Work and Pensions Select Committee inquiry

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

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February 2022

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About this inquiry

This inquiry by the Work and Pensions Select Committee is the third part in its investigation into the impact of the pension 'freedom and choice' reforms. The first two parts focused on pension scams and access, and this focuses on saving for retirement.

Key points and recommendations

- There is no consistent definition of adequacy, with varying measures being used at different times by different people. We believe a basket-of-goods type measure is preferable to a replacement rate measure.
- The Defined Contribution pensions system is likely to leave the majority of people without a good standard of living when they reach retirement. More needs to be done, starting with implementing the reforms recommended by the 2017 AE Review.
- In addition to these, the upper age limit for auto-enrolment should be removed – there is no reason why employees aged over their State Pension age should not benefit from pension saving.
- The Government should start work now on developing a long-term pensions saving strategy designed to ensure a good standard of living in retirement for all.
- The 'freedom and choice' reforms mean that individuals now bear almost all the investment and longevity risk – even if someone builds up a good-sized pot, they can be scammed or make poor choices that will leave them worse off. Far more support measures need to be put in place to help people navigate the retirement income system, including:
    - Creating an auto-appointment guidance system for Pension Wise, as recently recommended by this Committee.
    - Creating product pathways that help people navigate through the complex product marketplace to deliver a retirement income that meets their present and future needs.
- As part of its forthcoming review of Investment Pathways, the Financial Conduct Authority should introduce a charge cap of 0.75% on drawdown products.

About Age UK

Age UK is a national charity that works with a network of partners, including Age Scotland, Age Cymru, Age NI and local Age UKs across England, to help everyone make the most of later life, whatever their circumstances. In the UK, the Charity helps more than seven million older people each year by providing advice and support. It also researches and campaigns on the issues that matter most to older people. Its work focuses on ensuring that older people: have enough money; enjoy life and feel well; receive high quality health and care; are comfortable, safe and secure at home; and feel valued and able to participate.

Introduction

Auto-enrolment has overall been a resounding success, helping over 10 million people save into a pension. Age UK remains very supportive. However, while more people are saving into a Defined Contribution pension, most are unlikely to be saving sufficiently to deliver a good standard of living when they reach retirement. This not only risks leaving people on a lower income when they retire, it creates a gap between expectations and reality that could damage overall confidence in the pensions system.

When people come to access their pension savings, the pension ‘freedom and choice’ reforms have turned the pensions landscape upside down. In addition to leaving consumers exposed to a complex and often opaque product market, they have introduced more risks and greater uncertainty into the decision-making process. It is evident that people need more support to navigate this and ensure they can use their hard-earned savings to enjoy a decent standard of living that lasts throughout their later life.

Many of the consequences have been addressed by the Committee’s previous two inquiries on this topic, and we welcome this inquiry’s focus on the pre-retirement savings side. However, the ‘savings’ and ‘access’ sides to pensions are inextricably linked, and improving saving is an important part of the process for generating better outcomes in retirement.

Inquiry questions

Q1. Do households in the UK have adequate pension savings for retirement?

Firstly, it is necessary to define what is meant by ‘adequate’. Adequacy can be measured in different ways, for example whether it is considered to be a certain income-replacement rate or enough money to purchase a fixed ‘basket of goods’; whether it includes housing costs or not; and various other permutations. There is a plethora of academic literature exploring various measures in detail as well as suggestions of other possibilities. In recent years the debate within the UK has been framed around the replacement rate, owing to the Pensions Commission evaluating the state of pension saving on this basis. However, we do not believe it is this simple to calculate. In policy terms, it can lead to the conclusion that higher earners need to save more and hence require more generous pensions contributions. Under this thought process, lower earners, whose needs (under a replacement rate measure) are more closely met by the State Pension plus the auto-enrolment minimum contributions, do not need either additional incentives to save or the policy focus of Government to attain an adequate retirement income. Therefore, while this concept may be suitable for some people, it is less so for others.

Age UK believes a basket-of-goods type measure, such as the Pension and Lifetime Savings Association's (PLSA's) 'Retirement Living Standards' (modelled on the Joseph Rowntree Foundation's 'Minimum Income Standard'), is preferable. These give an absolute level of income needed to live a specified lifestyle. Clearly, these indices are not individualised, so people should seek guidance from Pension Wise and MoneyHelper to determine how they can use their pension income to meet their personal needs.

Given the inadequacies in the Defined Contribution system, there are likely to be income differences between age cohorts. Although there is a lot of intra-cohort inequality, more of the cohort near retirement can also rely on a final salary pension. Access to a DB pension makes a difference, and in future adequacy issues may get worse as DB pensions decline.

For most people, the current contribution rates are too low to deliver an adequate retirement income for many people. Modelling by the Pensions Policy Institute shows that if Defined Benefit savings are excluded, then 40% of people will fail to meet the Joseph Rowntree Foundation's Minimum Income Standard, and 91% will fail to meet the PLSA's 'moderate' retirement income target.[i]

Notwithstanding, the 'freedom and choice' reforms mean that a saver could build up a decent sized pot, only to make one poor decision and be rendered significantly worse off for the rest of their life – or worse, be scammed out of everything they have. This inherent tension between auto-enrolment, where people save through inertia, and accessing a pension, where the choice and risk sits entirely with the individual, needs to be rectified as a matter of urgency – it is disappointing that this has not already been considered in more detail. The Government and regulators should not shy away from this: Age UK believes that some of the measures identified in question 4 would help.

As a final point on this matter, we suggest that the word 'adequate' is replaced with something more aspirational that better reflects what savers would want for their retirement. We suggest either 'decent' or adopting the PLSA's terminology, but there are no doubt many other suitable options.

Q2 Are changes needed to auto-enrolment to provide an adequate level of pension savings for retirement?

Yes. Auto-enrolment is not currently sufficient to deliver a good standard of living in retirement to most people saving at the minimum rate. A good first step would be to implement the reforms recommended by the DWP's 2017 AE Review.[ii]

In addition to these recommendations, we believe the upper age limit should be removed. Currently, employers do not have to auto-enrol employees aged above State Pension age, while staff are only deemed to be an 'eligible employee' until the age of 74. With more than 1.3 million people aged 65+ still working[iii] there are a great many older workers who would benefit from continuing to save.

We would also like to see a Government strategy with a clear focus on how to increase levels of saving in future. This will require years of planning and work to achieve buy-in from a range of stakeholders, so it is important to start as soon as possible. This should consider the most appropriate measure for adequacy, and create a proper system of targets to help employers decide which scheme best meets their employees' needs, to assist employees in understanding how much they should be saving, and to improve decision-making at point of access.

Q3 What advice and guidance do people need when saving for retirement?

The choices that savers need to make at retirement – when they move from the inertia-driven savings phase to making proactive product choices – are complex and the marketplace difficult to navigate. Yet they have long-lasting consequences that can reduce income throughout retirement, making it imperative to get them right – or worse, be scammed out of their life savings and left with nothing.

It is essential that consumers are better prepared for the decisions they need to take. Age UK's 2019 report 'Fixing the freedoms'[iv] found that consumers need to:

- Access Pension Wise guidance or seek independent financial advice
- Maximise state pensions and means-tested benefits
- Gain a full picture of all pension and other assets
- Consider merging small pots
- Be aware of taxation
- Consider using DC pensions to repay expensive debt
- Maximise income from other financial assets
- Decide on which retirement income product they want and whether they prefer the lower secure income from an annuity or the potential for a higher income from income drawdown balanced by the risk of running out of money.
- Take difficult decisions about income drawdown including where they should be invested and how much they want to withdraw each year, reviewing their choices regularly to ensure that they are on track.
- Shop around for an annuity and declare medical details to qualify for a higher rate

Gathering the expertise to do all this is simply not possible for the vast majority of people. In giving evidence to the Treasury Select Committee in 2020, Charles Randell, FCA Chair at the time, said:

> *"This issue about people making poor choices when exercising the freedoms and responsibilities that have been put on them in the last 10 years, through a variety of changes in Government policy, is probably the one that I worry about most of all. The pensions dashboard, I think, is some way off, but it will be really important that the safeguards that help to slow down decision-making in these areas and to signpost people to the best sources of guidance they can get are as strong as they humanly can be, because it is heartbreaking. I am sure your postbag is the same as mine, with people who write with absolutely heartrending stories of decisions they have made that have resulted in the loss of their life savings. One cannot ignore that. It has to be the centre of one's worry list."*[v]

There is a lot that can be done by Government and the regulators by helping improve products and creating pathways to guide people's decision making.

It is concerning that take up of Pension Wise seems to be on a downwards trend. The latest FCA data shows that just 81,805 DC pots were taken to Pension Wise in 2020/21, down from 94274 in 2019/20.[vi]

A necessary first step to address this is, as recommended by this Select Committee's previous report, the introduction of an opt-out automatic appointment system for Pension Wise. At age 50, everyone would be automatically set up with an appointment unless they chose not to take it, with a further appointment available a few years later immediately prior to people accessing their pension for the first time.

We agree with the Select Committee's recommendation that a target of 60% of people using Pension Wise should be set. This is a reasonable definition of "the norm", which the Pensions Minister has previously stated should be the objective, and would represent a significant improvement that the current one in six pots that use the service. The current policy direction of implementing the 'stronger nudge' will fail to create a significant improvement in the number of people using Pension Wise – the pilots found only an 8% improvement[vii] – and we fully agree with the approach recently set out by this Committee.

While using Pension Wise does not guarantee good outcomes and there is more besides that can be done to help consumers, we argue that providing guidance or advice to consumers is a pre-requisite that will underpin further efforts to improve outcomes.

Q4 Could retirement income targets help savers plan for retirement?

We believe there is a role for retirement income targets, which can be a useful tool for some people to plan ahead for their retirement. We are supportive of the PLSA's Retirement Income Targets, which could be used as a basis for this. We are also represented on the steering group of the Living Pension project run by the Living Wage Foundation, which is due to report later this year.

However, engagement levels among employees are low, and no form of engagement is a substitute for pathways that are designed to nudge savers towards the best outcomes. Such pathways include:

- Default investment funds, protected by a charge cap set at a maximum of 0.75%, and with no exceptions for private finance (as is currently being consulted on by the DWP).
- An auto-appointment system for Pension Wise, on an opt-out basis, firstly at age 50 and again when the individual first accesses their pension.
- Investment Pathways to help direct people towards their preferred retirement product.
- Retirement Income Pathways, to help savers navigate the complex product landscape and generate the best possible long-term outcome.

On top of these pathways, there should also be clear minimum product standards to ensure that no-one is purchasing inappropriate retirement income products and that they deliver good value for money.

Q5 Apart from increasing contributions, how can the Government improve outcomes for savers?

There are several measures the Government can take to improve outcomes for savers, such as improving take-up of Pension Wise (see question 3); and implementing a series of pathways to help people navigate their lifetime pension journey, alongside minimum product standards (see question 4).

We would also like to see a radical improvement in data collection. Currently, the FCA only collects data on a per pot basis, and there is no source that gives a satisfactory picture of how individual consumers are behaving. This is a staggering oversight for a policy that has such significant consequences, and must be rectified immediately.

Providing further help for consumers is essential. The pension reforms have passed even more risk on to individuals and far too few people have the knowledge and skills to understand and mitigate these. Unless the Government and the regulators take the necessary action, the policy risks being a disaster.

Q6 Can pension providers change the design of pension products to improve outcomes for savers?

There is scope to improve the design of products, especially for non-advised consumers. Age UK's 2019 report 'Fixing the Freedoms' found there had been a lack of innovation in product markets since the freedoms were introduced. Some hybrid annuity/drawdown products had been launched and subsequently withdrawn, presumably because they were not deemed commercially viable at the time. More positively, however, it was also clear that IFAs were able to mix and match different options to create similar results, meaning specific hybrid products may not be necessary.

The main area of concern was the difference between the advised and non-advised marketplaces. Advised consumers were able to draw on a wider range of products, and other features like 'guardrails' that were in place to help them manage their spending. These were helpful innovations – however they are not available to non-advised consumers who are left entirely on their own when taking decisions.

Scope for improvement includes simplifying the charging structures of drawdown products, which is currently not adequately regulated. We believe that a charge cap should be introduced on drawdown products to mirror the cap on default investment funds at 0.75%. This will protect consumers who don't shop around.

The FCA is generally focused on transparency of charges, and while we agree this is a good thing we are sceptical that this helps the mass market. The regulatory focus should instead be set on enforcing minimum standards so that products will serve any consumer who chooses to purchase them. The FCA is set to review Investment Charges later in 2022, which we believe will be a suitable point to toughen up the rules on income drawdown.

Q8 Are different or additional measures required to help gig economy workers save for retirement.

Part of the auto-enrolment reforms should be to include income from multiple jobs as qualifying earnings, and ensure that the person's main employer auto-enrols them into their scheme.

Q9 Are there measures which the Government should consider to close the gender pension gap?

The gender pensions gap remains a serious problem. 50% more women than men are estimated to be expecting to retire without a private pension, highlighting some shortcomings in the auto-enrolment model.[viii]

Implementing the AE Review reform of lowering the earnings trigger would help many women start saving.

Also important is finding a lasting solution to the net pay scandal, as three quarters of affected savers are women. While it is positive that the Government has recently proposed a resolution, it seems less than ideal – instead of automatically refunding savers who do not receive tax relief under the arrangements of their net pay pension scheme, the proposal is that savers will have to proactively claim back their money. Undoubtedly many will not take this step and continue to miss out.

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[i] Pensions Policy Institute (2021), What is an adequate retirement income?
[ii] https://www.gov.uk/government/publications/automatic-enrolment-review-2017-maintaining-the-momentum
[iii] ONS, Labour Market Statistics, January 2022
[iv] Age UK (2019), Fixing the Freedoms, Helping smaller savers get the most out of the pension reforms https://www.ageuk.org.uk/globalassets/age-uk/documents/reports-and-publications/reports-and-briefings/33a.-fixing-the-freedoms---age-uk-discussion-paper-june-2019.pdf
[v] https://committees.parliament.uk/oralevidence/1148/html/
[vi] Retirement Income Market Data 2020/21, FCA 2021
[vii] https://moneyandpensionsservice.org.uk/wp-content/uploads/2020/07/maps-stronger-nudge-evaluation-report-july-2020.pdf
[viii] Now Pensions (2021)