Phoenix Insights

Supporting consumers at retirement: What role could Targeted Support play?

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Introduction

Phoenix Insights is launching a programme of public engagement to help examine the potential role for Targeted Support to help consumers with retirement decision making. This paper introduces the context and analysis that is informing the design of that programme of public engagement.

As a result of the introduction of automatic enrolment, it is possible for employees to build up money in a pension without making any active decisions. Schemes are chosen by employers, and money can be invested in a default fund. Currently, a pension scheme member only truly becomes a consumer when they come to access and use their pension. At this point, they must make choices and their engagement – on some level - is unavoidable.

There are long-running debates about how to respond to the twin problem of high-stakes decision making and perennially low engagement in pensions. The common thread running through these is that consumers are currently unsupported and therefore risk making uninformed decisions which do not reflect their circumstances, preferences or 'best' interest.

Proposals from the Financial Conduct Authority (FCA) and HM Treasury (HMT) for closing the 'advice gap'[i], along with the forthcoming requirement for DC pension schemes to offer retirement products and a default retirement solution[ii], have put the matters of consumers' best interests and consumer choice in sharp focus.

Whilst industry and government alike consider how best to meet consumers' needs, an important voice appears to be missing from the debate to date: that of the individual consumer. There are some complicated and nuanced trade-offs at play – concerning consumer protection; choice and agency; and competition. It is vital that consumers can explore and voice their views on these trade-offs and consider the role of potential new forms of information and guidance such as Targeted Support in supporting their decision-making at and during retirement. They need an opportunity to learn about what is at stake so they can be actively involved in the debate.

Phoenix Insights has partnered with independent research agency Community Research to support them in a programme of deliberative research with consumers. This means that participants will have more time and information to consider the topic and the wider context in which it sits. They will also be exposed to a range of perspectives on the concept of Targeted Support, along with concepts of consumer choice, consumer protection and consumer best interests in accessing a DC pension. The research will provide detailed insights into consumer views on the notion of Targeted Support as well as the principles that consumers feel should underpin it. By the end of the process, they will be in a position to offer a more informed view of what support savers need to make retirement decisions with good outcomes. They will consider the role Targeted Support (as proposed by the FCA and HMT) in retirement decision making, exploring what consumers will need in terms of communication, protection and redress.

This paper summarises an initial exploratory scoping exercise undertaken by Community Research to inform the design of this research. This has involved a focused rapid review of the evidence and commentary on the so-called 'advice gap'; its causes and consequences; and the response to the proposed solutions. This was followed by 12 in-depth interviews with representatives from the pensions industry, consumer champions, and behavioural science experts.

What's the nature of the 'advice gap' and how does it affect consumers at retirement?

Mind the 'gap'

According to often-cited FCA research, only 8% of adults access independent financial advice[iii]. While DWP research suggests 29% of adults planning for retirement use an independent financial advisor (IFA)[iv], this still leaves a majority of people not receiving full financial advice when faced with retirement decisions. This has been characterised as an 'advice gap'.

Existing evidence – and the stakeholders interviewed – point to a range of factors contributing to low take-up of full financial advice, concerning both the *supply* of advice, and the *demand* from consumers. In supply terms, whilst the Retail Distribution Review helped to protect consumers from partial advice and lack of transparency around charges, it also changed the advice market. IFAs now focus on those with higher levels of investible assets, as those with lower value investible assets do not represent an economically viable business proposition. However, many stakeholders argue that the *demand* from consumers isn't there: that there is not, in fact, an 'advice gap' that could be filled if full financial advice was more readily available. There is a host of well documented barriers and biases affecting consumers' take up of advice and their engagement with information and quality of decision-making around pensions[v].

In the interviews, stakeholders agreed that consumers face life-changing complex decisions without sufficient support, risking a range of harms such as running out of money; living more frugally than they need to; compromising their benefits eligibility; receiving poor returns on their investments; or paying more tax than necessary. However, there is broad consensus that the answer does not lie in simply enabling more savers to access independent financial advice.

A support need, not an 'advice gap'

There are signs that many consumers *do* seek out support of some kind at this crucial stage. 71% of people accessing their DC pension received information, advice or guidance from a financial advisor, their pension provider or Pension Wise before doing so[vi]. Notably, however, 13% had received no information, advice or guidance at all[vii].

> There is unanimous agreement across industry, government, consumer bodies and civil society that there is a gap between generic fact-style information and highly personalised advice.

However, in both the commentary and amongst our interviewees, there is unanimous agreement across industry, government, consumer bodies and civil society that there is a gap between generic fact-style information and highly personalised advice. The gap is significant insofar as many DC savers will make decisions using generic information only, and many will look to their incumbent pension provider for this (36% already do so[viii]). The risk here is that, without support that is tailored to some extent to their circumstances, consumers may make uninformed decisions, perhaps without even a basic awareness of the options available to them and their implications, leading to sub-optimal or bad outcomes.

Decisions about decumulation of DC pensions a particular concern

The review of the literature and conversations with stakeholders suggests there is particular concern around uninformed and unsupported decision-making when it comes to decumulation of defined contribution (DC) pensions. There are three main reasons for this concern:

1. *The stakes of making poor decisions at decumulation are higher for DC pension scheme members*: In less than ten years, a majority of savers will rely on their workplace DC savings more than any previous generation. Already, half (49%) of individuals with DC provision and who are between 50 and State Pension age have no defined benefit (DB) entitlement[ix]. The move away from DB pensions marks a substantial transfer of risk from employers to individuals, and future income can no longer be predicted with certainty. While DB pensions allowed members to enjoy a sustainable, life-long income without the need to make active choices, consumers with DC pensions face a multitude of options and decisions about how they access and use their pensions. However, they are largely unprepared for such an active decision-making role: automatic enrolment and default investment funds mean that DC pension scheme members can, if they wish, make no active decisions as

their pension accumulates. However, once they seek to access their pension(s), they have choices which they must make for themselves. They will face the many challenges that come with the flexibility of accessing their DC pensions, including (at least) tax and benefits implications and managing longevity, investment and inflation risks.

2. *Lack of regard for long-term needs*: Savers can now access their pensions (including the option to take 25% tax-free as a lump sum) from the age of 55 following changes to the pensions freedoms rules. A large majority of people currently accessing DC pension plans withdraw the pot in full, and those who access their tax-free lump sum do so before making their main decumulation decision[x]. It's impossible to know whether the decumulation decisions people are taking now are 'good' decisions or whether the behaviour of past consumers is a good indication of what DC consumers of the future will do. However, several stakeholders interviewed worry that savers do not consider their need for a sustainable lifetime income when they make these decisions. This is less of an issue where savers have trivial DC pots, DB pensions or alternative assets to rely on in retirement. However, if future DC consumers do follow the same patterns of behaviour, then there is legitimate reason to be concerned and ask how future harm can be mitigated.

3. *Changing retirement patterns add to complexity*: The traditional assumption is that people work until they retire, at which point they leave work altogether and access their pension. The evidence shows that this assumption is becoming increasingly out of step with what people will actually do. Only 15% of people expect that a hard stop retirement will be most people's experience of retirement in the next 10-25 years[xi]. Decumulation decisions, therefore, are not simply about income on leaving the labour market but will become increasingly about how to support a gradual departure from working. Some people will be accumulating (continuing to contribute) after they have taken a decumulation decision. Furthermore, decumulating a pension will become less of a one-off event, and might increasingly become a (long, in some cases) period of time in which several possible decisions are taken and revisited. Relatedly, the evidence that shows people decumulating before state pension age might seem to suggest that some consumers are responding to their pension freedoms by drawing down tax-free lump sums without consideration to their retirement[xii]. But some stakeholders believe that this group includes people who have needed to access resources to support their retirement before they are able to access the state pension. Workers in certain sectors and in lower earnings categories are more likely to be in this position.

> The changing pensions landscape and the evolving nature of retirement, along with the shifts in the advice market, creates a need for new consumer support solutions.

Together, these changes mean consumers now have many decisions to make at decumulation, and these decisions bring more risks, greater complexity, higher stakes and some are irreversible. However, this review suggests that consumers tend to be unaware of – and unprepared for – the decisions they'll need to make and their potential consequences.

Who is most in need of support?

Consumers with moderate to high levels of DC savings and no or low DB entitlement have been found to be most at risk of making decisions that can have a significant negative impact on their retirement outcomes[xiii]. Concern for this huge cohort was greatest amongst the stakeholders who were interviewed too. Their fear is for consumers whose level of DC wealth could, on top of state support, give them a reasonable replacement rate of their earned income, if they made the right decumulation decision(s) and didn't simply withdraw their pension at the earliest opportunity. In this regard, **it is the mass market consumer, whose only other real asset is their home, who is thought to be at the greatest risk of harm without support.** For this DC consumer of the near future, engagement at decumulation might be their only interaction with their pension provider(s), their only experience of accessing an investible asset and potentially the first time they have thought about how they will use their pension(s). So, the stakes are highest for this consumer who, from 55, may enter entirely unfamiliar and complex terrain and be without professional advice.

In contrast, those with higher levels of assets are at least risk of harm, according to both the available literature and stakeholders interviewed. Without advice, they may make sub-optimal decisions, but they are likely to be able to withstand the consequences of these without experiencing much detriment. Furthermore, they can afford to pay for advice and belong to social groups in which accessing professional advice, especially around key life stages and decision points, is the cultural norm.

At the other end of the spectrum, those with low incomes (based on the year before they retire or decumulate for the first time) and those with small pension pots (stakeholders tend to put this at around £20,000 or less), can't afford advice but also wouldn't get much value from it if they could, given the options their wealth affords them. Those in this cohort are, however, thought to be at risk of harm without support, particularly on the tax and benefit implications of a) withdrawing a lump sum (noting that for many, this will be their only experience of coming into a lump sum of money in their lives), and b) drawdown products that would give them a modest top-up to their state pension.

A role for Targeted Support?

Targeted Support has been proposed by the FCA as a new type of support that fits between factual and generic information (which is fundamentally impersonal) and regulated financial advice (which is tailored to individual circumstances). Targeted Support would harness customer data to make 'best interests' based suggestions for a target cohort, sometimes referred to as 'people like you' or 'people in similar circumstances to you'. Targeted Support could apply to a range of financial decisions, including decumulation decisions taken by members of defined contribution (DC) pension schemes.

Most of the stakeholders interviewed see some potential in Targeted Support to help people who don't currently receive financial advice when they face pension decumulation decisions. However, this support for the concept was qualified: Targeted Support is no silver bullet to the wider pensions challenges consumers face, and much depends on how it is implemented and delivered. Some stakeholders are not in favour of its introduction. Whilst they agree consumers need more help with decumulation decisions, they believe there is enough scope for providers to do more within the existing regulatory framework.

Questions for consumers

The rapid evidence review and stakeholder interviews suggests several question areas that will benefit from input from consumers, in particular:

What are the key principles that should guide the design of Targeted Support?

Stakeholders raise some fundamental themes that will govern how Targeted Support is designed and delivered. Some of these can conflict with each other, and the associated trade-offs will need to be carefully considered; including the following:

- *Giving consumers agency and control*: Enabling consumers to make their own decisions even when this brings higher risk of them making mistakes and experiencing suboptimal outcomes. Some feel strongly that consumer choice at decumulation is of critical importance given the increasingly diverse range of retirement options and the changing nature of retirement (e.g. phased exits from the labour market; premature hard stop exits before state pension age). It could be argued that only the customer can the specifics of their own financial circumstances, their hopes and aspirations for retirement, what pressures they are under, and therefore what is best for them.

- *Reducing risk/ protecting consumers from harm*: there are arguments that the amount and complexity of information and decisions lead to a paralysing overwhelm, which either prevents consumers making decisions, or leads to them making decisions with suboptimal outcomes. The current status quo presents consumers with a lot of choices, but inherent in this are many risks, which it is thought consumers would rather not own themselves. Some suggest it is in their best interests to make decisions on their behalf (such as the defaulted retirement solutions expected in the forthcoming Pensions Bill[xiv]) or to offer them a limited choice set of options that are likely to benefit them. A specific question on Targeted Support is whether it should present customers with all options for people in their cohort, or curate a limited choice set that might be more appropriate.

- *A focus on the greater good*: to be delivered at scale, it won't be possible for Targeted Support to be entirely tailored. Instead, it will offer suggestions based on what is best for a cohort of people who share characteristics, based on the data pension providers hold on – and/or gather from – the customer. One consequence is that, while suggestions will work for the majority, some may not benefit. For some stakeholders, this makes it imperfect but not worthless. Like defaulted retirement solutions, Targeted Support could play a role in reducing consumers' risk of harm but not in removing it entirely.

- *Allocation of risk and liability*: inherent in some of the above themes is the question of where the risk should lie for decisions taken in response to Targeted Support. Under the regulatory framework for advice, advisors assume the risk for decisions they recommend, and there is a route for redress for consumers. Several stakeholders voice strong concerns there will be very limited provider liability and redress for customers who receive Targeted Support.

What types of decumulation decisions are most relevant for Targeted Support?

Stakeholders talk about the different types of decisions that savers must take on their decumulation journey, flagging the various decision points (at 55 when pensions freedoms kick in; at retirement; during retirement). At each point, savers will be faced with decisions about what route or pathway to go down; which options to take within that pathway; and which products to choose, and from which providers.

There are split views over which of these decisions Targeted Support might apply to. While most think there is a useful function in guiding the initial decisions about pathways and choice sets, several (particularly those in consumer interest roles) have more worries the closer this gets to suggestions of products. This raises concerns about cross-selling and customers being encouraged to stay with their incumbent provider, even if others may have more suitable products. On a market level, some worry about this stifling competition and reducing innovation as a result. There was further disagreement over whether Targeted Support could deal with decisions around annuitisation given that they are an irreversible decision (at the time of the research, annuities were excluded from the Targeted Support proposal).

Some stakeholders talked about the potential interaction of defaulted decumulation pathways with Targeted Support. Whilst considering defaults is outside the scope of this work, they thought it possible that Targeted Support could be used to explain to customers what decisions had been taken on their behalf, and to give them the option of opting out or making their own choices. Certainly it is possible that some consumers may be in the position of accessing Targeted Support whilst also having been already defaulted into a decumulation route for one or more of their pension pots.

Who should offer Targeted Support?

Some stakeholders feel that pension providers are the obvious choice to provide Targeted Support. They base this on the fact that many people already turn to their pension provider for information about accessing their pension and that, ultimately, consumers must communicate with their pension provider at this point. However, this raises concerns about impartiality, redress and access to – and handling of – consumer data.

Stakeholders, particularly those championing consumer interests, also raise questions relating to trust: as well as the concerns about pathway and product suggestions discussed above, they point to past misselling scandals and mistrust around annuities. They also wonder whether the provider would include other suggestions that don't benefit them and results in a customer moving providers. Many of the questions concern the operation of the Consumer Duty, and how well trustee boards discharge their fiduciary duties, as much as they concern Targeted Support.

Further complications arise where a customer holds multiple pension pots (as is the case for many): which provider should offer Targeted Support? Will they take the other pots into account in their suggestions?

Is the data good enough?

Several stakeholders suggest that, like AI generated 'robo-advice' (which uses questionnaires to gather data and form a picture of the consumer), Targeted Support is only as good as the information it uses. It isn't clear whether Targeted Support would rely solely on cohort level data or ask questions of the individual consumer accessing Targeted Support to make this more specific, albeit not entirely tailored at the level of the individual.

There are questions over how good cohort-based data can be for making suggestions to individuals. Will this mass-market approach be able to take into account a sufficient number of variables, particularly considering the ever-diversifying circumstances and needs of people approaching (and in) retirement? Whilst a lot can be inferred from data points that pension providers are likely to hold already (such as salary, age, and postcode), factors like investible assets held elsewhere, inheritance, marital status and home ownership could radically change the appropriateness of the suggestions Targeted Support is able to make. They also question how pension providers will take account of tax and benefit implications within Targeted Support.

What are the minimal consumer protections that need to be in place, and when/ for whom do we need to increase protections?

Some of the concerns around consumer protection have been raised above, and the potential harms span the result of decisions (sub-optimal or harmful consequences) to the actions of providers (e.g. companies who see it as a way of selling more product even if not in best interests of the consumer). This raises questions over what protections consumers want to see and how they should be delivered and communicated. The possible options include the design of the rules by the regulator(s); disclosures and disclaimers to customers; and systems of redress. Some stakeholders raise further questions over how customers with additional vulnerabilities (such as low financial literacy/numeracy skills) can be protected, although these questions can be asked more generally with regards to advice and the provision of generic information.

How should the role and limitations of Targeted Support be communicated to consumers?

A chief concern for many stakeholders is how well consumers can distinguish between suggestion and personalised recommendation. Many suggest that – while regulators make distinctions between different categories of 'help' – consumers do not, and may already act on guidance or information as though it were advice.

Several stakeholders believe that providers need to make it explicitly clear to consumers that suggestions offered through Targeted Support are based on assumptions that they belong to a particular cohort and that Targeted Support cannot provide options that are bespoke to them, and so the suggestions it makes might not be the right ones. However, many express doubts over the extent to which consumers pay attention to – and understand – disclosures and disclaimers.

How – if at all – would consumers pay for Targeted Support?

It is unclear at this stage how and if Targeted Support would be paid for. In a scenario where consumers seek out and pay for Targeted Support, stakeholders struggle to see how the regulatory framework for this would be different from advice. Fundamentally, there are questions about whether consumers will value Targeted Support sufficiently to pay for it and, if they do so, if they will then assume that is tantamount to advice.

What are the other options?

As mentioned, some stakeholders are not in favour of the idea of Targeted Support, or at least want the focus to be on doing within the existing scope of the regulatory framework. This includes making the most of recent developments such as the growing potential of AI; the introduction of the Consumer Duty; and clarification over the use of communication of 'service messages' (including alerting customers to risks with their pensions) to consumers[xv]. Some believe that government and regulators should focus instead on systems-based changes (such as defaulted decumulation pathways within regular DC schemes) to ensure that consumers avoid sub-optimal outcomes. In interviews with consumer interest organisations, some question whether financial services providers can be trusted to act in the best interests of consumers.

Involving consumers in the debate

The next steps are for a programme of engagement with consumers to begin in early 2025. This work aims to bring an informed consumer voice into the debate, enabling consumers to make a meaningful and essential contribution on Targeted Support, considering how this might work for them as individuals and for society at large.

We are establishing a Consumer Advisory Panel, working with deliberative research experts Community Research. The Panel will meet several times over the first half of 2025, gradually building their understanding and opinions on how to help consumers facing decumulation decisions. Panellists will be exposed to a wide range of perspectives to ensure they hear from all sides of the debate so they can reach informed opinions. The work will culminate in a public report, which aims to bring the consumer voice into this important discussion. We will be sharing our findings across the industry, with regulators, government and other interested parties and related sectors. If you want to find out how you can be involved in the project, please do not hesitate to contact Phoenix Insights.

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6. Nest
7. Nest Insight
8. PIMFA
9. Standard Life
10. Which?

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[iii] Financial Lives 2022: Key findings from the FCA's Financial Lives May 2022 survey, p.87
[iv] https://www.gov.uk/government/publications/planning-and-preparing-for-later-life/planning-and-preparing-for-later-life#appendix-1-additional-tables This survey looks at 40-75 year olds.
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