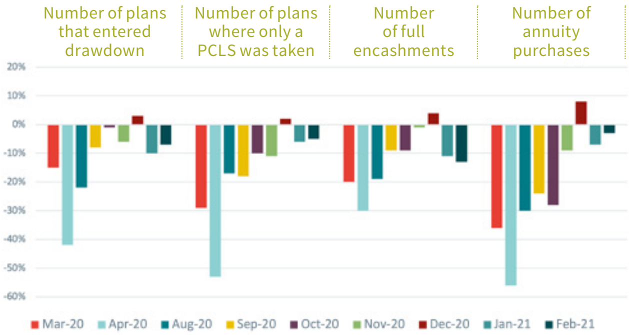
The Covid-19 crisis has the potential to impact retirement income and decumulation decisions. However, its impact seems to have been limited so far. Providers responded to the crisis by engaging with customers to inform them about the impact Covid-19 might have on their investments and help them to avoid making sudden decisions with lasting consequences.

In April 2020 the FCA published guidance[48] for providers on supporting customers without giving advice. While this was an incremental step and more detailed examples are needed, the willingness to provide guidance to firms on this issue on specific circumstances was seen as positive by the industry.

[44] Smart (2021) The Future of Global Retirement https://www.smart.co/future [45] Dominic Lindley for Pension Bee (2020) Drawdown Doldrums: Barriers and challenges faced by people accessing their defined contribution pensions https://www.pensionbee.com/resources/drawdown-doldrums-report-2020.pdf [46] Ignition House (2021) [47] An activity is considered to be advice when it involves personal recommendation; i.e. presenting e.g. an investment option as suitable to the customer, or something that takes the customer's personal circumstances into consideration. [48] https://www.fca.org.uk/firms/pensions-and-retirement-income-our-guidance-firms

In practice, all forms of pension access fell markedly when the crisis first struck, and gradually increased since then, while generally remaining slightly below the level of the previous year. The ABI has attributed this to a range of factors – people taking more time to consider decisions, waiting for stock markets to recover, or pausing spending. Providers have warned that this might change as the situation progresses and government support is withdrawn, and providers' customer services will need to be ready for this, building on their experience to date.

FIGURE 5: MONTHLY PENSION ACCESS DECISIONS COMPARED TO PREVIOUS YEAR



Most firms agreed with the statement, "My firm has changed the support we provide to customers about withdrawal decisions since the Covid-19 crisis"; and of those which did, all intended for that change to remain in place, with one undecided. Members have updated customer support as a result of Covid in the following ways.

> "We have changed our call scripts to include specific call outs on their financial position in light of the falls in investment markets. We have also put more digital services in place for advisers and customers to take withdrawals."
>
> **ABI MEMBER**

> "Although we haven't changed the processes we have for decisions, we have streamlined the admin processes to implement the customer requests."
>
> **ABI MEMBER**

> "Our response to the Covid-19 crisis focussed on protecting the critical customer transactions, including withdrawals, and looking after our customers at a time of great uncertainty. Much of this is or will be embedded in guidance either permanently or triggered by any future market shock."
>
> **ABI MEMBER**

Stop and think wording implemented across transactions	Communications to those taking a regular income to review sustainability of withdrawal	Risk warnings strengthened to highlight the additional risks associated with taking benefits early, in particular income sustainability.
Tracking customer behaviour to ensure support is appropriate	Heightened focus on vulnerable customers.	Emails sent to some customers explaining how we are here to help and raising awareness of pension scams.
Financial hardship information added	Communications strengthened to remind customers about the importance of financial advice and/or guidance from Pension Wise.	Dedicated Covid-19 support Hub created for advisers and their clients.

Different approaches to guidance

There are a range of approaches to guidance including the level of digital support and education provided, follow-ups with customers, and choice architecture in the process of accessing a pension.[49] This is in addition to some common practices following recently updated regulations, including annual statements in drawdown, signposting to guidance, and illustrations of the impact of withdrawals. There are three broad approaches used by providers:

- Serving advised customers only. Some do not offer non-advised drawdown (but often do allow annuity purchases and full withdrawals). These providers do not have an appetite to support non-advised customers given the user experience they must provide and the potential risks to which customers are exposed. These firms either entirely or almost entirely offer drawdown with advice, reflecting the general position before 2014/15; others may encourage customers to seek advice, or help to transfer customers to providers that support non-advised drawdown. Further, providers could decide during the investment pathways process that a customer who is hesitant about choosing any option should not proceed without advice.
- Communicating with customers. For those providers that do serve non-advised customers, most provide support through ongoing communication, including both general guidance and information relevant to the customer (e.g. a projection of withdrawal sustainability). Some providers find more innovative

[49] All firms providing pension services have to provide certain information to clients on a mandatory basis. This involves sending 'wake-up packs' to customers at set points in time before retirement, pointing them to PensionWise guidance, and warning customers of the risks they take with certain decisions.

ways to support customers including through digital channels, which more easily allow for providing the right information at the right time - see case studies #1 and #2.

- Providing guardrails. Some providers go further than communication alone, and intervene more directly when they see customers behaving in ways that contradict the customer's stated intentions. These interventions, such as prompts or additional guidance conversations, can help to steer customers away from potential risks - (see case studies #3 and #4). This may start to feel like advice, and in some cases, firms' advice businesses led or were involved in the development of this service.

CASE STUDY #1
on guidance providers offer

a) This provider considers human contact important in supporting the effectiveness of their digital information provision. They also keep in regular touch with customers with frequent communications, going beyond the regulatory requirements. In more detail, they:

(1) Provide online content in the form of short online lessons, discussing for example investment basics, how to turn savings into income, combining pensions, or what to do when the markets drop. Some of these lessons also feature short explanatory videos, and they use the opportunities provided by the digital environment, e.g. through providing call-outs and warnings at relevant points.

(2) Rely on human contact to promote engagement with the pensions questions: they validate customers' understanding of pension issues through phone conversations before they make a final decision, pointing them back to learning material if they seem not to have understood. They also illustrate what the customer's drawdown decisions will mean, such as how long their savings are likely to last, and tax charges.

(3) Use annual statements to the customer to maintain engagement. These show how the customer's account is performing, and what their outlook is given their current rate of drawdown.

CASE STUDY #2
on guidance providers offer

b) This firm provides an extensive suite of online material for customers to use (tailored to the firm's fairly engaged and knowledgeable customer base) – but otherwise provides a streamlined customer experience during consultations with minimal interruptions.

(1) They provide extensive digital material, discussing different investment ideas for different retirement goals, as well as the risks and benefits of various decumulation products (including mixing products).

(2) Their website also features various calculators that help customers 'play around' with different decisions and understand their impacts; for example: a drawdown calculator for understanding what level of drawdown might be sustainable, and an income tax calculator to understand tax implications of withdrawals.

(3) They offer streamlined guidance consultations with minimal attempts to steer customers.

(4) Staff are trained to help customers understand whether they would benefit from advice if they are struggling with a decision.

(5) They contact clients to give ongoing reviews in drawdown; for example, showing how long their savings might last.

CASE STUDY #3
on guidance providers offer

c) This provider goes beyond mandatory information requirements in many ways, providing interactive digital tools as well as using choice architecture to steer customers towards decisions that might be best suited to their stated goals. More specifically:

1) They provide pre-retirement information that goes beyond and complements wake up packs: They start earlier, get in touch more frequently and make the messaging more dynamic and personalised (for example, based on the customer's age and their proximity to retirement)

2) Their website features educational articles (e.g. about taxes and investment decisions), calculators that help customers 'play around' with different decisions and understand their impacts (e.g. what income what might be sustainable, tax impacts), as well as interactive tools that help customers decide what product might be the best suited to them based on their goals (e.g. do they want guaranteed income or do they prefer to have some flexibility?)

3) Before investment pathways, they offered a signposted customer journey with template solutions catering to different retirement goals. Compared to Investment Pathways' four options, they had a more granular offering and the flexibility to adjust options if a customers wished.

4) During the signposted journey, customers express their intentions, which the firm then uses for outbound checks if the customer's behaviour is not consistent with what they stated (e.g. if the stated plan was not to touch a pot for a period but the customer does request to withdraw).

5) The telephony customer journey includes an intentional breakpoint (although this is not necessarily enforced for everyone). Customers are sent a summary of their intended plan, and are provided a checklist of key considerations, as well as a reminder of the different retirement options and support available.

CASE STUDY #4
on guidance providers offer

d) This provider relies on an interactive customer journey rather than education. They offer a sophisticated drawdown product that allows customers to set aside money for different uses, featuring a default allocation.

(1) An easy-to-navigate online journey that tries to remove complexity and focuses on providing customers with a simple and intuitive way of understanding their pensions. The journey relies heavily on behavioural insights to provide warnings and call-outs.

(2) They offer a sophisticated drawdown product that allows customers to allocate money into different pots (a drawdown fund, a pot for later life, a pot for the 'rainy days'). Customers can 'play around' with various allocations to see what it means in terms of the regular income they will be able to have, and what the tax implications are.

(3) The journey includes a default choice in terms of how to allocate money between the different pots.

As the case studies showcase, there are a range of approaches in the market. All of these are sensible – providers have different customer portfolios (e.g. in terms of pot size and financial knowledge) which lead to different customer needs and risks. The choice of approach may also be influenced by the provider's risk appetite in relation to the advice boundary – compliance costs and regulatory risk may be a disincentive to developing guidance that is more tailored to the customer, whilst not giving a personal recommendation.

The advice boundary

There are a range of views among providers about the advice boundary, but there is general agreement that it can hamper the development of better guidance. Several providers noted that it is difficult to navigate the regulation, and there is a lot of uncertainty around whether a particular action would cross the advice boundary. In such a situation, providers may often err on the side of caution.

Some providers said that the boundary prevented them from doing all they would like to support customers. For example, they would like to personalise information provision, for example by presenting customers with a sub-set of information or choices based on information provided by the customer, recognising that this information may be incorrect or incomplete. Some providers would also like to steer customers towards sustainable withdrawal rates, through defaults or otherwise, and make suggestions at outset or following withdrawals that may improve their outcomes, but feel that this may be considered to be advice.

> "This is both the advice boundary itself but also importantly the ability to navigate the regulation… We need clarification, support and opinion from the regulator around specific examples. Without this, a risk-averse behaviour is driven with providers erring on the side of caution which does not optimise guidance. Note – we also don't need prescription in the regulation."
>
> **ABI MEMBER**

> "We can use digital technology to educate the customer on their retirement savings adequacy. And we can use digital technology to empower customers to address any retirement savings inadequacy. But these two services cannot be merged into one customer journey. The boundary creates a broken journey."
>
> "If government change the definition of advice in the legislation it would enable the FCA to have greater flexibility in defining conduct rules. This would flow through to potentially better support from providers and other groups such as trustees and employers."
>
> **ABI MEMBER**

At the same time, other providers do not find the advice boundary to be a limitation for the service they provide. In some cases, this may be due to the firm preferring a more light-touch approach to guidance, though this did not correlate well with their guidance strategies in general. Some providers quoted the advice boundary for not engaging in certain types of guidance while other providers found ways to achieve similar goals within the bounds of guidance.

The overall picture suggests that the primary problem with the boundary might not be its overall location, but that its nature is inhibiting the quality of guidance available in the market by creating uncertainty about what is allowed and what isn't in certain situations. It may limit innovation and product development as providers are wary of running up against the boundary, and face high compliance costs.

There are things some providers would like to do that would indeed likely require moving the boundary. In relation to withdrawals, this might include:

- Telling a customer about implications of a lump sum, which go beyond the examples in the FCA's Perimeter Guidance.[50]
- Talking a customer through what a sustainable income could look like, taking account of their circumstances but without a full fact find.
- Providing more details on risk within investment pathways.
- Prompting a customer that people in their situation often secure a guaranteed income at a particular age.
- Intervene more strongly to warn customers against scams and dubious investments.

We believe that accessing a pension is a special case that requires an alternative approach to the existing rules. We recommend that the FCA, HM Treasury and DWP consider this situation alongside others, such as starting investing, or moving between simple funds or assets. To enable the introduction of this additional support would require an amendment to FCA rules or guidance; or for HM Treasury to review the Regulated Activity Order. This could also fit with a DWP requirement on pension schemes to provide or signpost to additional support.

Early impacts of investment pathways

Investment pathways were introduced by the FCA in February 2021 to help customers choose investments that are compatible with their intentions, reducing the risk of a mismatch of investment and withdrawals. They create pre-packaged investment products to fit four stated objectives – an example of using choice architecture to simplify decisions and steer customers away from poor outcomes.

In its Retirement Outcomes Review, the FCA showed that non-advised customers had less variable investment returns if their providers offered a journey with good choice architecture; so much so that it becomes similar to the standard deviation experienced by advised clients.[51] Solutions similar to investment pathways existed before the FCA proposed this remedy, but were not universal as providers took a range of approaches to helping customers make investment decisions. The regulation aims to ensure a common standard across the industry.

However, providers did have a number of concerns about the implementation of pathways. Most importantly, they thought that the regulation may be too prescriptive and limit scope for innovation. In some cases, providers felt it does not fit their business model, that they could not offer what they believe their customers would value, and may lead to the removal of some features of providers' offerings, potentially reducing the quality of support they offer.

Most providers said that, while imperfect, investment pathways are a step in the right direction and that the FCA's intervention will help them better support customers. A majority of providers who responded to the survey also said that pathways prompted wider changes in the support that they provide to non-advised customers.

> "We will inform the customer if they are invested in an investment pathway that is not compatible with their withdrawal strategy."
>
> "It has resulted in a re-design of the non-advised at-retirement customer journey, for example to illustrate the effect of tax on the specific withdrawals they want to make."
>
> **ABI MEMBER**

Early evidence from investment pathways in practice suggests they are working as intended, though the impacts will need to be monitored closely and the policy is very much in its infancy (see Table 2 opposite). The data does not represent the whole market or all ABI members; and the numbers choosing each pathway option do not add up to the number using the investment pathways because some customers choose not to go ahead after the first step. The fact that customers are choosing a range of options validates the FCA mandating an approach based on choice. For example, it makes clear that a single default would have been wrong for either customers choosing Pathway Objective 1 or 4.

[50] Work and Pensions Committee (2018a) [117] HM Treasury (2010) [118] Defined Contribution Investment Forum (2019)
[119] ABI (2015) [120] Ignition House (2017) [121] Ignition House (2017), Defined Contribution Investment Forum (2019), Age UK (2019)
[122] Defined Contribution Investment Forum (2019)

TABLE 2: ABI DATA ON INVESTMENT PATHWAYS, Q1 2021

NUMBER OF CUSTOMERS WHO:	
Use the investment pathways	5390
Self-select	1408
Remain in current investments	6395

OF THOSE WHO CHOOSE INVESTMENT PATHWAYS, THE NUMBER OF CUSTOMERS WHO GO ON TO CHOOSE:	
Option 1: I have no plans to touch my money in the next 5 years	1624
Option 2: I plan to use my money to set up a guaranteed income (annuity) within the next 5 years	178
Option 3: I plan to start taking my money as a long-term income within the next 5 years	1159
Option 4: I plan to take out all my money within the next 5 years	1800

Anecdotal observations from members implementing the pathways include that:

- Fewer customers than expected are entering the pathways at all. But it is hardly surprising that customers who have already chosen a fund, because they have recently consolidated or opened a product, choose to remain in those assets. It would be a concern if many customers choose to remain invested in their current investments solely because it is an easier and quicker option.
- Customers in different books of business are behaving differently – those in workplace or heritage products appear more likely to enter the pathways. This provides some comfort that customers are making active decisions.
- Few customers using pathways say they intend to set up a guaranteed income in the next 5 years. This is also not particularly surprising, as those customers have just chosen a different option and many will be doing so at younger ages when a guaranteed income will be lower. But many or most customers choosing pathways should eventually secure a guaranteed income.

It will be important to evaluate how well such a mandated choice architecture works in the real world over time. The FCA's post-implementation review is a good opportunity to assess the customer experience, and providers will monitor how compatible customer behaviour is with stated intentions. If investment pathways do prove successful in mitigating risks to customers, they could provide a template for providers seeking to improve their support for customers in other parts of the pension and investment journey – subject to the advice boundary.

There is room for more choice architecture in the non-advised market. In the survey and the interviews Frontier has conducted, providers said that the responsibility of supporting non-advised customers in drawdown lies with firms, both individually and collectively. Choice architecture is an area where they can indeed do more – but regulators may be able to help this process as well.

Chapter 4
More to do

This report has considered how firms can support non-advised customers with ongoing withdrawal decisions and help mitigate some of the associated risks. As Chapter 3 showed, firms across the sector take differing approaches to providing their customer's with guidance, but there is also merit in looking at further interventions that could be made by firms and others.

Our survey revealed markedly different views among firms about the most effective approaches for a provider to help customers reach an effective withdrawal strategy, from relying on existing communications and guidance, to default withdrawal rates, 'official' rates such as those set by the Government Actuary's Department, or services that automate actions based on customer preferences.

Based on our research with Frontier Economics, we identify three main areas where additional support could be provided and which firms intend to explore.

1. Improving communications and harnessing digital

Firms invest substantially in researching and delivering effective communications for their customers. Firms' approaches to pension withdrawals communications differ across the sector, focusing on different formats. Some rely more on written information, some on phone conversations and others use digital tools, though in practice most use a combination.

With an evolving customer base and constant developments in technology, there will always be ways for firms to make improvements to their communication and the clarity of the information. As more customers prefer to interact digitally, there is an opportunity to take advantage of tools to provide simple yet engaging content. As Smart's report found, "in a world where the one-size-fits-all model of retirement is gone, technology can be used to support one-to-one relationships with savers, meeting their individual needs."

Digital channels allow communication to be tailored to the individual customer at the point in the journey where information is most relevant. Some of the following are examples from third parties, which providers could signpost to, or learn from in developing their own offering.

- Illustrations of the impact of different withdrawal rates and ages are sometimes provided with interactive calculators to help customers understand and consider different withdrawal options.
- Video or animated content can help customers digest information in a more accessible way that can be tracked, without concern about delivering a personal recommendation.
- The Money and Pensions Service investment pathways tool was developed following a recommendation by the ABI in 2017 and then referenced in the FCA's ROR. While we would like to see it cover all pathways available on the open market, it serves as a starting point for customers trying to understand what the wider market looks like.
- Commercial suppliers offer comparison of providers' drawdown offerings, direct to consumers as well as through financial advisers, including modelling different withdrawal rates.
- These services could include tailored reviews or digital prompts for customers based on their circumstances, such as health conditions or supporting financial dependants, without a personal recommendation.

In addition to these developments to guidance processes, automated advice will make personal recommendations available at reduced cost, potentially through the workplace or via pension providers.

An effective mix of communication will be different for each firm. However, all firms should continue to seek out opportunities to improve the clarity and accessibility of their communication. This will involve learning from customers and using behavioural insights, as well as identifying good practice in the industry.

2. Offering withdrawal pathways

Customers want to use their retirement savings in different ways. The DWP's recent study into pension freedoms identified four different decumulation journeys, including "topping up employment income", "improving financial security in later life" and "funding retirement"[53], although there are many options that are not captured by these journeys.

Retirement products need to reflect this, and providers are well placed to help. But it is unlikely that high quality information alone will be enough to ensure all non-advised customers achieve what they want, given that some customers do not engage with such information or do not have a sufficient understanding of drawdown to interpret this information.

Providers can use choice architecture to support customers who are at risk of experiencing unsustainable withdrawal. Investment pathways are a good example of using choice architecture for investment decisions. Similar choice architecture could also be used for withdrawal decisions. This could be within non-advised drawdown; or potentially at a much earlier moment in the journey. It could be offered by firms or an impartial guidance service.

[53] DWP (2020), "Pension Freedoms: a qualitative research study of individuals' decumulation journeys", section 5.

For example, customers could be asked to self-select which journey they plan to take, and then offer 'default' strategies for customers that minimise the risks of unsustainable withdrawal. These pathways could be relatively simple, just using rules of thumb, or more complex allowing customers more flexibility. Some firms already have preferred solutions or pathways for customers. For those that do not, withdrawal pathways could build on the existing starting point or choice that customers are offered when they come to make choices about withdrawal.

This is easier said than done, as the ready-made solutions are not obvious and cannot guarantee a match to the customer's circumstances, which would require financial advice. The challenge is for providers to be able to establish the customer's intention, taking account of more than just their pension. This would need to be supported by a regulatory environment that allows gathering information about customer circumstances to suggest and agree an appropriate withdrawal rate.

The most common approach to withdrawals used by financial planners has changed strikingly according to surveys by NextWealth and Richard Parkin Consulting for Aegon. In 2018, 66% used a fixed rate withdrawal strategy, most commonly the 4% rule; this fell to 37% in 2021, while the proportion using modelling tools has increased to 38% from 28% the year before. It is possible that similar tools could be used to help non-advised customers plan withdrawals.

Customers are likely to be influenced by whichever benchmarks they are presented with. In Australia, a large study found that "almost one half (48%) of the observed retirees used the minimum drawdown rates as an anchor, while more than one quarter (28%) tended towards drawing level dollar amounts."[54]

> "Setting default rates doesn't work as everyone's needs are different. In that sense investment pathways are quite effective as they deliver better outcome through a more targeted choice architecture which "defaults" only after having established an initial more appropriate outcome."
>
> "The days of hard and fast withdrawal rates are long gone."
>
> **ABI MEMBER**

In that context, a range of approaches to improving the choice architecture could be employed, with engagement from the regulator and the Money and Pensions Service about what works.

3. Putting up guardrails

Withdrawal pathways can help customers choose a sustainable withdrawal strategy, but some customers may make decisions throughout that retirement that unintentionally lead to unsustainable withdrawal. Firms could do more to ensure customers avoid these mistakes by putting guardrails in place.

Guardrails could cover levels of withdrawals, and these could be tailored to account for inflation and market volatility. As with the idea of withdrawal pathways, this would work more effectively if it were possible to take account of customers' intentions and wider financial circumstances, without giving advice.

There are three parts to putting up such guardrails.

- First, firms need to collect information about customers' intentions (either through selecting a withdrawal pathway or otherwise). This is included in the FCA's record-keeping guidance for investment pathways; and providers are likely to collect this information to inform product reviews.
- Second, firms need to monitor the customer's behaviour and compare with the customer's stated intention (e.g. if the plan was to maintain a regular income, but the customer wishes to drawdown a large amount). Providers felt that the five-year period relating to investment pathways is a long time, during which customers' circumstances and objectives can change. Providers are dealing with this challenge by ensuring contact is more frequent than that; and communicating with the customer if their withdrawal behaviour is not compatible with the chosen pathway. The ABI has produced a guide on this[55].
- Finally, firms can add appropriate friction to the customer journey when their behaviour does not match their intention. For example, providing additional warnings, requiring an additional confirmation if the customer intends to withdraw more from their pot then they initially indicated, or asking customers to participate in a guidance conversation before proceeding with an action. This can be done without giving advice, but the intervention can only be inviting the customer to make a decision for themselves.

Such guardrails do not stop a customer from making decisions, but act as a protection against unintended outcomes for the customer. Firms do not need to have a good understanding of a customer's wider financial circumstances to provide such guardrails, although having more information about customers is helpful.

[54] Balnozan (2018) https://www.apra.gov.au/sites/default/files/Balnozan-Modelling-heterogeneous-drawdown-behaviours-in-phased-withdrawal-retirement-income-products.pdf
[55] ABI (2020) Finding the Right Path https://www.abi.org.uk/globalassets/files/publications/public/lts/2020/findingtherightpath.pdf

There is a tension between using guardrails and the idea of pension freedoms. Some firms feel that customers should be free to make their own decisions, provided they have the right information. Some firms also want to provide streamlined customer journeys without interruption as some customers may be frustrated by such features. However, appropriate choice architecture could also be used here by asking customers early in their retirement journey if they want such guardrails (and how strong they want them to be) during the first conversation about accessing pensions. As such, customers who have a strong preference for a smooth, independent journey can opt out of these entirely.

Members had several of their own ideas about support for withdrawal decisions as set out below.

Customers need benchmarks and rules of thumb. The PLSA guide on adequacy/levels of retirement income is a good example of this.	Dynamic model where income flexes in response to the customer's age and health, and market conditions.	FCA/MaPS should have a default rate for each age and messaging would then be around the fact that the customer can change the rates, can link to inflation and the risks of taking too much and running out or too little and not spending it.
Digital prompts alerting customers if their withdrawal decisions move out of specific ranges. Reminders to designate their defined pathway objective from time to time to ensure it is current	Enhanced guidance. Navigating the advice boundary to enable better, clearer conversations with customers.	Interventions when customers act in a way different to that which they have told – keeping customers on track and reminding them when they need to review decisions (or making the decision for them through pre-coded guiderails).

The role of regulation

This report suggests ways in which firms can do more to support non-advised drawdown customers. The approaches listed could involve additional personalisation, presenting filtered options based on customer circumstances. But this feels very close to the advice boundary. As noted earlier, we believe that accessing a pension is a special case that requires an alternative approach to the existing advice rules.

Changes are needed to enable pension schemes and providers to provide greater support. But we do not currently see the need to regulate how exactly this support should be provided or what it must look like. While mandating or prescribing how firms support their customers might ensure minimum standards for all, it would have the unintended consequence of reducing flexibility. Flexibility is important, especially in support for withdrawals, as it allows customers with different needs to be provided with more tailored services, and enable firms to innovate and go beyond the minimum standard. Customer needs vary hugely in retirement based on their personal preferences and wider financial circumstances. There is unlikely to be a one-size-fits-all approach that works and is proportionate for all customer groups.

With a change in the advice rules, the onus would be on the industry to show that it has an appropriate level of support in place, and for individual firms to show that they are meeting their responsibility to treat customers fairly. The set of recommendations in this report should help firms to provide an appropriate level of support for customers. Policy-makers will rightly continue to take a keen interest in how well this support works, and the impact it has on customers' long-term retirement outcomes.

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