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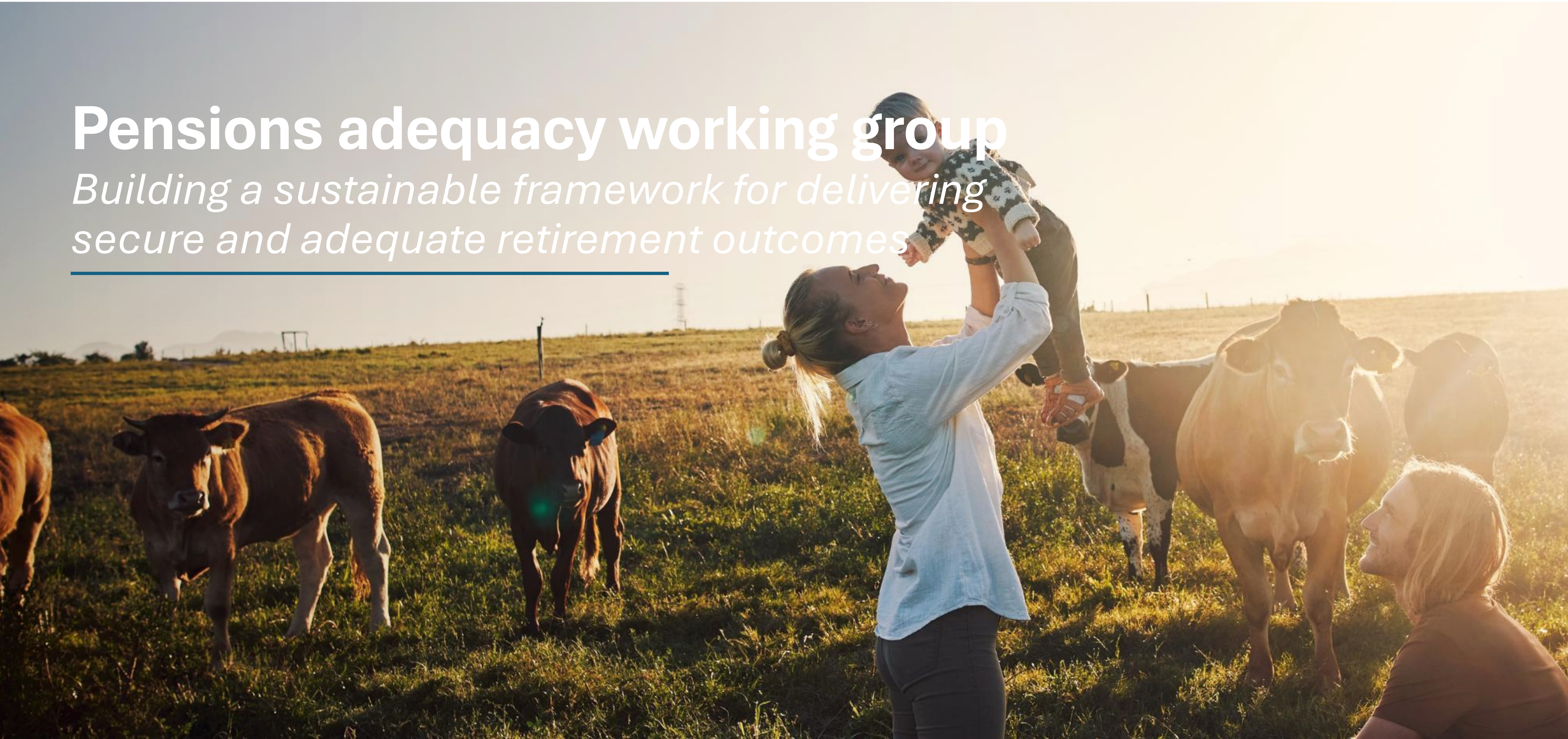
Pensions adequacy working group

Building a sustainable framework for delivering secure and adequate retirement outcomes



INTRODUCTION

Introduction

01 Who are the working group?

- Hannah English, Hymans
- Rich Evans, Isio
- Isabella Gardiner, PwC
- Steven Leigh, Aon
- Saye Mkangama, PwC
- Laura Sherry, XPS

02 Objectives?

On behalf of the ACA

- Develop holistic and practical solutions to the adequacy challenge
- Engage with Government to influence direction of change
- Share insights to inform the work of the Pensions Commission

03 What will we cover today?

- Findings from our draft report
- Planned next steps
- Seeking your feedback

Background

Background

£8,400

The average person receives around **£17,750** when the State Pension and benefits are included.

Pensions UK defines three annual retirement budgets:

Minimum

£13,400 | 80% of DC savers on track

Moderate

£31,700 | 40% of DC savers on track

Comfortable

£43,900 | Less than 20% of DC savers on track

What do these budgets not include:

- Rent or mortgage costs
- Rising food and energy costs, and
- Limited public transport in rural or deprived areas

11 million

workers are underpensioned

Disproportionately affected:

01 Multiple job holders

02 Women

03 Carers

04 People with disabilities

05 Ethnic minority groups

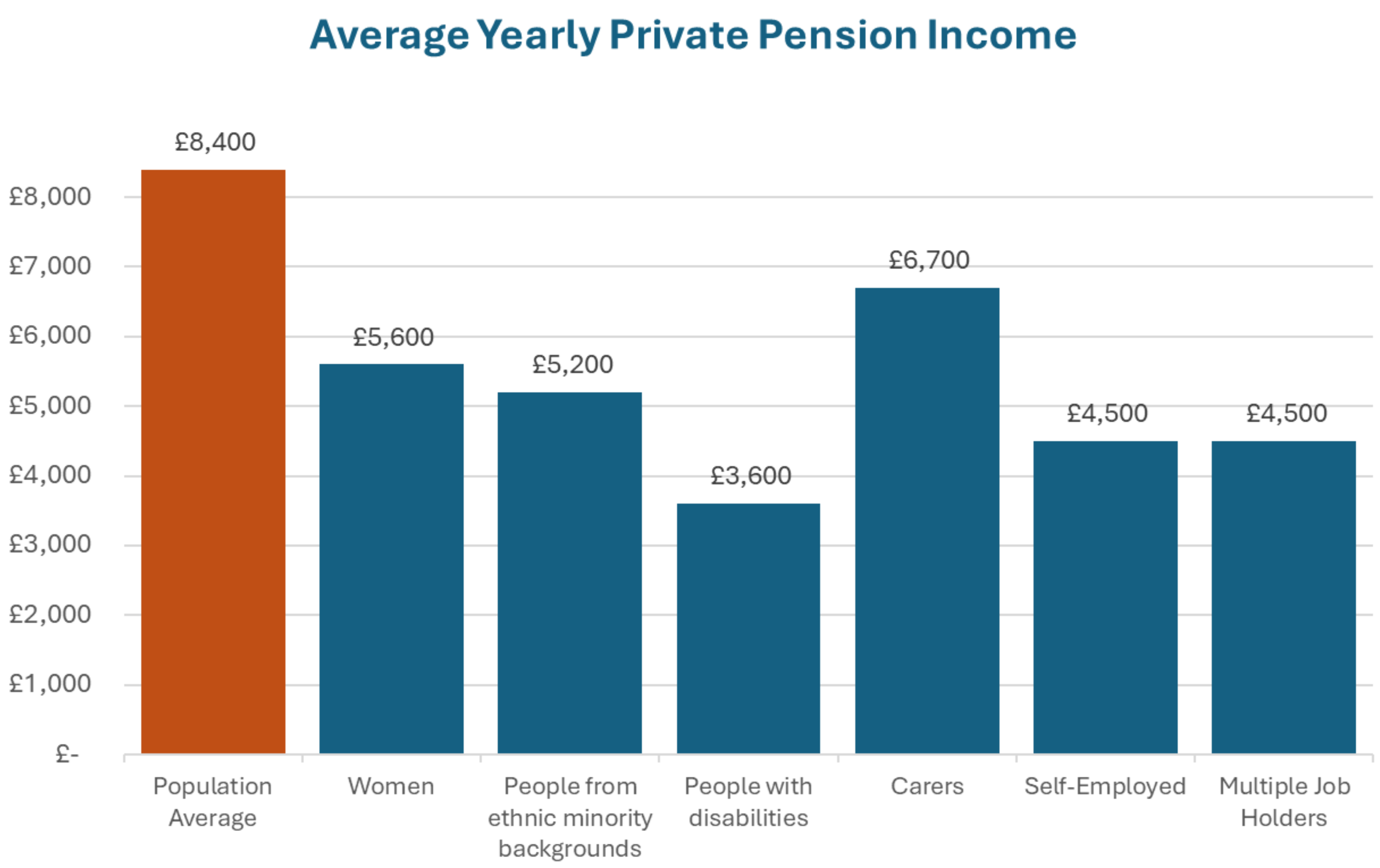
06 Self-employed

Source: Pensions Policy Institute

Underpensioned Groups

How much are groups affected by?

Is it getting better?



Source: Pensions Policy Institute

What can we learn from other countries?

Australia	High mandatory contributions (12%)
Denmark	High mandatory contributions, collective DC
Canada	Strong state + earnings-linked pensions
Sweden	Digital dashboard, defaults, high engagement
Iceland	Near-universal mandatory occupational pensions (12-15%)

Report findings

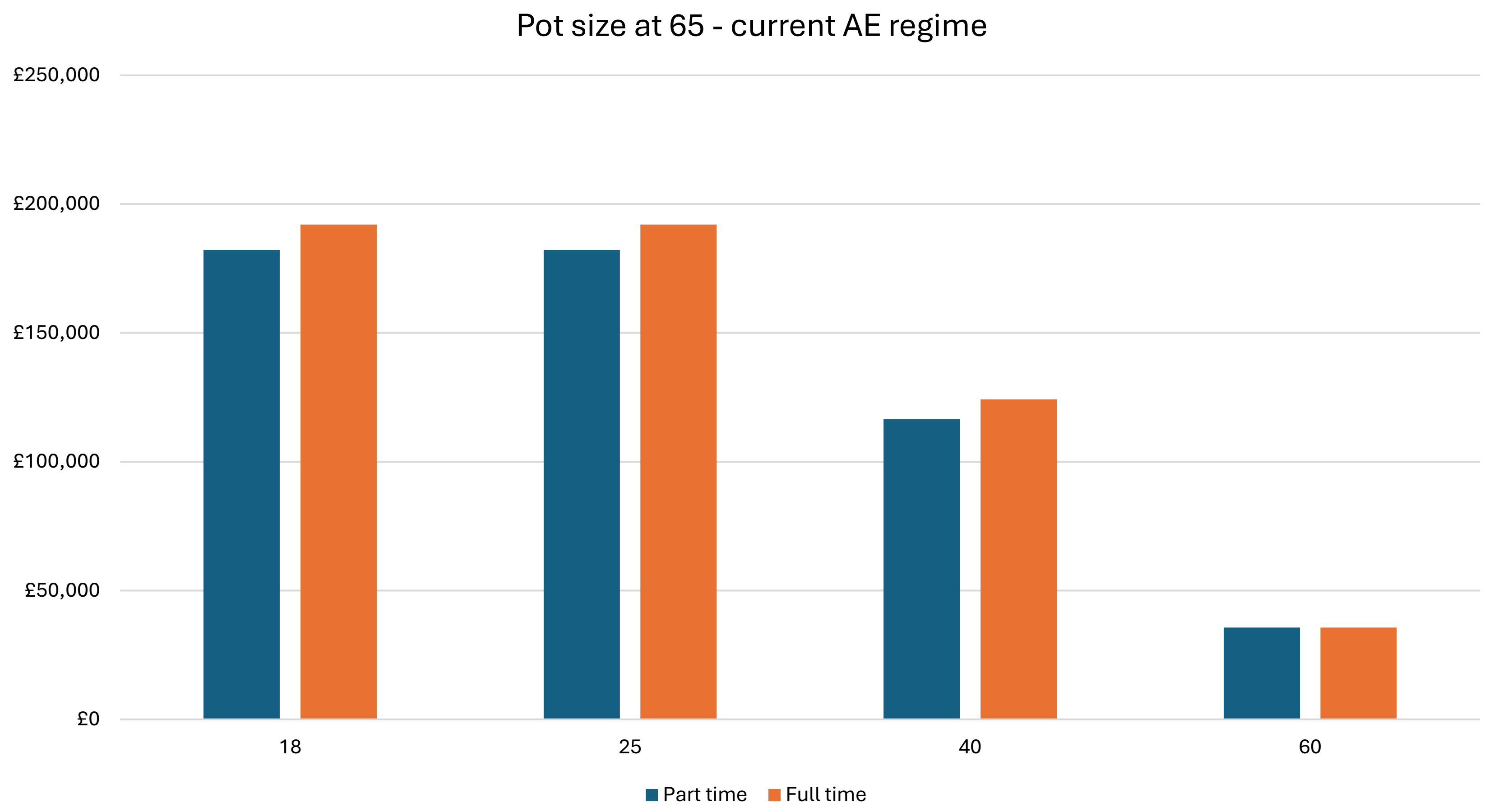
Scope and approach

01 Building trust and understanding

02 Harnessing inertia to effect behavioural change

03 Changes to the delivery model

Baseline modelling



Stability of the tax system

Why is this important? 01

Change creates complexity and uncertainty

What behavioral change could this drive? 02

Higher levels of voluntary saving

Modelling outcome 03

For a 25 year old, £500 of additional income in retirement for each 0.5% of additional voluntary saving

Recommendation 04

Government establish a long-term framework that is simple, transparent and stable, with changes made infrequently and only following clear consultation

Financial education, digital tools and targeted support

Why traditional engagement isn't working? 01

- Annual statements, brochures and static portals assume time, financial confidence and stable employment

Role of inertia? 02

- Automatic enrolment shows how powerful defaults can be but can lock people into poor outcomes
- Opportunity to use inertia in pensions positively - through stronger defaults, simpler journeys and support at key moment

What good looks like? 03

- Digital banking shows that well-designed technology can change behaviour at scale
- But pensions are different and need to be combined with targeted education and human support
- Education targeted and lifecycle-based, using AI and data to target guidance more intelligently

Recommendation 04

- Strengthen defaults, make consolidation easier, improve digital journeys, and target support where it is most needed

Sidecar savings

01 Background

- Savers struggle to balance short-term financial needs with long-term retirement saving
- Financial shocks disproportionately impact lower earners and younger savers
- Around 50% of households hold financial debt (ONS)

02 What is a sidecar saving

- Contributions directed into a cash accessible savings pot
- When pot reaches a cap, further monthly contributions are redirected into the pension as AVCs
- If cash is withdrawn from the pot, contributions are diverted back to rebuild the pot

03 Evidence

- Multiple employers have trialled sidecar savings
- Participation increases significantly when the approach is implemented using an opt-out model
- Savings buffers are built relatively quickly
- No evidence of pension opt outs
- Saving into pension instead of repaying debt interest could increase retirement income for a 25-year-old by around 11% (credit card rates) or 50% (payday loan)

04 Recommendation and implementation

- Introduce sidecar savings via an opt out model
- Legislate to enable employers to set up accounts without employee consent, subject to controls
- Put a fixed amount in each month e.g. £50
- Include a capped savings threshold before savers nudged to divert contributions into pensions e.g. £2k

Extending auto-enrolment

01 Background

- The 2017 Review of AE proposed changing the rules to:
  - Reduce minimum eligibility age to 18
  - Remove the lower earnings band so that minimum contributions apply from the first £1 of earnings
- Successive governments have been non-committal on a timetable to implement these changes

02 Industry views

- There is a general consensus that 8% minimum pension contribution is too low to deliver an adequate level of retirement income
- However, pushing for a higher percentage rate for all risks ignoring that the target retirement income for lower earners may be largely delivered by the state pension.
- Removing the lower earnings band could disproportionately impact the current standard of living for lower earners

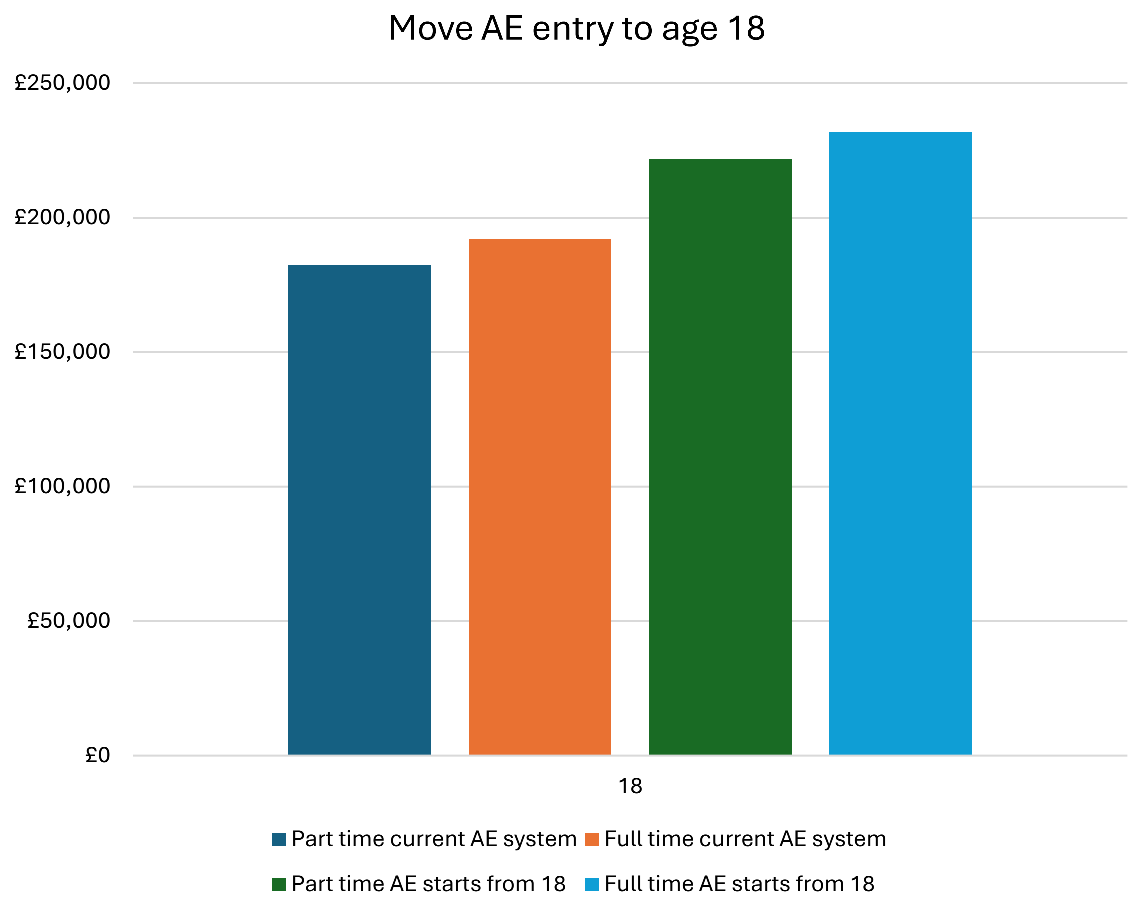
03 Options modelled

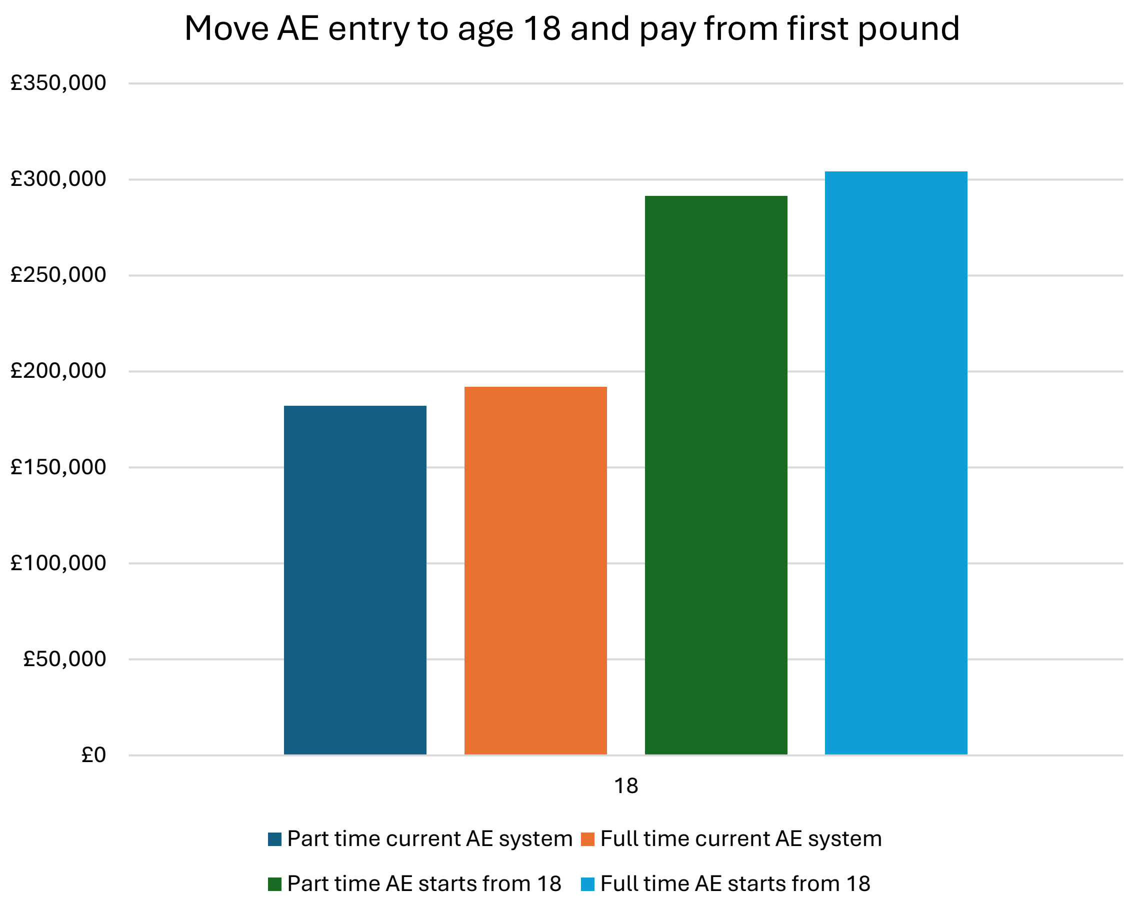
- We have considered the impact on the following basis:
  a) Both proposed changes are implemented in full
     - c. 60% increase in pension income for an 18-year-old
  b) Just reduced eligibility age to 18
     - c. 22% increase in pension income for an 18-year-old
  c) Employer only contributions up to the lower earnings band
     - c. 36% increase in pension income for an 18-year-old

04 Recommendation

- Further consideration of:
  - Minimum retirement income targets
  - Earnings threshold for auto-enrolment eligibility to pick up people with multiple jobs each below the current £10k level
  - Different AE rates for higher earnings bands
  - The balance between employer and employee contribution rates

Modelling outcomes





CDC

Why CDC is interesting? 01

- By pooling investment and longevity risk across the whole membership, CDC can provide higher average retirement outcomes and a more predictable income than individual DC pots

What can CDC solve? 02

- Manage costs for emplyers, individuals and government
- Reduce decision making by using this as default solution

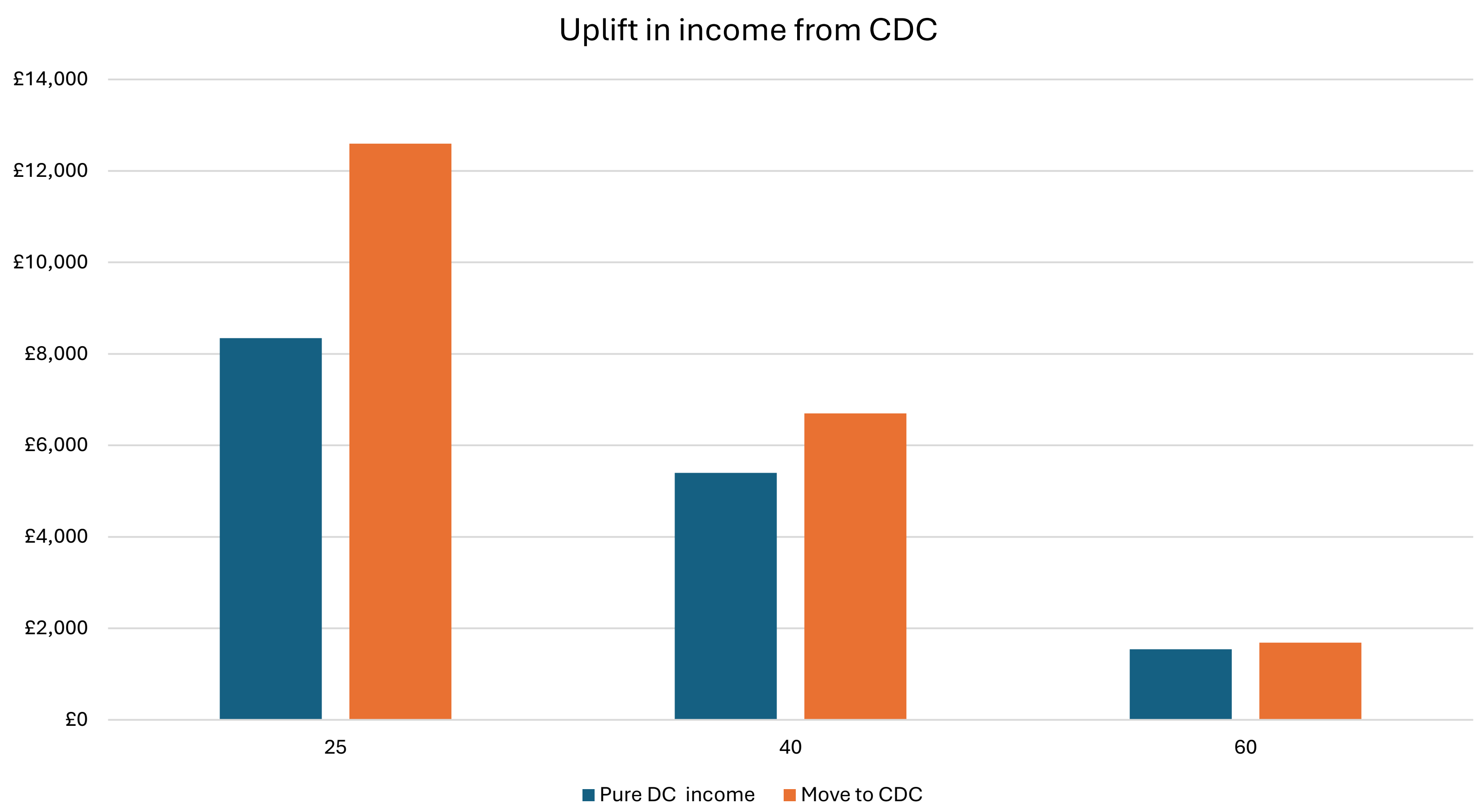
Modelling outcome 03

- 50% increase in outcomes at retirement for a 25 year old

Recommendation 04

- Government to support WOL CDC.
- Government backed multiemployer CDC scheme available for all and lower AE contribution levels to encourage employer take-up

Modelling outcomes



State Pension

01 Why the State Pension needs to be considered?

- Foundation of pension savings and key component of providing an adequate income
- May over provide for some households in receipt of meaningful private provision or multiple state pensions.
- Question of if its sustainability in the long-term

02 What can a reformed State Pension provide?

- Provide a foundation for all savers, whilst targeting additional support to those that need it most, explicitly benefiting those under pensioned groups
- Can use examples in Canada and Iceland where additional testing is based on income declared via tax returns

02 Recommendation and implementation

- A universal state pension payable to all without means testing, linked to national insurance years.
- A means tested supplement to bridge the gap to a defined target minimum income standard
- Reform would need clear communication and lengthy transition, potentially with around ten years' notice and protection for accrued entitlements

NEXT STEPS

Next Steps

01 Reflect on feedback from today and finalise our report

02 Consider further analysis needed and other bodies / organisations we may want to partner with

03 Ongoing work across the year as the debate evolves and provide input to the Pension Commission