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Protecting pension savers – five years on from the Pension Freedoms: Saving for later life

I am writing on behalf of the Association of Consulting Actuaries in response to the above-named consultation issued by the Work and Pensions Committee.

Our key points are:

- Whilst automatic enrolment (AE) has been successful in significantly increasing pension participation, we are concerned this has created a false sense of security amongst many savers, who may be surprised to reach retirement with inadequate levels of savings.

- This could be especially problematic for younger savers, for whom competing savings needs (such as student loan repayments, saving for housing deposits, and increased "resilience" needs as a result of the pandemic) mean it could become increasingly difficult to build up retirement wealth over time.

- In addition to improving education, we repeat our suggestion to increase minimum AE contribution rates to 10% and that the earnings threshold (which currently stops millions being signed up for AE) should be reduced or removed.

- However, given the current climate we suggest that changes to AE requirements should be accompanied by additional flexibility, e.g. to access pensions early in some circumstances, which may have been helpful to many employees during the pandemic.

We trust that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. In that event, please contact me on 077850907425 or at steven.taylor@lcp.uk.com.

Yours sincerely

Steven Taylor
ACA Honorary Secretary
On behalf of the Association of Consulting Actuaries Limited

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

- Individuals' savings in retirement are made up of a combination of resources, which in addition to state pensions could include defined benefit pensions, defined contribution pensions, as well as property and other sources of wealth.

- For recent retirees, a key driver of adequate savings was likely to be access to defined benefit pension schemes (even where individuals had stopped accruing benefits – membership in legacy schemes for limited periods has still provided a good base for many), where annual combined employer and employee contributions often well exceed 30% of salaries. However, for current workers these types of pension arrangement are now increasingly limited to the public sector.

- Within the private sector it is most common for workers to be provided with a defined contribution scheme, however median total employer and employee contributions to these arrangements remain worryingly low at around 11% of salaries (according to ACA's 2021 Pension Trends Survey), with a large proportion contributing at the automatic enrolment minimum level of 8% (of "qualifying earnings"). For workers in the "gig" economy, or on very low earnings, the proportion of salaries being saved are likely to be lower still. The self-employed are another area of concern.

- ACA's previous research suggested that, when State Pension is included, employees on median earnings might need to save an average of 16% of salaries throughout their lifetime to achieve an overall income in retirement of around 60% of their pre-retirement earnings (and assuming they work all the way until State Pension Age). Given this, we believe there is a risk that large portions of current employees are unlikely to be saving sufficient amounts to enjoy the living standards in retirement that they would consider adequate. This is likely to be especially true for retirees who are not homeowners and so may have significant housing costs in retirement.

- Further, for the younger generation of employees, competing savings needs (such as student loan repayments, saving for housing deposits, and increased "resilience" needs as a result of the pandemic) mean it is increasingly difficult to build up retirement wealth from an early age. This means that based on current pensions trends, the challenges of building up adequate savings appear likely to increase over time.

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

- The present contribution level of 8% of qualifying earnings equates to closer to 4% of total earnings for those on low incomes and is likely to be inadequate for many savers.

- ACA's previous research suggested that even for employees on median earnings, when State Pension is included, workers who contribute at the automatic enrolment minimum level, might achieve a replacement ratio of around 40% of pre-retirement earnings.

- Whilst this may be adequate for some savers, for many it will not be, especially if they have significant housing costs in retirement.

- Whilst AE has undoubtably been a success in expanding coverage levels, at present we believe many employees do not receive sufficient guidance during their working lifetimes (or enter the workplace with enough financial knowledge) to calibrate their contributions to a level that would be sufficient to meet their expectations in retirement. Given this we believe there is a risk that many current savers will “sleepwalk” into inadequate pension provision, having worked under the false sense of security that they are “in a pension” and therefore will be provided for in retirement.

- One option is therefore to mandate an increase to automatic enrolment levels and we have previously suggested minimum AE contributions should increase to 10% or 12% of total earnings by the end of the Parliament with costs shared between employers and employees.

- We have also suggested that the earnings threshold (which currently stops millions being signed up for AE) should be reduced or removed and AE should be adapted to include the growing number of self-employed and those engaged in the ‘gig economy’.

- However, given the current climate and competing savings needs, we note that requiring higher contributions in the short term is likely to put strain on many savers. Given this, we suggest that changes to AE requirements should be accompanied by additional flexibility, e.g. to access pensions early in some circumstances, for example, as may have been helpful to many employees during the pandemic.

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

- At present, retirement savings advice is often focused on “at retirement” decision making, rather than in the accumulation phase. However, if savers are to make informed decisions about the levels of contributions they need to make to target a certain income level in retirement, it is important they receive regular guidance during the accumulation phase.

- This guidance should also cover areas such as the pension tax regime, which ACA’s research suggests is also poorly understood (with 90% of survey respondents saying the current system is “too complicated”) as well as other savings vehicles, such as ISAs.

- We would suggest this engagement begins early in an individual’s working lifetime, potentially with key touch points, for example every 10 years, and also ramping up significantly several years before retirement, aligning with The Pensions Regulator’s pensions consumer journey work.

- This programme should be designed so as to enable individuals to make important and timely decisions in the accumulation stage (for example around savings levels and fund choices) as well as helping individuals to be more engaged and informed by the time they reach the point of “at retirement” decision making.

- Our view is that multi-layered support, using consistent language and touchpoints, from employers, the Government, and pension scheme providers, is necessary in order to maximise the chance of cutting through to individuals.

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

- Yes, we believe that retirement income targets, such as those developed by the PLSA, could be a helpful part of guidance during the accumulation phase. In particular, savers should be helped to assess their likely income needs in retirement based on a range of individual factors such as housing costs.

- We suggest that such planning tools should also include improving understanding of the possible impact of inflation on spending power in retirement, especially in the current environment.

- We would hope that access over time to pensions dashboards will help facilitate these and other potential forms of planning tools that enable savers to make positive decisions during accumulation and that are likely to improve outcomes.

- Our member firms advising trustee bodies and sponsors also find that retirement income targets can help these bodies with designing benefit structures and communications strategies in order to improve the overall retirement readiness of their scheme members.

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

- As noted above, given the challenges of competing savings needs we believe that to facilitate build up of adequate savings in retirement, there is now an urgent need for increased flexibility in the way people save for retirement, for example by extending pension freedoms to younger savers (subject to appropriate and robust safeguards and incentives) to promote both resilience and intergenerational fairness. This may also remove a psychological barrier to saving from some who fear pension saving is "locking away" money.

- A wider theme of ACA's recent research is around intergenerational fairness and in particular the idea that it is increasingly difficult to view elements of the pensions system in isolation.

- For example, the ability of today's savers to build adequate retirement resources is also constrained by the wider tax system (including for example upcoming NI rises to pay for social care), student loan repayment costs, other savings needs (such as building up housing deposits), "resilience" needs (which have risen significantly as a result of the pandemic) as well as other living costs (which are rapidly rising due to inflation). The means that helping current and future generations make adequate savings for retirement requires a joined up policy approach.

- For example, ACA has identified that it would be desirable to increase levels of AE contributions up to 10% or 12% to ensure future generations save enough for their retirement, however we recognise that this would impose other constraints.

- A clearer and simpler system of pension taxation for defined contribution schemes (in which most young people save), combined with additional education at younger ages could be an important element of this.

- However it is also important that this and other public policy measure are supportive of these challenges, for example by potentially allowing greater flexibility to draw down retirement savings if needed for other reasons. This also might be consistent with allowing greater flexibilities for older retirees to access pension lump sums without having to then go into drawdown.

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

- For the majority of current savers, who are in defined contribution schemes, "at retirement" decisions will be extremely important. In recent years savers have increasingly embraced "drawdown" options rather than annuitisation, so as to better shape incomes to meet their needs. However, the decision to enter into drawdown creates a continued need to manage retirement funds and calibrate withdrawal rates, which becomes increasingly onerous as retirees age. There is also a risk that behavioural factors lead retirees to over (or under) utilise retirement resources, resulting in overall poor outcomes.

- Drawdown products are themselves complex and diverse across providers, with a wide range of fee levels, service offerings, and investment performance. We continue to believe that whilst the governance and quality of pre-retirement pension scheme vehicles has been improved to a high standard, decumulation vehicles remain a mixed bag that only the most informed (or well-advised) savers are able to navigate.

- To mitigate these risks we suggest greater focus is given to the range of drawdown options in retirement, especially focusing on mechanisms that might ease the burdens on retirees at older ages

- Developments in collective defined contribution schemes, have potential over time to offer a further decumulation option (in addition to annuitisation and drawdown). A key advantage of such vehicles could be the potential to offer higher initial income levels than comparator annuities and so meet a need for higher income levels in retirement and without placing additional burdens on retirees over time.

- ACA supports the development of CDC pension vehicles, including for decumulation, which we understand are currently expected to emerge in later stages of CDC regulations. Once these are available, we anticipate it would be possible for individuals to transfer pensions to such arrangements at the point of retirement.

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

- For the self-employed it is difficult to replicate the "nudge" effects that have made automatic enrolment successful in the work-place.

- However, there are opportunities for government to provide education and guidance to the self-employed around pensions and that could encourage greater participation.

- For example, in managing their tax affairs the self-employed are able to obtain tax relief on contributions (within the constraints of annual and life-time allowances) and many take advantage of “carry forwards” around tax relief which allow them to make higher contribution in years where they have better cash flow.

- However, the tax system, including the process of claiming relief is complex and poorly signposted (with many higher rate payers failing to claim reliefs available to them). We would suggest that in addition to any future plans to reform pension tax relief, the government focuses on education around future (and existing) tax relief mechanisms which we believe could have the effect of better incentivising pensions saving for the self-employed.

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

- Gig economy workers could benefit from the steps highlighted above for the self-employed. However, in addition, for these workers, in many cases there will be a body that provides them with some services relating to their work and which we believe could be utilised to automatically enrol workers into a form of workplace savings.

- This is a complex area and any policy steps might need to also involve other aspects of the employer/employee relationship (such as including minimum wage regulations). However, we believe that this is an area that warrants detailed policy attention given the potentially significant numbers of employees in these sectors who are unlikely to currently be building up adequate savings for their retirement.

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

- Evidence suggests that historically there has been a significant gap between retirement resources built up by males and females.

- At a structural level, today’s pension scheme should operate in a manner that treats all individuals consistently. However (especially in the state system) this has not always been the case (as recent media coverage has identified), and so for current pensioners this is likely to have contributed to a gender pension gap.

- At present a key driver of unequal gender pensions outcomes is likely to be the wider gender wage gap (which we would expect to have direct impact on retirement outcomes given the typically direct link between salary and pension contributions). Recent governments have taken steps to address the gender wage gap, and to the extent these measures are successful over time we would hope to see a correlation to a more equal build-up of pension resources.

- In addition, socio-economic factors are also key. Females remain more likely to take time out of the workforce during their careers, which inhibits the build-up of private pension provision (which will rely in part on the generosity of maternity benefits). In state pensions this is currently mitigated to a degree by the continued ability to build up National Insurance credits, but even here there is a risk that lack of information means that some women may miss out on full entitlements and so a key policy step is likely to be to ensure these mechanisms are well publicised and understood, and that parental leave policies are designed to support equal share of family responsibilities.

- In addition to considering the “gender” pensions gap (including non-binary and transgender individuals), from a diversity policy perspective we think it would also be helpful to consider “gaps” that might emerge for other groups. For example:

  - to the extent that members of some communities are more likely to be in lower wage categories, or have different cultural attitudes towards retirement saving, retirement outcomes are likely to be directly affected and so could warrant a public policy response; and

  - from an intergenerational perspective it is also helpful to consider how wider elements of public policy might map to availability of resources for younger employees. For example, as we set out above, we anticipate that upcoming NI rises, the impact of high inflation on Student Loan repayments (and other expenditure) and increased “resilience” savings needs arising from the pandemic will directly affect that ability of these groups to devote adequate resources to their pensions savings.