Independent Governance Committee ("IGC") of Standard Life Assurance Limited
January 2021 Report on the launch of Investment Pathways

Background

In July 2019 one of the industry regulators, the Financial Conduct Authority ("FCA"), set out new rules requiring firms such as Standard Life, which allow customers to enter 'drawdown' without taking advice, to introduce Investment Pathways. Drawdown is a means by which customers can take benefits from their pension pots in a way that suits them, for example:

- by taking money out gradually over time to provide an income;
- taking larger cash sums out over a shorter period;
- keeping money invested;
- or a combination of these options.

Investment Pathways were introduced by the FCA with the aim of improving the decision making of non-advised customers as they enter drawdown and to promote competition amongst pension providers. Investment Pathways provide four investment options which customers can select depending on their aims over the next 5 years.

The FCA also extended the remit of IGCs, which had previously been established to review the value for money received by members of contract based workplace pension schemes, to assess the value for money of Investment Pathways. This included a requirement for IGCs to make that assessment before Investment Pathways are offered to customers.

Investment Pathways were intended to be introduced from 1 August 2020 but due to the Covid-19 pandemic this was deferred until 1 February 2021. The purpose of this report is to summarise our initial assessment of the Investment Pathways to be introduced by Standard Life.

We have reviewed the design, planned implementation and clarity of Standard Life's Investment Pathways proposition and consider it to represent reasonable value for money at this time. Our overall view is that Standard Life has been concerned, in all its development of the Investment Pathway process and the Pathway Investment Funds, with enabling customers to make an appropriate choice for them and achieve a good outcome from whichever Pathway Investment Fund they enter. Our focus is on ensuring that customers receive both value for money and good outcomes, and we will set out our findings on this in our annual reports going forward.

Views expressed in this report are the IGC's own and should not be taken as advice or guidance.

Standard Life Investment Pathways

As soon as customers start to access their pension pot, Standard Life has to offer non-advised customers four different Investment Pathway options for the investment of their remaining funds. The four options depend on how they intend to use their remaining pension pot over the next five years and determine which Pathway Investment Fund they enter as follows:

Option 1	I have no plans to touch my money in the next 5 years	Pathway Investment Fund 1

Option 2	I plan to use my money to set up a guaranteed income (annuity) within the next 5 years	Pathway Investment Fund 2
Option 3	I plan to start taking my money as a long-term income within the next 5 years	Pathway Investment Fund 3
Option 4	I plan to take out all my money within the next 5 years	Pathway Investment Fund 4

Each Pathway Investment Fund has been designed by Standard Life to reflect the respective uses, but the IGC recognises that four options cannot cover the intentions of every customer. Customers who do not wish to take regulated financial advice will need to consider carefully whether any of the options offered sufficiently matches their future intentions.

Because of this, Standard Life also allows customers to make their own choice of where to invest their remaining pot, through their 'let me do it' option, rather than through Investment Pathways. Whilst the 'let me do it' option is outside of our formal remit, we have raised certain concerns about the lack of support for customers taking this option as set out below.

The Basis of Our Assessment

We have had ongoing discussions with Standard Life over many months as it has been developing its Investment Pathways. We believe these discussions have led to greater clarity in the digital journey and other communications, improvements in charges applied and therefore an increase in the value for money customers can expect. We set out below our approach to this review and our findings.

Our assessment of Standard Life's proposed Investment Pathways has been based on the following key questions:

Q1. When a customer uses the digital facilities, phone calls or correspondence to start accessing their pension pot, has the 'journey' that the customer has to take been designed to be as clear and straightforward as possible, so that the customer is enabled to choose the appropriate Pathway Investment Fund?

Q2. Are the risk and return characteristics of each of the Pathway Investment Funds designed in the interests of the customers who have selected them, and are the objectives of each Pathway Investment Fund clear?

Q3. Can the costs and charges made on Standard Life Investment Pathways be expected to provide value for money – and how do they compare to other alternatives in the market?

Q4. Are all communications to customers 'fit for purpose' – clear and understandable, including in explaining the relevance and purpose of the communication?

Q5. Are the arrangements made for ongoing service, communications and investment management of the Pathway Investment Funds expected to contribute to value for money and offer the prospect of good outcomes for customers?

We know that, for some years, Standard Life has been offering its pension customers the ability to withdraw some of their cash and to move into drawdown products. It has carried out extensive research amongst over 50,000 of these drawdown customers. This research has been disclosed to the IGC and considered, together with the results of our other enquiries, to assess the answers to our questions. The findings on each of our questions are set out as follows.

Q1. When a customer uses the digital facilities, phone calls or correspondence to start accessing their pension pot, has the 'journey' that the customer has to take been designed to be as clear and straightforward as possible, so that the customer is enabled to choose the appropriate Pathway Investment Fund?

Our conclusion is, generally, 'yes'. Standard Life has used ongoing customer research to design the digital and telephone journeys that customers go through. Research has also been used to design all correspondence. This research and design approach seeks to ensure that customers are appropriately guided and informed.

The IGC has been taken through the digital journey, listened to some calls with customers who started the process of taking some cash from their pension pot, and reviewed some of the communications that customers will receive.

Current experience is that some 60% of customers go through the digital process and we believe it has been well designed. Telephone support and paper communications are also available to guide and help customers.

Telephone support is provided by well-qualified Standard Life Retirement Consultants who have been trained to deal with calls regarding Investment Pathways as part of their training and competence framework. These members of staff are aware that this may be a key life stage for customers, some of whom may be vulnerable, with a lack of financial understanding, and have received training to offer particular help to such customers. As part of its assessment of value for money for workplace pensions within our scope, the IGC has previously considered the way in which Standard Life has carried out training of staff to help vulnerable customers.

Communications regarding Investment Pathways have been prepared by Standard Life in accordance with a 'Fit for Purpose' protocol which we have agreed with them.

Following the launch of Investment Pathways, Standard Life will be monitoring all aspects and providing information to the IGC to enable us to check that customers find the Investment Pathway journey works for them.

Q2. Are the risk and return characteristics of each of the Pathway Investment Funds designed in the interests of the customers who have selected them, and are the objectives of each Pathway Investment Fund clear?

We believe that the risk and return characteristics of the Pathway Investment Funds have generally been designed in the interests of customers who will have selected one of the four Investment Pathways. However, the limitation of offering a customer only one fund for each Investment Pathway, as required by the rules set out by the FCA, means that even if each Pathway Investment Fund is suitable for those who select the corresponding Investment Pathway option, it may not be optimal in meeting the individual aims and objectives of every customer who might select it. This is a consequence of requiring the four options to be designed in a way to suit a large range of customers. In our comments on each Pathway Investment Fund below, we set out some of our reasons for qualifying our positive responses.

We also note that the Pathway Investment Funds proposed do not as yet have any particular ESG features, but understand that they are covered by the strategic approach that Phoenix expect to roll out over the coming months.

<table>
<tr><td>Option 1</td><td>I have no plans to touch my money in the next 5 years</td><td>Pathway Investment Fund 1</td></tr>
<tr><td colspan="3">
This fund seeks to achieve longer term growth in the value of the customer’s pension pot ahead of inflation, whilst protecting against substantial falls in value. This growth objective is supported by investing more than half of the pot in stock markets and most of the rest in bonds. There is a necessary trade-off here between reducing the risk of falls in value, and the risk of not maintaining the real value of the pension pot after inflation.
Customers who plan to use their Standard Life pension pot alongside other sources of income in retirement, or customers who have no future plans to access this pot even over a much longer time horizon than 5 years, may wish to consider taking more investment risk, recognising the likely fluctuations in value. This is a ‘risk versus reward’ balance that customers need to consider. There is the option of ‘let me do it’ for such customers (see below).
Our conclusion: The risk and return characteristics of this fund have been designed in the interests of most of the customers who are likely to select it, but will not be optimal for all.
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<tr><td>Option 2</td><td>I plan to use my money to set up a guaranteed income (annuity) within the next 5 years</td><td>Pathway Investment Fund 2</td></tr>
<tr><td colspan="3">
The costs of buying a guaranteed income (known as an annuity) generally depend on the market pricing of longer dated bonds. This fund has been designed to reduce the impact of changes in market pricing on the amount of the annuity that may be bought in future. When interest rates go down, the cost of buying an annuity goes up, but the value of the fund should go up to offset, at least partially, this increase in cost. On the other hand, if interest rates go up, fund values are likely to fall but the cost of buying an annuity will also have gone down.
Those planning to buy a guaranteed income at some stage in the next 5 years should be reasonably protected by this fund against the risks of changes in costs of buying such an income. However, if customers change their mind and start withdrawing funds instead, their annuity purchase cannot be protected, and if annuity purchase is no longer their aim this fund would no longer be appropriate.
Our conclusion: The risk and return characteristics of this fund have been designed in the interests of customers who have the specific objective of using the whole of their remaining fund to buy a guaranteed income within the 5 year time horizon.
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<tr><td>Option 3</td><td>I plan to start taking my money as a long-term income within the next 5 years</td><td>Pathway Investment Fund 3</td></tr>
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This fund has a lower proportion of the customer’s pension pot invested in stock markets than for the fund in Option 1 i.e. less than half, as it seeks greater stability and lower fluctuations in value, to reduce the potential impact of the timing of customer withdrawals. However, aiming to protect the fund against significant changes in value may limit the growth opportunity of the customer’s pension pot.
Our conclusion: The risk and return characteristics of this fund have been designed in the interests of customers who are willing to take some risk on the value of their pension pot in order to seek protection against inflation, but who also expect to start drawing on it in the next five years.
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Option 4	I plan to take out all my money within the next 5 years	Pathway Investment Fund 4

This fund is designed to meet the aims of customers entering this pathway by limiting likely fluctuations in value by investing in cash deposits and short-term bonds. It is suitable for customers fully expecting to take out all of their remaining pension pot within the 5 years. However, with interest rates at their current very low level, there is a risk that, after charges, the money invested in this fund will grow very slowly, and may even decrease.

Our conclusion: The risk and return characteristics of this fund have been designed in the interests of those customers planning to take all the money out of their pension pot within the next 5 years.

The 'Let me do it' Option

The Investment Pathway approach introduced by the FCA has placed constraints on the options that can be offered to non-advised customers when they wish to withdraw any cash from their pension pot. Customers should seek advice if they are unsure what to do, but many do not. If customers conclude that none of the four Investment Pathway options sufficiently meet their needs, they can take the 'Let me do it' option and choose their own funds for their remaining pot. Whilst this option is not within our formal scope, we have raised with Standard Life that we do not currently consider that the journey using the on-line facilities for this 'let me do it' route is sufficiently easy to navigate; for the majority of customers, this option currently presents a potentially bewildering range of funds from which to choose.

Standard Life intends to improve the process for those who decide to take this option in 2021. The IGC will monitor progress in this respect, although it is not strictly within our scope as these will not be Investment Pathways customers.

Q3. Can the costs and charges made on Standard Life Investment Pathways be expected to provide value for money – and how do they compare to other alternatives in the market?

<u>What Charges will Apply?</u>

The costs and charges made on a Standard Life Investment Pathway depend on a number of factors, including the size of the customer's pension pot and where the money transferred into the Investment Pathway originated. The level of charge does not vary according to which pathway option is selected.

- During the development of Investment Pathways, we have challenged the maximum charge that will be applied and are pleased that this will be set at a maximum of 0.75% of the size of the pot per annum.
- Someone with a larger pot with Standard Life may be charged less (as a percentage of the pot) than this, with lower charges applying where the pot is larger than £250,000.
- If the pot being moved into an Investment Pathway is part of an employer's pension arrangement run by Standard Life, the employer may have negotiated lower charges ("scheme discounts") for their employees. We are pleased that Standard Life has confirmed that the charge will remain unchanged after moving into the chosen Pathway Fund, such that those customers will continue to benefit from any scheme discount.

<u>Alternatives in the Market</u>

At this stage only a small number of providers have launched their own Investment Pathway products, so a full assessment of alternatives is not yet possible. We have, however, been provided with details of charges applied by some other firms and seen that a number are applying charges lower than 0.75% per annum. It is not clear at this early stage whether those other providers are representative of what will become the wider market, or whether the comparisons are on a 'like for like' basis. We have also noted that a number of providers apply different levels of charges depending on which pathway option is selected -Standard Life does not do this. Importantly, and as explained above, many customers of Standard Life Investment Pathways will actually pay a lower charge due to scheme discounts continuing to be applied.

In addition to the charges on each Pathway Investment Fund described above, there are costs incurred when individual investments are bought and sold. Transaction costs have been tracked over the past year for funds related to the Pathway Investment Funds developed by Standard Life. We have considered the likely level of transaction costs, expect these to be reasonable and have been assured that no substantial changes to the level of transaction costs are expected going forward.

Conclusion

Overall we believe that the charges on Standard Life's Pathway Investment Funds can be considered to provide reasonable value for money. This is not to say no customers could potentially find another provider in the market and pay lower charges but:

- charges are set at a maximum of 0.75% per annum and may be lower if the customer moves from an employer's pension arrangement which includes a scheme discount or has a larger pot; and
- overall value for money depends not only on charges, but also on future investment performance (how the fund grows over time) and the customer service and communications received, such as the telephone guidance Standard Life offers to help customers through the process.

When moving into an Investment Pathway, customers should consider carefully what charge will apply to them, allowing for any employer scheme discount, and whether they could achieve a lower charge by moving to an investment pathway offered by another provider. Customers may find the Money Advice Service comparison tool helpful (when available) in comparing their individual charges with those available elsewhere.

We will monitor product charges in the market as part of our ongoing review of overall value for money within our annual report.

Q4. Are all communications to customers 'fit for purpose' – clear and understandable, including in explaining the relevance and purpose of the communication?

Standard Life has agreed with us a 'fit for purpose' protocol that will be applied before, during and on completion of the design and content of all communications with customers within our scope. This protocol includes testing with customers their understanding and the relevance of the communication. We have reviewed and considered the Investment Pathway communications to be used at launch when customers first enter Investment Pathways and subsequently. Our goal is to ensure that all communications are clear and understandable, meet their intended purpose. and take into account the characteristics, needs and objectives of the relevant customers. As communications for Investment Pathways are further developed, we will scrutinise these in the light of the protocol to ensure that we can continue to affirm that communications with customers are fit for purpose. We welcome and will review any feedback from customers on communications issued by Standard Life. We have asked for ongoing research and feedback to be obtained so that we can ensure conformity with our 'fit for purpose' protocol.

Our conclusion is that the Investment Pathway communications developed for launch are 'fit for purpose' and do set out the relevant information clearly and understandably, as well as explaining their purpose.

Q5. Are the arrangements made for ongoing service, communications and investment management of the Pathway Investment Funds expected to contribute to value for money and offer the prospect of good outcomes for customers?

Standard Life already manages the funds of customers who use drawdown products. We have looked at the services provided to them, and the additional arrangements being introduced for Investment Pathway customers.

We have looked specifically at:

- the annual statements that will be sent to Investment Pathways customers; and
- communications designed to be sent to Investment Pathway customers who take actions in future that do not seem to be consistent with the aims of the particular Investment Pathway that they have chosen. As an example, it would be unexpected for a customer who has selected Option 1 (which is designed for someone who has no plans to touch their money within 5 years) to start making withdrawals of money after one or two years. This may indicate that the customer made the wrong choice or that their circumstances or plans have changed, such that the customer may need to consider moving to another fund. Communications to customers in these circumstances are vital to help customers make sure that they do not continue in an inappropriate fund.

We consider that the content and presentation of these communications is appropriate and that there are satisfactory arrangements in place to ensure that communications remain so.

We are satisfied that the Investment Funds are subject to the same investment governance as existing workplace funds. We will continue to monitor how well the Investment Pathway Funds perform and whether they achieve their aims and objectives. In addition, we will monitor the ongoing charges and costs to ensure VFM.

Our conclusion is that the arrangements made are expected to contribute to value for money and offer the prospect of good outcomes for customers.

Overall Conclusion

We have reviewed the design, planned implementation and clarity of Standard Life's Investment Pathways proposition and consider it to represent reasonable value for money at this time. During the course of 2021, we will continue to monitor the value for money and outcomes achieved. Our overall view is that Standard Life has been concerned, in all its development of the Investment Pathway process and the Pathway Investment Funds, with enabling customers to make an appropriate choice for them and achieve a good outcome from whichever Pathway Investment Fund they enter.

We are aware that there are a number of areas where further improvements are to be implemented – for example, in the 'let me do it' option explained above. We will monitor the delivery of these improvements, and the performance of the Standard Life Pathway Investment Funds. Where we have concerns in any of the areas referred to above, we will raise these with Standard Life and ask for them to be addressed. Our focus is on ensuring that customers receive both value for money and good outcomes, and we will set out our findings on this in our annual reports going forward.

The IGC would like to record its thanks to the many Standard Life colleagues who have helped the IGC in its review of the whole Investment Pathways project over the course of the past months.