Work & Pensions Committee Call for Evidence:
Protecting pension savers – five years on from the pension freedoms: Saving for later life

1. Do households in the UK have adequate pension savings for retirement?

Based on where we are today, most households do not have adequate pension savings for retirement and importantly, many will not realise this fact until it is too late to rectify.

It is important to consider how the pension landscape has changed in recent decades with Defined Contribution (DC) overtaking Defined Benefit (DB) as the dominant scheme type within the private sector in recent decades. Whilst current retirees may hold DC wealth, many will also hold DB wealth which is significantly higher. If we look at recent ONS statistics, the difference in pot sizes are vast. The median combined DB and DC pension wealth for someone approaching retirement is £91,200. This is heavily skewed by DB which has an isolated median of £181,000 compared to DC of £28,500.

As accrued DB wealth continues to decline in the private sector, we can expect the combined median to reduce as the ongoing reduction in DB will not be adequately offset by increased DC wealth. This can be clearly evidenced through the difference in contribution rates – DB has an average contribution of 25.6% (19.2% employer/6.4% employee) with DC significantly lower with an average of 5.1% (2.4% employer/2.7%employee). The real test for Auto Enrolment (AE) will be when those who first come to retire with pension wealth solely accrued since 2012. There will be more than one measure of success, however this broadly comes down to whether the pot size is appropriate for expected retirement outcomes and if not, whether the individual is aware of any shortfall and has had sufficient time to mitigate it if they want and are able to.

Generation X are often considered as the cohort which sits in between the shift from DB to DC and potentially the hardest hit, with many not having any DB wealth combined with AE not starting until they are already well into their working lives.

To put pot size and retirement outcomes into perspective, the updated PLSA Living Standards indicate a couple seeking a 'moderate' retirement need a pension pot of circa £133,000 each as well as full entitlements to the basic state pension. This would provide a total combined household annual income (based on 2 x single life, level annuities plus 2 x full basic state pension) of £30,600 per annum. If the annuity was to provide inflation protection, then the pot size would need to be significantly more. If we consider the current pension wealth of those retiring which is boosted by DB, the average pot falls considerably short of even reaching the £133,000 required for a non-inflation linked annuity. Furthermore, this pot size assumes the home is fully owned (mortgage free) and is after tax free cash is taken – tax free cash is often seen as a windfall (perhaps as the name suggests) and is often used to fund big ticket purchases but is not often used in its entirety to supplement retirement income. Mortgage and rental costs will also significantly increase retirement expenditure and is becoming more prevalent for all age groups.

We do, however, need to consider retirement provision from a more holistic perspective. The UK pensions system currently comprises 3 pillars – basic state pension, occupational schemes and private/individual pension savings. All these need to be considered when we review any aspect of the pension framework. Furthermore, any future pillar(s) change cannot be made in isolation and must consider the impact this has on total pension provision.

We also need to be mindful that retirement provision is broader than pension savings alone. Total wealth needs to be considered, which will include Savings and Investments such as ISAs, bank accounts, other investment vehicles and housing equity.

2. Are changes needed to auto-enrolment to provide an adequate level of pension savings for retirement?

Implementing the 2017 AE proposals – removing the lower earnings limit and reducing the minimum age to 18 are a good starting point. The TISA retirement paper 'Getting Retirement Right' models various scenarios and shows a contribution rate of 12% of whole salary will help households achieve a 'moderate' retirement in certain circumstances – commencing increases on an incremental basis in 2027 and finishing in 2032. We recognise minimum contributions can only be increased to a certain limit and the onus must then be placed on individuals to meet potential shortfalls.

Given the recent increase in part-time employment as we emerge from the pandemic, we should consider whether AE provision is needed for multiple jobholders earning in total over the earnings trigger.

The AE framework needs to recognise that for some lower earning individuals and households, earnings need to be focused on meeting everyday household expenditure and, where possible, trying to pay down any personal debt accrued, such as personal loans, overdrafts and credit cards. For some, however, this will not be possible and debt needs to be relied on or even increased. The current framework means if they opt out, they lose the benefit of the employer contribution, despite it potentially providing a greater benefit for this group than any other.

Looking at the economic landscape, we have the introduction of the Social Care levy in 2022/23, inflation is at its highest rate for 30 years and energy costs are likely to rise significantly from April 2022. The increasing cost of living crisis must be a factor when we consider changes to AE.

The interaction of state benefits and personal wealth needs careful consideration and review to ensure we are not in a situation where saving for your retirement could have a detrimental impact on outcomes. However, the reality is that, for some low-paid households, a small amount of savings wealth could remove or reduce the entitlement to an even higher level of state benefits.

3. What advice and guidance do people need when saving for retirement?

Around 8% of adults receive regulated financial advice. We should not need to consider any further requirements for this group, but we should be considering how we increase the take-up. There is a recognised shortage of regulated advisers, with this expected to increase in the coming years. An increase in numbers would increase accessibility and potentially drive down the cost, which is perceived as too expensive by many.

TISA 2021 research reveals that millions of people in the UK would benefit from a much wider range of support services to make informed choices about their savings and investments. But that support would need to be personalised for the industry to have any real chance of achieving meaningful engagement with consumers. The financial services industry is currently restricted from utilising the personal circumstances of a consumer when issuing financial guidance, whether that be an alert, prompt, nudge or the provision of information deemed most useful. This means consumers, particularly those occupying the UK's "Advice Gap" are missing out on well needed engagement.

Not only does industry want to solve this problem for consumers, but there is also strong interest amongst consumers for their product providers, banks and building societies to make better use of their data – whether it be data the consumer were to input via a tool or the data that the product provider knows about them already. Consumers welcome the idea of their data being used, especially to make better savings and investments decisions quicker and easier for them.
Consumers would like more personalisation and they have sufficient trust in their product providers to make the best use of technology and data. These are findings that we have uncovered from our latest research.

Consumers need guidance much earlier in the retirement journey. The earlier they start saving the more their money will work for them and the less they will need to save each month. For many, realisation of pension shortfalls come too late to be able to significantly change outcomes – MaPS does not currently support guidance for this cohort.

Support can and does come from some employers, who can use the workplace forum as an opportunity to educate their workforce on some important saving principles, such as the benefit of compound interest. Whilst support varies significantly across employers, typically based on size and sector, all employers have an opportunity to help their workforce in some way. This could be as simple as prompting employees to consider the level of their pension contributions during pay review periods.

We do have Pension Dashboards on the horizon in 2023 that are being heralded as a game changer in enabling individuals to engage with their pensions. It has great potential and if implemented in the right way, will provide a significant part in boosting engagement. It is not the holy grail and people will still need to be engaged to use it, but with an increasing consumer demand for digital savings engagement, this is a positive step in the right direction.

Providers are enhancing their propositions and offering some excellent online consumer journeys providing tools to enable members to create 'what if' scenarios and goal setting to understand outcomes. With the average regular pension withdrawal in 2020/21 for all age groups up to pot sizes of £249,000 being 8% or more and a significant proportion not receiving advice or accessing Pension Wise guidance, it is critical that consumers are provided with the tools to help understand the impact that withdrawal decisions will have on later retirement, especially considering long-term care might be required.

4. Could retirement income targets help savers plan for retirement?

For the engaged individual, targets will help if:

- The target can be made relevant to the individual in terms of the type of retirement lifestyle it can provide. The PLSA Retirement Living Standards have been widely adopted and could be used to compliment personalised guidance.

- This is accompanied with details of what the target translates into in terms of pot size, scenarios to help understand the contribution levels required and details of typical life events that could impact on reaching that target from a household perspective, such as raising a family and caring responsibilities. Individuals and households could then benchmark themselves against this to determine if they broadly on track to meet their own expectations.

Targets are not likely to be of significant benefit when used in isolation but do help form part of the broader support framework that is required.

5. Apart from increasing contributions, how can the Government improve outcomes for savers?

We need to increase general awareness and knowledge so for instance, individuals understand the benefits of compound interest and what sort of retirement outcomes they can expect based on their existing trajectory.

A key barrier to engagement is that pensions are too complicated for most people to understand. An effective UK pension system which promotes engagement and trust needs to be built on the principle of simplicity.

Despite an A-Day overhaul in April 2006, the industry have been subject to a continuous raft of change including an ongoing reduction in tax allowances, different tax thresholds being introduced for different groups, various changes to consumer decumulation journeys and increasingly complex transitional protection regimes (whilst older style protections which are no longer appropriate for today's pensions landscape remain in place which restrict consumer choice).

The proposed increase in the NMPA is a good example of where what appears to be a relatively straightforward change, has resulted in a complicated set of proposals which consumers will not understand.

We recognise that change is inevitable given the ever-changing landscape, however, whatever the reason for change, we need this to adhere to the fundamental principle of simplicity.

In 1997, interest rate decisions were depoliticised when responsibility was handed to the Bank of England. Although an independent Savings Commission is not a new idea, we would suggest this is given further consideration with a view to bringing more stability to the pensions system, increasing consumer trust, understanding and engagement, and enabling industry to focus on enhancing consumer outcomes through the products and services offered.

Pension savings are currently restricted through two allowances – the Annual Allowance (AA) and the Lifetime Allowance (LTA). Notwithstanding the complexities created through the various annual allowances which exist, it is not appropriate or fair to have a cap applied in two scenarios. The LTA essentially penalises investment growth and the current limit would purchase an annual annuity income of approximately £28,000 (RPI linked, single life, 5-year guarantee) – perhaps not as high as you might expect. Conversely, a Defined Benefit fund could purchase an index linked scheme pension of over £50,000 per annum before breaching the LTA. There is a clear discrepancy which requires a review.

A potential alternative to the LTA and AA is to introduce a contribution allowance which places a lifetime cap on the total contributions that can be made. This would encourage earlier contributions where possible, enabling the pension pot to increase faster through greater exposure to compound interest.

6. Can pension providers change the design of pension products to improve outcomes for savers?

There have been and continue to be some products on the market which combine Drawdown and Annuity enabling consumers to receive an income on a blended basis. However, many of these have not been popular in the past, largely due to the complicated nature of the product and the associated cost. Typically, these are only permitted to be sold through a regulated adviser due to their complexity.

From a consumer needs perspective, consumers need the ability for flexibility and the certainty of guaranteed income. Both options exist today in the form of Flexi-Access Drawdown and Lifetime Annuity and most consumers will need a combination of both. The risks that consumers are exposed to include where to invest Drawdown funds, how much to Drawdown per year, when is the right time to shore up income through Annuity purchase and how much should be annuitised. Retirement is often seen as a stage of two halves, where lifestyle, priorities and expenditure changes and often, it is around this transition where a review is required and decisions need to be made. However, it is difficult for individuals who are in their retirement to know or realise when they start to make this transition and as cognitive abilities perhaps also decline, decision making becomes more challenging or doesn't happen at all.

Government needs to ensure that retirees receive the appropriate guidance and support all the way through their retirement. For many currently, decision making doesn't start until retirement is approaching but it is needed throughout the whole journey. The mid-life MOT is being trialled however we should also be considering a later-life MOT alongside additional support initiatives for retirees.

7. What should the Government be doing to support self-employed people to save for retirement?

We are aware that DWP have established a working group which is looking into the challenges and opportunities for the self-employed in terms of long-term savings.

In the absence of an employer contribution, an incentive needs to be considered. AE has been a success to date and whilst the inertia approach has been effective at enrolling employees, opt out rates have been low largely due to the presence of an employer contribution. If we consider Stakeholder, this performed poorly largely due to the absence of a mandated employer contribution. Some form of top-up, over and above tax relief will be required for it to be perceived as financially worthwhile for this group.

The tax-return is a potential mechanism to bring this group into an AE styled pension framework. Enrolment and contributions could be triggered through this process without extra work being required from individuals.

Regular income cannot be guaranteed and when received, may need to be invested back into the business. Locking money away until normal minimum pension age will understandably not be a priority for this group. We support initiatives such as the sidecar which encourages saving, whilst retaining some flexibility to access.

The age limit of 40 for opening a Lifetime ISA limits the opportunity of consumers using these as a retirement vehicle, which is especially relevant for the self-employed. We propose that Lifetime ISA age requirements should be simplified to allow both openings and subscriptions up to the age of 55. This would also ensure no disadvantage to consumers over age 40 who have closed their Lifetime ISA (e.g. following a house purchase) who later wish to save in one for their retirement.

8. Are different or additional measures required to help gig economy workers save for retirement.

There remains confusion over what the definition of 'worker' is within this cohort, what their employment status is and what benefits this entitles them to. The recent Uber court ruling has not provided certainty in this regard.

Many gig economy workers are on 'zero-hour contracts' meaning a regular guaranteed income stream cannot be relied upon. Similar to the self-employed, flexibility is needed for this group.

For those whose working status brings them into potential AE eligibility, we also need to consider whether enrolment is needed for multiple jobholders, earning in total over the earnings trigger.

9. Are there measures which the Government should consider to close the gender pension gap?

A fundamental reason behind the gender pension gap is pay - according to recent statistics, average earnings for a male full-time employee are over 15% higher than their female counterpart. The difference increases for high earners. Whilst this is being addressed and improvements have been made, there is still more work to do.

Whilst improvements have been made to reduce gender inequality, it remains women who typically take time out to raise families and take on caring responsibilities. These life events significantly impact on the ability to save into a pension. This group should not be penalised for doing the right thing by their families. Aside from increased government support, we need to consider other ways to boost pension savings such as:

- Increase flexibility in the AE framework to recognise this cohort
- Increase awareness of the £3,600 contribution allowance i.e. working partner could contribute to non-working partner's pension if financial situation allows